

SELL (downgraded)

Report date	Aug. 07, 2019
Current price	VND 39,200
Target price	VND 34,000
Downside	13.3%
Bloomberg	HVN VN Equity
Market cap	VND 59,426bn USD 2,518mn
52 weeks movement	VND 30,300 – VND 44,000
Average daily value	VND 16.87bn USD 726,650
FOL	30%
Current FO	10.05%

Vietnam Airlines Corporation (HSX: HVN)

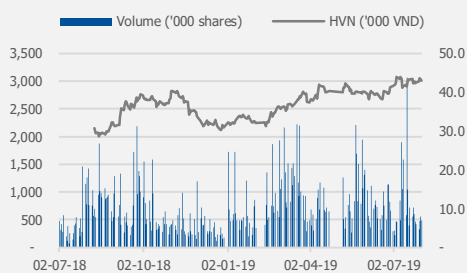
Too many aircrafts for its own demand

Thoughts on the stock

We downgrade to SELL rating for HVN with target price of 34,000 VND/share

- International market share will be threatened by Bamboo Airways, who planned to receive B787 for international route at the end of 2019. Bamboo Airways tends to apply full-service strategy, oriented to be a 5-star airline, and compete directly to the flag carrier. With similar services, lower air fare, mysterious attraction, Bamboo Airways could take the international market share from Vietnam Airlines.
- Vietnam Airlines has been reforming its fleet through operating lease in an attempt to be more efficient. Selling old-owned aircrafts will gradually reduce debt pressure, lowering interest expenses and foreign exchange losses. However, it puts more pressure on short-term results due to increasing lease expenses and reducing operating margin as seat capacity could grow faster than passenger demand.
- We maintain our view on VND/USD exchange rate and a lower average fuel price that will favor Vietnam Airlines' earnings.

Price movement



Stock performance	1M	3M	12M
HVN (%)	-1.9%	4.6%	13.0%
VNIndex (%)	3.3%	1.8%	4.7%

Source: Bloomberg

Major shareholders

Commission for the Management of State Capital at Enterprises	86.19%
ANA Holdings Inc.	8.77%



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What's new

- For 2Q19, HVN reported consolidated earnings of VND 79bn**, down 74.4% yoy in light of (i) domestic market share reduced by 3.1% to 35.9%, (ii) higher lease expenses, which pressed gross margin to 10.1% compared to 2Q18's margin of 13.2% and (iii) extraordinary gains from sale-lease back of VND 64bn from one A350-900XWB.
- We continue to revise down our forecasted FY19 and FY20 consolidated earnings to VND 2,442bn and VND 2,456bn respectively** based on (i) lower growth prospect of air passenger market, especially domestic market and international tourist arrivals by air, (ii) lower air passenger carried of 22.1m, up 0.8% yoy, in 2019, (iii) higher lease expenses from receiving more narrow-body aircrafts via operating leases, (iv) the average jet fuel kerosene-type price of 79.7 USD/barrel, down 6.0% yoy, and (v) lower interest expense and forex loss resulted from lower total debt.
- For 1H19, VNA received eight A321-Neo via operating lease, one A350-900XWB via SLB, and returned one A321.** For FY19, we forecast that VNA's gross margin will reduce regardless of 15-20% fuel saving from A321-Neo fleet because fleet size is increasing much more than passenger carried. They also planned to receive nine remaining A321-Neo for 2H19. Amid moderating air passenger market, Vietnam Airlines could lose money when more aircrafts are on the ground.

Valuation

We downgrade HVN to SELL with the target price of 34,000 VND/share based on the DCF method – FCFF approach.

Parent company (VND bn)	FY18	FY19F	FY20F	FY21F
Revenue	70,742	74,347	74,496	76,976
Gross profit	9,341	9,364	9,243	9,370
EBIT	3,445	3,183	2,862	2,734
Net profit	2,111	2,124	2,157	2,418
Consolidated net profit	2,335	2,442	2,456	2,723
EPS (VND)	1,715	1,722	1,732	1,920
EPS growth rate (%)	(11.2%)	0.4%	0.6%	10.9%
P/E (x)	19.2	23.9	23.8	21.5
P/E target (x)		19.7	19.6	17.7
EV/EBITDAR (x)	4.0	3.9	3.9	3.7
DPS (VND)	1,000	1,000	1,000	1,000
P/S (x)	0.6	0.7	0.8	0.8
ROE (%)	12.0	11.3	11.0	11.9
Net debt/equity (%)	172.7%	134.9%	94.5%	57.5%

Source: MBS Research

Quarterly financial analysis and Earnings model

Table 1: Quarterly financial analysis and Earnings model (parent company VNA)

VND bn	2Q18	2Q19	Growth	1H19	Comment	FY18A	Previous FY19F	New FY19F	Comment
Net sales	16,957	17,513	3.3%	36,586		70,742	73,805	74,347	
Passenger transportation	14,499	14,543	0.3%	30,654	For 2Q19, carried passenger growth has been estimated to 2.2% yoy, passenger yield slightly reduced. For 1H19, domestic market share reduced to 35.9%	59,261	60,915	61,958	For FY19F, we forecasts revenue to increase by 5.1% with passenger carried of 22.1m and passenger yield increased slightly by 1.0%.
Cargo transportation	1,694	1,746	3.1%	3,416	Total air cargo market grew by 2.16%	6,834	7,566	7,039	Growth of 3.0% as air freight market
Charter flight	667	687	2.9%	1,529		3,449	4,078	4,106	
Ancillary revenues	410	471	14.8%	872		1,648	1,660	1,660	
Costs of goods sold	14,743	15,976	8.4%	31,627		61,401	64,269	64,983	
Raw material costs	5,474	5,432	(0.8%)	10,515	Slightly reduced regardless of fuel price falling of 8.0% and more efficient fleet. It could be a loss of fuel hedging.	22,135	21,084	21,070	Slightly reduced because of lower average jet fuel price and more efficient fleet
Staff costs	1,265	1,119	(11.5%)	2,198		3,910	3,989	3,989	Increased by 2.0%
Depreciation	1,139	1,177	3.3%	2,328		4,592	4,861	4,861	
Others	6,856	8,247	20.3%	16,585	Lease expenses increased significantly as Vietnam Airlines continuously received A321Neo via operating lease while maintaining old narrow-body fleet.	30,764	34,335	35,063	Aircraft leasing expenses could soar following assumed receipt of two A350-900, three B787-10, and twelve A321-Neo, but maintenance expenses reduce as receiving new aircrafts.
Gross profits	2,223	1,537	(30.8%)	4,960		9,341	9,536	9,364	
Gross profit margin	13.1%	8.8%		13.6%	Gross profit margin reduced sharply due to higher lease expenses	13.2%	12.9%	12.6%	Falling in gross profit margin due to lease expenses soaring
SG&A expenses	1,536	1,668	8.6%	3,350		5,896	6,169	6,180	
SG&A margin	9.1%	9.5%		9.2%		8.3%	8.4%	8.3%	All expenses reduced or slightly increased, except for staff costs increased by 13.7%
EBIT	687	(130)	(119%)	1,610		3,445	3,368	3,183	
Dividend from subsidiaries	872	1,019	16.9%	1,019	Negative EBIT as SG&A margin higher than gross profit margin	930	993	993	
Gains from sale - lease back	85	64	(24.6%)	125	For 2Q19, VNA received one A350-900XWB via SLB	465	118	118	We expect gains from SLB in 2019 only come from two A350. In 2018, VNA also recorded gains from engine SLB that we will not project into FY19.
Foreign currency transaction gains/(losses)	(692)	(165)	(76.1%)	(368)	Foreign exchange rate was 23,305 VND/USD (28/06/2019), compared with 22,959 VND/USD on 29/06/2018.	(792)	(491)	(491)	Assuming that VND will depreciate by 1.5% to USD
Net income	617	601	(2.7%)	1,615		2,111	2,338	2,124	
Consolidated net income	309	79	(74.4%)	1,276		2,335	2,656	2,442	
Passenger carried (mn)						21.9	22.2	22.1	
Jet kerosene price (\$/barrel)	87.8	80.7	(8.0%)	79.6		84.8	81.1	79.7	Assumed as a base case for FY19
Passenger yield (VND - annual)						1,631	1,647	1,647	

Source: HVN, MBS Research

Valuation

Table 2: DCF Valuation – FCFF Approach

VND bn	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F
EBIT	3,183	2,862	2,734	3,122	3,213	3,260	4,144
Efficient tax rate	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
(+) Depreciation cost	4,861	4,626	4,391	3,939	3,536	3,184	2,901
(+) Change in net working capital	129	1,794	2,061	749	1,431	1,382	1,641
(-) Capital expenditure	382	382	395	415	462	508	571
FCFF	7,473	8,613	8,517	7,083	7,397	6,991	7,701
WACC	12.4%						
Terminal growth rate	1.0%					Terminal value	72,367
Discount factor	1.01	0.90	0.80	0.71	0.63	0.56	0.50
PV of cash flow	6,889	9,886	7,144	6,486	5,900	5,471	5,075
							34,203
Total PV	73,819					Cost of capital	
(+) Cash and investment	12,223					Beta	0.89
(-) Outstanding debt	37,820					Risk-free rate	5.8%
Equity value	48,222					Risk premium	11.0%
Shares outstanding (mn)	1,418					Cost of debt before tax	11.9%
Equity value per share	34,000					WACC	12.4%

Source: MBS Research

Table 3: Valuation of full-service carriers

Airlines	Nation	Market cap (USD mn)	ROE (%)	Load factor (%)	EV/EBITDAR (x)	P/E (x)
Thai Airways	Thailand	721	-47.9	77.1	4.47	N/A
Singapore Airlines	Singapore	7,901	4.9	82.5	5.51	16.6
ANA Holdings	Japan	11,618	10.2	74.2	4.07	11.0
Cathay Pacific	Hong Kong	5,519	3.8	84.0	5.55	18.4
Air New Zealand	New Zealand	1,995	14.8	83.4	3.89	9.8
China Airlines	Taiwan	1,633	2.7	N/A	N/A	33.1
EVA Airways	Taiwan	2,163	10.9	80.9	N/A	9.2
Juneyao Airlines	China	3,273	12.7	86.7	N/A	18.9
Spring Airlines	China	5,610	12.1	88.7	N/A	24.3
Qantas Airways	Australia	6,207	24.5	84.5	3.76	11.2
Mean					4.54	16.9
Median					4.27	16.6
HVN	Vietnam	2,518	13.4	NA	NA	23.6

Source: Bloomberg

Financials and Valuation Summary

Income Statement (VND bn)						Ratios			
	2017	2018	2019F	2020F	2021F		2018	2019F	2020F
Revenue	63,375	70,742	74,347	74,496	76,976	Valuation			
Cost of goods sold	54,930	61,401	64,983	65,253	67,605	EPS	1,715	1,722	1,732
Gross profit	8,444	9,341	9,364	9,243	9,370	P/E	19.2	23.9	23.8
Financial income	671	1,195	1,248	1,384	1,401	P/S	0.6	0.7	0.8
Financial expenses	1,885	2,185	1,848	1,602	1,293	Profitability			
SG&A expenses	5,805	5,896	6,180	6,381	6,636	Gross profit margin	13%	13%	12%
Profit before tax	1,911	2,418	2,360	2,396	2,687	EBITDAR margin	26%	29%	29%
Net income	1,816	2,111	2,124	2,157	2,418	Net profit margin	3%	3%	3%
Consolidated net income	2,371	2,335	2,442	2,456	2,723	ROE	12%	11%	11%
						ROA	5%	5%	5%
Balance Sheet (VND bn)						Growth			
	2017	2018	2019F	2020F	2021F		2018	2019F	2020F
Current assets	10,060	10,561	12,568	11,131	10,001	Revenue	12%	5%	0%
I. Cash & cash equivalents	4,100	4,252	5,948	5,960	6,158	Profit before tax	27%	-2%	2%
II. Receivables	2,687	2,940	3,055	3,061	3,163	Profit after tax	16%	1%	2%
III. Inventories	536	538	569	572	592	EPS	(11%)	0%	1%
IV. Other current assets	2,737	2,831	2,996	1,539	87	Total assets	(7%)	(2%)	(8%)
Non-current assets	69,137	62,982	59,221	54,780	50,868	Equity	8%	5%	4%
I. Prepaid assets	8,538	6,862	7,798	7,830	8,113	Liquidity			
II. Fixed assets	53,012	48,657	44,177	39,934	35,938	Current ratio	0.4	0.4	0.5
1. Tangible fixed assets	52,919	48,574	44,096	39,854	35,860	Quick ratio	0.3	0.3	0.3
2. Intangible fixed assets	93	82	81	80	78	Debt/Total assets	56%	49%	44%
III. Deposits for leasing aircraft & aircraft engines	2,227	2,026	2,026	2,026	2,026	Debt/Equity	262%	196%	166%
IV. Investment in affiliates	4,917	4,824	4,598	4,368	4,162	Interest coverage	1	2	2
V. Other non-current assets	441	613	622	623	629	Operating efficiency			
Total assets	79,197	73,543	71,790	65,912	60,868	Receivables turnover	24.1	24.3	24.3
Liabilities	62,266	55,275	52,593	45,909	40,107	Days sales outstanding	15	15	15
Current liabilities	24,323	23,974	27,296	26,422	26,726	Inventory turnover	114.2	114.2	114.2
I. Short-term payables	16,077	16,710	17,668	17,742	18,381	Days sales of Inventory	3	3	3
II. Accrued expenses & deferred revenue	927	1,118	1,175	1,178	1,217	Payables turnover	3.7	3.7	3.7
IV. Short-term borrowings	7,319	6,145	8,452	7,502	7,127	Days payables outstanding	99	99	99
Non-current liabilities	37,943	31,301	25,297	19,487	13,381				
I. Long-term payables	975	1,647	1,912	2,130	2,408	Cashflow Statement (VND bn)			
II. Long-term borrowings	36,968	29,655	23,385	17,357	10,973	CFO	8,749	6,919	8,400
Equity	16,931	18,267	19,197	20,003	20,761	CFI	(1,593)	(279)	(275)
I. Share capital & share premium	13,496	15,404	15,404	15,404	15,404	CFF	(9,301)	(4,945)	(8,112)
II. Retained earnings	2,366	2,863	3,793	4,599	5,357	Net cash flows during the period	(2,145)	1,695	12
IV. Other capitals	1,069	0	0	0	0				
Total liabilities & equity	79,197	73,543	71,790	65,912	60,868				

Source: HVN, MBS Research

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STOCK RATING: The recommendation is based on the difference between the 12-month target price and the current price:

Rating	When (target price – current price)/ current price
BUY	>=15%
HOLD	From -15% to +15%
SELL	<= -15%

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