

China Aircraft Leasing Group

1848 HK

Target (HKD): **14.00 → 9.80**

Upside: **1.6%**

19 Jun price (HKD): **9.65**

- 1 Buy
- 2 Outperform
- 3 Hold (from Buy)
- 4 Underperform
- 5 Sell

Negative on management change, wait for rerating catalyst

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- We see the recent change in CEO as negative for the stock
- But, CALC says its business outlook remains intact
- Downgrade to Hold (3); lower 12-month TP to HKD9.80 due to weak market sentiment

■ What's new

China Aircraft Leasing Group (CALC) held a conference on 19 June to provide details on the alleged bribery investigation related to Mr. Mike Poon (CEO and Executive Director) and China Southern Airlines (1055 HK, HKD8.68, Hold [3]). CALC also announced that Mr. Mike Poon resigned and would be replaced as CEO by Mr. Chen Shuang, the Chairman and a Non-executive Director. CFO Dr. TT Yu also resigned and was replaced by Mr. Barry Mok. We consider the resignation of the CEO to be a short-term negative, while we are neutral on the change in CFO.

■ What's the impact

We are negative about Mr. Poon's resignation and his absence during the call. Additionally, the board was unable to reach him before the announcement. We believe this may imply that he is being investigated.

For the CFO change, we believe it is more a personal issue, unrelated to the CEO change, and think that CALC preferred to announce all its bad news at one time. CALC is now looking for a new CEO to replace Mr. Chen.

CALC reiterated that its business outlook remains intact for 2015-16. It confirmed that its ongoing negotiations with airlines, financing facilities, leasing contracts have not been affected by the issue. Its leasing target remains at 70 aircraft by end-2015 and 100 by end-2016.

CALC also said that China Everbright (CE) and Friedmann Pacific Asset Management (owned by Mr. Poon) do not have any plans to reduce their holdings in CALC. Additionally, the new CEO Mr. Chen said CE considered aircraft leasing as one of its major businesses and does not rule out a possible increase of its stake in CALC. We believe it would be positive for CALC if CE or another SOE were to own a higher stake, as we believe corporate governance issues would have a lower impact on operations than private enterprise.

■ What we recommend

While we leave our earnings forecasts for 2015-17 unchanged, we downgrade CALC to Hold (3) from Buy (1) as we revise down our DCF-based 12-month target price to HKD9.80, which is now based on a 30% discount to our DCF valuation (previously no discount). We believe a 30% discount is appropriate as we reference some small/mid-cap non-SOE companies which have had corporate governance issues in the past (see table On pg. 2).

We think market sentiment in the near term should be negative on the

stock, but we expect CALC's business model to remain attractive in the long term. A potential rerating catalyst for the stock would be SOEs buying shares from Mr. Poon, but we expect this to take time to realise. Key risks to our call are lower-than-expected demand for aircraft in China and a possible need for equity financing.

■ How we differ

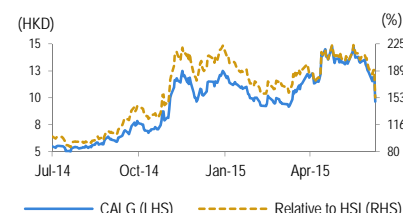
We are 1 of the 4 firms on the street that cover the stock. We are still more optimistic than the street on CALC's 2015-16 earnings outlook.

Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	5.02-14.78
Market cap (USDbn)	0.73
3m avg daily turnover (USDm)	5.98
Shares outstanding (m)	586
Major shareholder	CE Aerospace (36.7%)

Financial summary (HKD)

Year to 31 Dec	15E	16E	17E
Revenue (m)	1,994	2,847	4,574
Operating profit (m)	1,515	2,049	2,552
Net profit (m)	523	643	805
Core EPS (fully-diluted)	0.750	0.877	1.097
EPS change (%)	21.1	16.9	25.1
Daiwa vs Cons. EPS (%)	15.5	7.2	n.a.
PER (x)	12.9	11.0	8.8
Dividend yield (%)	2.9	3.5	4.4
DPS	0.276	0.340	0.426
PBR (x)	2.6	2.1	1.7
EV/EBITDA (x)	14.5	11.9	9.9
ROE (%)	26.5	26.5	27.1

Source: FactSet, Daiwa forecasts

Selected Corporate Governance issues of H-share listed China companies

Company	Bloomberg code	Date	Event	Share price performance		
				First day performance after the news released	1Year performance	Since-the-event performance
China South City	1668 HK	Jan-15	Mr. Cheng Chung Hing, the Co-chairman and Executive Director of CSC, was on a list circulated on internet of Shenzhen property developers who may be subjected to investigation. The company denied the rumour and no management member was charged.	-14%	N.A.	-24%
Hydoo International	1396 HK	Jul-14	The company announced it was not able to contact Mr. Wong Choiming, the Chairman and Executive Director of the company. The board finally removed Mr. Wong from his positions and replaced him.	-34%	N.A.	-41%
Kaisa Group	1638 HK	Oct-14	In October, Mr. Kwok Ying Shing, Chairman and an Executive Director of the company, was reported being detained or unreachable. The company denied the rumour. 2 months later, the company announced that 4 of its projects in Shenzhen were blocked from sale by the Urban Planning Land and Resources Commission of Shenzhen Municipality.	-6%	N.A.	-45%
Beijing Capital Intl Airport	694 HK	Jun-07	Li Peiyong, former Chairman and General Manager of Capital Airports Holding Company (Parent company of BCIA) was "Shuanggui" in mid-2007. He was convicted of bribery and executed in 2009.	1%	-6%	2%
China Southern Airlines	1055 HK	Jan-15	The company announced Mr. Xu Jie Bo (Executive Director, CFO) and Mr. Zhou Yue Hai(Executive Vice-President) were both removed from the company due to the suspicion of job-related crimes.	4%	N.A.	123%
Sinotrans	598 HK	Nov-14	Media reported Sinotrans & CSC Holdings' Guangxi and Liuzhou subsidiary (sister company of Sinotrans) were likely in relation to irregularities in the custodian warehousing operations and related collateral management services. Sinotrans denied the issue has any relation to its operations.	-13%	N.A.	-14%
China Gas	384 HK	Dec-10	Mr. Liu Ming Hui (Managing and Executive Director) and Mr. Huang Yong (Executive President) were escorted away by officials from the Shenzhen Municipal Public Security Bureau. Mr. Liu was released after one year and resumed as Managing Director and President of the company.	-15%	7%	388%

Source: companies, various media outlets

CALC: Management Profile

CEO		
Resigned	Mr. Poon Ho Man	Mr. Poon, founder of CALC, was responsible for formulating and reviewing the Group's strategic planning and managing overall business operations. He has more than 7 years of experience in the aircraft leasing industry in China.
New	Mr. Chen Shuang	Mr. Chen has held the position of Chairman and Non-Executive Director of CALC since Aug 2013. He is mainly responsible for reviewing CALC's overall strategic planning and business development. He will now be appointed as CEO and re-designated as an Executive Director. Mr. Chen is also a Director at China Everbright Holdings and CEO of China Everbright Limited.
CFO		
Resigned	Dr. Yu Tai Tei	Mr. Yu joined CALC in June 2013. He has more than 29 years' experience in the areas of finance, business control, auditing and tax. He had an important role during CALC's IPO launch and convertible bond issuance.
New	Mr. Mok Chung Tat, Barry	Mr. Mok has over 20 years of experience in the banking and finance industry. He has extensive knowledge about the debt and capital markets. He also specialises in structured finance, syndicated loans and corporate bond transactions.

Source: company

Financial summary

■ Key assumptions

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Total fleet size (no.)	0	10	16	25	44	70	100	132
No. of realization transaction (no.)	n.a.	n.a.	n.a.	1	4	8	14	14
Ad hoc orders (no.)	0.0	10.0	6.0	8.0	8.0	6.0	10.0	12.0

■ Profit and loss (HKDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Finance lease income	n.a.	223	364	478	775	1,075	1,183	1,229
Operating lease income	n.a.	0	84	145	218	578	1,156	1,849
Other Revenue	n.a.	0	0	64	152	341	508	1,496
Total Revenue	0	223	448	687	1,145	1,994	2,847	4,574
Other income	0	0	0	0	0	0	0	0
COGS	0	(24)	(39)	(90)	(200)	(279)	(399)	(1,089)
SG&A	0	0	0	0	0	0	0	(280)
Other op. expenses	0	(0)	(31)	(54)	(71)	(200)	(400)	(653)
Operating profit	0	199	377	542	874	1,515	2,049	2,552
Net-interest inc./(exp.)	0	(124)	(250)	(330)	(521)	(857)	(1,239)	(1,539)
Assoc/forex/extraord./others	0	3	1	(2)	27	0	0	0
Pre-tax profit	0	78	128	210	381	657	809	1,013
Tax	0	(27)	(33)	(37)	(78)	(135)	(166)	(208)
Min. int./pref. div./others	0	0	0	0	0	(0)	(0)	(0)
Net profit (reported)	0	51	95	173	303	523	643	805
Net profit (adjusted)	0	51	95	183	344	523	643	805
EPS (reported)(HKD)	n.a.	0.153	0.253	0.376	0.577	0.892	1.098	1.375
EPS (adjusted)(HKD)	n.a.	0.153	0.253	0.400	0.655	0.892	1.098	1.375
EPS (adjusted fully-diluted)(HKD)	n.a.	0.153	0.253	0.400	0.619	0.750	0.877	1.097
DPS (HKD)	0.000	0.165	0.051	0.115	0.160	0.276	0.340	0.426
EBIT	0	199	377	542	874	1,515	2,049	2,552
EBITDA	0	199	408	596	945	1,715	2,449	3,206

■ Cash flow (HKDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	0	78	128	210	381	657	809	1,013
Depreciation and amortisation	0	0	31	54	71	200	400	653
Tax paid	0	(27)	(33)	(37)	(78)	(135)	(166)	(208)
Change in working capital	0	177	(35)	1,103	3,025	3,027	5,199	5,491
Other operational CF items	0	121	252	328	519	857	1,239	1,539
Cash flow from operations	0	349	343	1,658	3,919	4,607	7,482	8,489
Capex	0	(584)	(3,678)	(5,601)	(8,230)	(11,076)	(12,480)	(11,232)
Net (acquisitions)/disposals	0	(2)	0	0	0	0	0	0
Other investing CF items	0	0	0	1	1	0	0	0
Cash flow from investing	0	(586)	(3,678)	(5,600)	(8,229)	(11,076)	(12,480)	(11,232)
Change in debt	0	436	3,230	5,504	4,458	8,482	6,798	5,476
Net share issues/(repurchases)	0	0	390	89	621	0	0	0
Dividends paid	0	0	0	(53)	(69)	(94)	(162)	(199)
Other financing CF items	0	(127)	(302)	(306)	(631)	(857)	(1,239)	(1,539)
Cash flow from financing	0	309	3,318	5,234	4,378	7,531	5,397	3,737
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	0	72	(16)	1,292	68	1,062	399	994
Free cash flow	0	(235)	(3,335)	(3,943)	(4,312)	(6,469)	(4,998)	(2,743)

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (HKDm)

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	0	90	73	1,367	1,426	2,488	2,887	3,881
Inventory	0	0	0	0	0	0	0	0
Accounts receivable	0	106	808	2,183	3,503	3,531	3,137	2,505
Other current assets	0	8	79	116	234	346	394	491
Total current assets	0	203	960	3,667	5,163	6,365	6,418	6,877
Fixed assets	0	1	1,541	1,487	1,707	5,563	10,622	14,181
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	0	3,136	4,388	7,679	11,443	13,549	13,971	14,602
Total assets	0	3,340	6,889	12,833	18,313	25,477	31,011	35,661
Short-term debt	0	370	374	2,821	4,690	5,977	6,398	6,819
Accounts payable	0	0	0	0	0	0	0	0
Other current liabilities	0	238	87	249	447	778	1,112	1,786
Total current liabilities	0	609	461	3,070	5,137	6,755	7,510	8,605
Long-term debt	0	2,486	5,713	8,615	10,653	15,770	20,067	23,016
Other non-current liabilities	0	10	20	189	743	743	743	743
Total liabilities	0	3,105	6,195	11,875	16,532	23,268	28,320	32,364
Share capital	0	235	619	743	1,332	1,332	1,332	1,332
Reserves/R.E./others	0	0	76	195	429	858	1,340	1,946
Shareholders' equity	0	235	695	939	1,761	2,190	2,672	3,278
Minority interests	0	0	0	20	19	19	19	20
Total equity & liabilities	0	3,340	6,889	12,833	18,313	25,477	31,011	35,661
EV	5,653	8,420	11,666	15,741	19,589	24,931	29,251	31,626
Net debt/(cash)	0	2,767	6,014	10,069	13,917	19,259	23,579	25,954
BVPS (HKD)	n.a.	0.699	1.846	2.045	3.007	3.739	4.561	5.596

■ Key ratios (%)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	n.a.	n.a.	100.6	53.4	66.7	74.1	42.8	60.6
EBITDA (YoY)	n.a.	n.a.	105.0	46.0	58.4	81.4	42.8	30.9
Operating profit (YoY)	n.a.	n.a.	89.5	43.7	61.1	73.3	35.3	24.6
Net profit (YoY)	n.a.	n.a.	84.8	92.8	87.5	52.0	23.1	25.1
Core EPS (fully-diluted) (YoY)	n.a.	n.a.	64.8	58.1	54.9	21.1	16.9	25.1
Gross-profit margin	n.a.	89.3	91.2	86.8	82.5	86.0	86.0	76.2
EBITDA margin	n.a.	89.3	91.2	86.8	82.5	86.0	86.0	70.1
Operating-profit margin	n.a.	89.2	84.3	79.0	76.3	76.0	71.9	55.8
Net profit margin	n.a.	23.1	21.2	26.7	30.0	26.2	22.6	17.6
ROAE	n.a.	43.9	20.5	22.5	25.5	26.5	26.5	27.1
ROAA	n.a.	3.1	1.9	1.9	2.2	2.4	2.3	2.4
ROCE	n.a.	12.9	7.6	5.7	5.9	7.4	7.7	8.2
ROIC	n.a.	8.7	5.8	5.0	5.2	6.5	6.8	7.3
Net debt to equity	n.a.	1,179.1	865.6	1,072.8	790.2	879.3	882.5	791.8
Effective tax rate	n.a.	34.3	25.9	17.8	20.5	20.5	20.5	20.5
Accounts receivable (days)	n.a.	86.4	372.3	794.7	906.4	643.9	427.4	225.1
Current ratio (x)	n.a.	0.3	2.1	1.2	1.0	0.9	0.9	0.8
Net interest cover (x)	n.a.	1.6	1.5	1.6	1.7	1.8	1.7	1.7
Net dividend payout	n.a.	107.6	20.2	30.7	27.7	31.0	31.0	31.0
Free cash flow yield	0.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: FactSet, Daiwa forecasts

■ Company profile

China Aircraft Leasing Group (CALC) is the largest independent aircraft lessor in China, managing a fleet of 44 aircraft as at the end of 2014. CALC was listed in Hong Kong on 11 July 2014.

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Rating	Percentage of total
Buy*	61.0%
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Source: Daiwa

Notes: data is for single-branded Daiwa research in Asia (ex Japan) and correct as of 31 March 2015.

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