

**HOLD** (maintained)

## Vietnam Airlines Corporation (UPCOM: HVN)

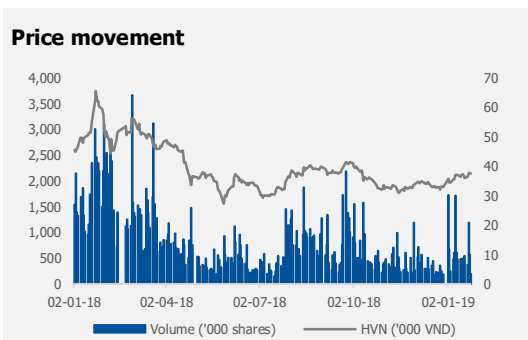
Report date	Feb. 18, 2019
Current price	VND 40,300
Target price	VND 38,500
Upside	-4.5%
Bloomberg	HVN VN Equity
Market cap	VND 53,190bn
	USD 2,290mn
52 weeks movement	VND 28,000 – VND 64,200
Average daily value	VND 22.53bn
	USD 971.48k
FOL	30%
Current FO	9.4%

### Exciting 2019 but fairly valuation

#### Thoughts on the stock

**We maintain HOLD rating for HVN shares with the target price of VND 38,500, downside 4.5% from current price.**

- Vietnam Airlines has been reforming its fleet as an attempt to operate more efficiently. Replacing old aircrafts with new models using operating leases will enhance fleet efficiency and reduce debt pressure in the long-term. However, it also puts more pressure on short-term results due to increasing lease expenses and reducing margin as seat capacity grows faster than passenger demand.
- Jet fuel prices have fallen sharply since reaching a four-year high in October 2018. Lower fuel cost in 2019 will expectedly support airlines' profit margins.



Stock performance	1M	3M	12M
HVN (%)	7.6%	18.5%	-12.1%
VNIndex (%)	2.6%	1.3%	-7.8%

Source: Bloomberg

#### Major shareholders

Ministry of Transportation	86.16%
ANA Holdings Inc.	8.77%

#### What's new

- For FY18, HVN reported its consolidated earnings of VND 2,282bn**, down 3.7% yoy in light of (i) passenger carried of 22.0m, up 0.4% yoy, passenger yield increased by 11.9%, (ii) foreign currency transaction loss, and (iii) lower gains from sale-lease back at Jetstar.
- Consolidated earnings forecast for FY19 is revised up to VND 2,760bn** based on (i) passenger carried of 22.7m and passenger yield reduced by 4.0% in line with fuel price falling, (ii) the average jet fuel kerosene-type price of \$80.6/barrel, and (ii) lower interest expense and forex loss resulted from lower total debt.
- So far, VNA has received five A321-Neo**, three in 4Q2018 and two in 1Q2019, from the package of twenty A321-Neo for the period 2018-2019. Meanwhile, VNA will maintain its narrow-body fleet size of 57 A321-Ceo till 2020. Despite 15% of fuel saving, VNA's operating cost in FY19 seems not to be enhanced considerably, provided all other factors remain the same, because (i) the proportion of A321-Neo fleet is still small and (ii) VNA operates A321-Neo through operating lease, and thus fleet size expanding faster than the equilibrium will hit back the bottom line.
- Interesting story in FY19.** HVN plans on moving to HOSE in April 2019 and then undergoing a divestment of 35.2% by government holdings. As a national flag carrier, HVN should be then added to portfolios of investment funds, especially foreign ones. We believe these are key catalysts for HVN in 2019.

#### Valuation

We recommend a 12-month target price of VND 38,500 for HVN stock, based on the DCF valuation – FCF approach with WACC of 14.4%. The events of upgrading to HOSE and sale of government's stake have not priced in our target price.

Parent company (VND bn)	FY17	FY18	FY19F	FY20F
<b>Revenue</b>	<b>63,375</b>	<b>70,787</b>	<b>71,719</b>	<b>78,264</b>
EBIT	2,639	3,443	3,960	4,653
<b>Net profit</b>	<b>1,816</b>	<b>2,091</b>	<b>2,614</b>	<b>3,210</b>
<b>Consolidated net profit</b>	<b>2,371</b>	<b>2,282</b>	<b>2,760</b>	<b>3,370</b>
EPS (VND)	1,931	1,859	1,946	2,376
EPS growth rate (%)		-3.7%	4.7%	22.1%
<b>P/E (x)</b>	<b>20.2</b>	<b>17.8</b>	<b>20.5</b>	<b>16.8</b>
<b>P/E target (x)</b>			<b>19.8</b>	<b>16.2</b>
EV/EBITDAR (x)	5.3	3.9	3.8	3.6
DPS (VND)	600	1,000	1,200	1,400
P/S (x)	0.8	0.6	0.8	0.7
<b>ROE (%)</b>	<b>10.9</b>	<b>11.9</b>	<b>13.8</b>	<b>15.7</b>
Net debt/equity (%)	237.4%	172.9%	136.6%	84.9%

Source: MBS Research



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## Quarterly financial analysis and Earnings model

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

VND bn	1Q18	2Q18	3Q18	4Q18	Comment	FY18A	FY19F	Comment
<b>Net sales</b>	<b>18,090</b>	<b>16,957</b>	<b>18,590</b>	<b>17,150</b>		<b>70,787</b>	<b>71,719</b>	
Passenger transportation	14,905	14,499	15,409	14,096	For FY18, net sales has grown 11.7% as passenger carried of 22m and passenger yield increased by 11.9%	59,261	58,450	For FY19F, MBS forecasts revenue to increase slightly by 1.3% with passenger carried of 22.7m and passenger yield reduced by 4.0% in line with fuel price falling
Cargo transportation	1,562	1,694	1,767	1,811	Grew 15.1% as total cargo volumes of 350 thousands ton, up 8.6% yoy	6,834	7,566	Growth of 10.7% as same as air freight market
Charter flight	1,146	667	890	751	Grew 17.1% as the common trend of air transport industry going in line with tourism sector	3,454	3,972	Growth reduced to 15.0% as tourism sector moderation
Ancillary revenues	401	410	437	437		1,685	1,749	
Others	76	(313)	87	55		(447)	(18)	
<b>Costs of goods sold</b>	<b>15,238</b>	<b>14,734</b>	<b>16,275</b>	<b>15,211</b>		<b>61,458</b>	<b>61,696</b>	
Raw material costs	5,194	5,474	5,868	5,596	Reduced in 4Q2018 as fuel price falling. For FY18, fuel expenses has increased by 32.5%	22,132	21,160	Slightly reduced because of lower average jet fuel price and more efficient fleet
Staff costs	1,037	1,265	1,024	596	Suddenly reduced in 4Q2018 that could be pilot and flight attendants transferred to Bamboo Airways	3,921	4,000	Increased by 2.0%
Depreciation	1,153	1,139	1,150	1,150		4,592	4,613	
Others	7,854	6,856	8,233	7,869	Maintenance and outside expenses were well-controlled	30,813	31,923	Aircraft leasing expenses may soar following assumed receipt of two A350 and twelve A321-Neo, but maintenance expenses reduce as receiving new aircrafts
<b>Gross profits</b>	<b>2,853</b>	<b>2,222</b>	<b>2,315</b>	<b>1,939</b>		<b>9,329</b>	<b>10,023</b>	
Gross profit margin	15.8%	13.1%	12.5%	11.3%	Despite jet fuel price soaring, gross profit margin was remained similar to FY17's as VNA raised air fare to balance with fuel expenses	13.2%	14.0%	Enhancing gross profit margin as fuel expenses reduced
<b>SG&amp;A expenses</b>	<b>1,487</b>	<b>1,536</b>	<b>1,481</b>	<b>1,382</b>		<b>5,886</b>	<b>6,063</b>	
SG&A margin	8.2%	9.1%	8.0%	8.1%	The operation has been more efficient as SG&A margin reduced to 8.3% from 9.2% in FY17. All expenses reduced or slightly increased, except for staff costs soared by 23.6%	8.3%	8.5%	All expenses reduced or slightly increased, except for staff costs increased by 10.8%
<b>EBIT</b>	<b>1,366</b>	<b>687</b>	<b>833</b>	<b>557</b>		<b>3,443</b>	<b>3,960</b>	
Gains from sale - lease back	0	85	5	392	In 4Q2018, VNA recorded most gains from SLB of two A350 received before. Our estimate of gains from SLB for FY18 was VND 179bn	482	482	We keep gains from SLB in 2019 the same as FY18's; VNA is planning to receive two A350 through SLB in 2019
Foreign currency transaction gains/(losses)	(131)	(692)	(210)	243	For FY18, VNA has recorded foreign currency transaction losses of VND 791bn, compared to the gains of VND 97bn in FY17	(791)	(398)	Assuming VND will depreciate 2.0% to USD and 2.5% to JPY
<b>Net income</b>	<b>711</b>	<b>617</b>	<b>378</b>	<b>443</b>		<b>2,091</b>	<b>2,614</b>	
					Growth of 15.2% from SLB gains and dividend received from subsidiaries and affiliates			Growth of 25.0%
<b>Consolidated net income</b>	<b>1,053</b>	<b>309</b>	<b>353</b>	<b>567</b>		<b>2,282</b>	<b>2,769</b>	
					For FY18, HVN recorded net income of VND 2,282bn higher than our last estimate of VND 2,049bn because of extraordinary gains from sale-lease back			Growth of 20.9%
Jet kerosene price (\$/barrel)	79.2	87.8	89.7	82.5		82.5	80.6	Assumed as a base case for FY19
Passenger yield (VND - annual)						1,691	1,624	

*Source: HVN, MBS Research*

## Valuation

Maintaining HVN with HOLD rating, we revise down our 12-month target price to VND 38,500 (4.5% downside) from VND 40,800 because of a higher WACC.

**Table 2: DCF Valuation – FCFF Approach**

VND bn	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F
EBIT	3,960	4,652	5,532	6,006	6,361	7,330	8,122
Efficient tax rate	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
(+) Depreciation cost	4,613	4,402	4,193	3,986	3,803	3,645	3,532
(+) Change in net working capital	(556)	3,721	1,116	1,326	1,660	1,647	1,798
(-) Capital expenditure	369	392	443	490	544	599	657
<b>FCFF</b>	<b>7,757</b>	<b>12,738</b>	<b>10,530</b>	<b>10,938</b>	<b>11,384</b>	<b>12,076</b>	<b>12,818</b>
WACC	14.4%						
Terminal growth rate	1.0%					<b>Terminal value</b>	<b>96,541</b>
Discount factor	0.89	0.78	0.68	0.59	0.52	0.45	0.40
<b>PV of cash flow</b>	<b>6,889</b>	<b>9,886</b>	<b>7,144</b>	<b>6,486</b>	<b>5,900</b>	<b>5,471</b>	<b>5,075</b>
							<b>38,226</b>
Total PV	85,007					<b>Cost of capital</b>	
(+) Cash and investment	8,614					Beta	1.0
(-) Outstanding debt	39,004					Risk-free rate	5.7%
<b>Equity value</b>	<b>54,687</b>					Risk premium	11.7%
Shares outstanding (mn)	1,419					Cost of debt before tax	11.3%
<b>Equity value per share</b>	<b>38,546</b>					<b>WACC</b>	<b>14.4%</b>

Source: MBS Research

At the target price, P/E forward 2019 equals to 19.8x and EV/EBITDAR of 3.7x, higher than traditional airlines in the region. We bet on competitive advantages of Vietnam's air transport industry and Vietnam Airlines' huge growth potential resulted from improving efficiency.

**Table 3: Multiple valuation to full-services peers**

Airlines	Nation	Market cap (USD mn)	ROE (%)	Load factor (%)	EV/EBITDAR (x)	P/E (x)
Bangkok Airways	Thailand	755	4.76	NA	5.77	17.7
Singapore Airlines	Singapore	8,299	5.89	81.9	3.90	14.3
ANA Holdings	Japan	11,865	9.50	75.0	4.20	12.2
Cathay Pacific	Hong Kong	5,363	0.90	84.2	6.45	79.5
Qantas Airways	Australia	6,803	26.16	82.9	3.61	10.1
Air New Zealand	New Zealand	2,302	18.74	83.1	3.64	8.7
Turk Hava Yollari	Turkey	3,588	13.87	80.4	5.30	8.4
Deutsche Lufthansa	Germany	10,572	22.74	79.8	2.12	4.1
Alaska Air Group	USA	7,965	21.45	NA	5.63	14.2
LATAM Airlines Group	USA	5,509	5.50	NA	5.77	26.5
Air Canada	Canada	5,480	10.66	NA	3.21	10.7
COPA Holdings	Panama	3,051	18.38	NA	4.58	8.4
<b>Mean</b>					<b>4.52</b>	<b>17.9</b>
<b>Median</b>					<b>4.39</b>	<b>11.5</b>
HVN	Vietnam	2,290	14.6	NA	4.4	21.5

Source: Bloomberg

## Financials and Valuation Summary

Income Statement (VND bn)						Ratios			
	2017	2018	2019F	2020F	2021F		2018	2019F	2020F
<b>Revenue</b>	<b>63,375</b>	<b>70,787</b>	<b>71,719</b>	<b>78,264</b>	<b>86,639</b>	<b>Valuation</b>			
Cost of good sold	54,930	61,458	61,696	67,233	74,344	EPS	1,859	1,946	2,376
<b>Gross profit</b>	<b>8,444</b>	<b>9,329</b>	<b>10,023</b>	<b>11,030</b>	<b>12,295</b>	P/E	17.8	20.5	16.7
Financial income	671	1,195	250	300	264	P/S	0.6	0.7	0.8
Financial expenses	1,885	2,185	1,641	1,334	949	<b>Profitability</b>			
SG&A expenses	5,805	5,886	6,063	6,378	6,763	Gross profit margin	13%	14%	14%
<b>Profit before tax</b>	<b>1,911</b>	<b>2,393</b>	<b>2,905</b>	<b>3,567</b>	<b>4,895</b>	EBITDAR margin	27%	32%	31%
<b>Net income</b>	<b>1,816</b>	<b>2,091</b>	<b>2,614</b>	<b>3,210</b>	<b>4,405</b>	Net profit margin	3%	4%	4%
<b>Consolidated net income</b>	<b>2,371</b>	<b>2,282</b>	<b>2,760</b>	<b>3,370</b>	<b>4,581</b>	ROE	12%	14%	16%
						ROA	5%	6%	6%
						<b>Growth</b>			
						Revenue	12%	1%	9%
						Profit before tax	25%	21%	23%
						Profit after tax	15%	25%	23%
						EPS	(4%)	5%	22%
						Total assets	(7%)	(3%)	(7%)
						Equity	8%	8%	8%
						<b>Liquidity</b>			
						Current ratio	0.4	0.4	0.4
						Quick ratio	0.3	0.3	0.3
						Debt/Total assets	56%	49%	45%
						Debt/Equity	262%	196%	166%
						Interest coverage	1	2	2
						<b>Operating efficiency</b>			
						Receivables turnover	24.1	24.3	24.3
						Days sales outstanding	15	15	15
						Inventory turnover	112.8	112.8	112.8
						Days sales of Inventory	3	3	3
						Payables turnover	3.7	3.7	3.7
						Days payables outstanding	99	100	100
Balance Sheet (VND bn)						Cashflow Statement (VND bn)			
	2017	2018	2019F	2020F	2021F		2018	2019F	2020F
<b>Current assets</b>	<b>10,060</b>	<b>10,569</b>	<b>12,074</b>	<b>10,074</b>	<b>11,151</b>	CFO	8,749	6,525	11,173
I. Cash & cash equivalents	4,100	4,252	5,737	6,261	6,931	CFI	(1,593)	(569)	(601)
II. Receivables	2,687	2,941	2,947	3,216	3,560	CFF	(9,301)	(4,472)	(10,048)
III. Inventories	536	545	547	596	659	<b>Net cash flows during the period</b>	<b>(2,145)</b>	<b>1,485</b>	<b>524</b>
IV. Other current assets	2,737	2,831	2,842	0	0				
<b>Non-current assets</b>	<b>69,137</b>	<b>62,872</b>	<b>59,527</b>	<b>56,445</b>	<b>53,807</b>				
I. Prepaid assets	8,538	6,750	7,404	8,068	8,921				
II. Fixed assets	53,012	48,657	44,412	40,412	36,663				
1. Tangible fixed assets	52,919	48,574	44,331	40,332	36,584				
2. Intangible fixed assets	93	82	81	80	78				
III. Deposits for leasing aircraft & aircraft engines	2,227	2,146	2,189	2,232	2,277				
IV. Investment in affiliates	4,917	4,824	5,024	5,224	5,424				
V. Other non-current assets	441	496	498	508	522				
<b>Total assets</b>	<b>79,197</b>	<b>73,442</b>	<b>71,600</b>	<b>66,519</b>	<b>64,958</b>				
<b>Liabilities</b>	<b>62,266</b>	<b>55,194</b>	<b>51,966</b>	<b>45,377</b>	<b>41,396</b>				
<b>Current liabilities</b>	<b>24,323</b>	<b>23,895</b>	<b>26,983</b>	<b>26,265</b>	<b>28,464</b>				
I. Short-term payables	16,077	16,623	16,903	18,420	20,368				
II. Accrued expenses & deferred revenue	927	1,127	909	992	1,098				
III. Short-term borrowings	7,319	6,145	9,171	6,853	6,998				
<b>Non-current liabilities</b>	<b>37,943</b>	<b>31,299</b>	<b>24,984</b>	<b>19,112</b>	<b>12,932</b>				
I. Long-term payables	975	1,645	1,599	1,755	1,959				
II. Long-term borrowings	36,968	29,655	23,385	17,357	10,973				
<b>Equity</b>	<b>16,931</b>	<b>18,247</b>	<b>19,634</b>	<b>21,142</b>	<b>23,562</b>				
I. Share capital & share premium	13,496	15,404	15,404	15,404	15,404				
II. Retained earnings	2,366	2,844	4,230	5,739	8,158				
III. Other capitals	1,069	0	0	0	0				
<b>Total liabilities &amp; equity</b>	<b>79,197</b>	<b>73,442</b>	<b>71,600</b>	<b>66,519</b>	<b>64,958</b>				

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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