



Asia  
China  
Transportation  
Air

Industry  
**China Southern  
Airlines**

Date  
30 August 2017

**Results**

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# 1H17 earning decline despite a lack of FX loss

## 11% earnings decline caused by higher fuel cost, but offset by FX gain

China Southern Airlines (CSA) reported 11.8% YoY increase in 1H17 revenue, on the back of 12.5% passenger traffic (RPK) YoY growth, offset by 2.0% YoY yield decline due to competitive pressure, in our view. Yet with 1) a 50.1% YoY jump in fuel cost on higher fuel price, and 2) 10.6% YoY increase in ex-fuel operating cost, the airline recorded a 35.0% YoY decrease in 1H17 operating profit. At the bottom line, helped by a FX gain of RMB561m (vs. a 1H16 FX loss of RMB1.5bn), CSA recorded 11.1% YoY 1H17 net profit decline to RMB2.8bn. If stripping out the FX impact, CSA's 1H17 recurring net profit decreased by 52.3% YoY.

## Deutsche Bank view – competition in international routes to cap upside

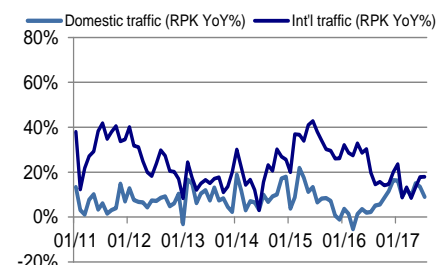
Since CSA's 1H17 net profit accounts for 50% of our full-year estimate and 48% of consensus, we consider the results as in line. In July, CSA recorded a stable 11.3% YoY RPK growth, with a robust 17.9% YoY growth in international passenger traffic. Going forward, we expect the growth rate to normalize slightly in 2H17, with mild YoY growth in domestic yield and some decline in international yield. Meanwhile, CSA is still subject to increasing competition for the SE Asia/Australia/New Zealand routes from other airlines, including LCCs. Together with higher fuel cost, we still expect CSA's FY17 operating profit to be under pressure and maintain a Hold rating on the CSA-H shares. In addition, given the valuation premium over the H-shares, we rate CSA's A-shares a Sell. We will provide more update after the company's conference call on 30 August.

### Focus stocks

China Southern Airlines (1055.HK), HKD5.91 Hold  
Price Target HKD6.45  
China Southern Airlines-A (600029.SS), CNY8.44  
Sell Price Target CNY5.90

Source: Deutsche Bank

### CSA - passenger traffic and capacity growth



Source: Company data

Figure 1: China Southern Airlines - 1H17 results summary

(RMBm)	1H17	1H16	YoY%	Deutsche Bank comments
<b>Operating income</b>	<b>60,488</b>	<b>54,119</b>	<b>11.8%</b>	
Passenger	53,626	48,662	10.2%	On 12.5% RPK growth and 2.0% yield drop
Cargo	4,193	3,122	34.3%	On 17.2% RFTK growth and 13.9% yield increase
Others	2,669	2,335	14.3%	
<b>Operating expenses</b>	<b>(57,854)</b>	<b>(48,636)</b>	<b>19.0%</b>	On the back of 9.8% ATK growth
Jet fuel cost	(15,402)	(10,259)	50.1%	On higher average jet fuel price
Other operating costs	(42,452)	(38,377)	10.6%	
<b>Other net income</b>	<b>1,948</b>	<b>1,568</b>	<b>24.2%</b>	Subsidies increased by 29.5% to RMB1,340m
<b>Operating profit</b>	<b>4,582</b>	<b>7,051</b>	<b>-35.0%</b>	
Net finance cost	(1,286)	(1,161)	10.8%	
FX (loss)/gain	561	(1,516)	n.a.	
<b>Net profit</b>	<b>2,772</b>	<b>3,118</b>	<b>-11.1%</b>	
<b>Recurring net profit</b>	<b>2,211</b>	<b>4,634</b>	<b>-52.3%</b>	Excluding FX impacts

Source: Deutsche Bank, Company data

Deutsche Bank AG/Hong Kong

Distributed on: 29/08/2017 17:27:26 GMT

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