

Pieces falling into place

China Transportation

HMIA (357 HK, HK\$9.93) (H-shares)

Not Rated

Background and business focus. Hainan Meilan International Airport (HMIA) provides aeronautical and non-aeronautical services at the Hainan Meilan International Airport, located in Haikou, Hainan province in China. The aeronautical segment includes the operation of terminal facilities, ground handling services and passenger and cargo handling services. The non-aeronautical business consists of the leasing of commercial and retail space at the airport and airport-related operations such as franchising, advertising, car parking, tourism services and sales of duty-free and consumable goods. HMIA listed its H-shares on HKEx in Nov 2002.

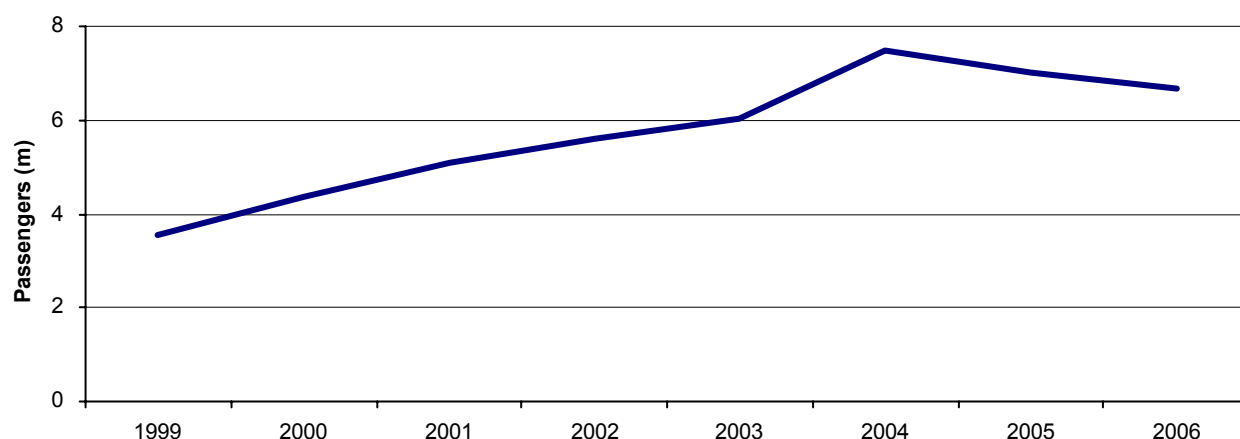
Table 1: Turnover breakdown

Turnover (RMBm)	FY05	FY06	YoY (%)	1H06	1H07	YoY (%)
Aeronautical related business	248.4	230.8	(7.1)	122.7	126.1	2.8
Passenger charges	95.4	89.0	(6.7)	47.8	46.2	(3.3)
Aircraft movement fees & related charges	42.3	41.0	(3.1)	22.0	20.8	(5.5)
Airport fee	85.3	80.6	(5.5)	43.2	44.3	2.5
Ground handling services income	25.4	20.1	(20.9)	9.7	14.9	53.6
Non-aeronautical	86.5	103.6	19.8	53.8	48.8	(9.3)
Retaining	10.2	9.5	(6.9)	5.6	8.1	44.6
Franchise fee	16.0	27.8	73.8	14.0	11.4	(18.6)
Rental	16.5	17.8	7.9	8.7	8.5	(2.3)
Tourism	19.5	20.5	5.1	11.8	-	-
Freight	-	-	-	-	4.7	-
Advertising	9.2	12.0	30.4	5.7	6.4	12.3
Car parking	5.3	5.1	(3.8)	2.8	2.5	(10.7)
Others	9.9	10.8	9.1	5.3	7.1	34.0
Total	334.8	334.4	(0.1)	176.6	174.9	(1.0)

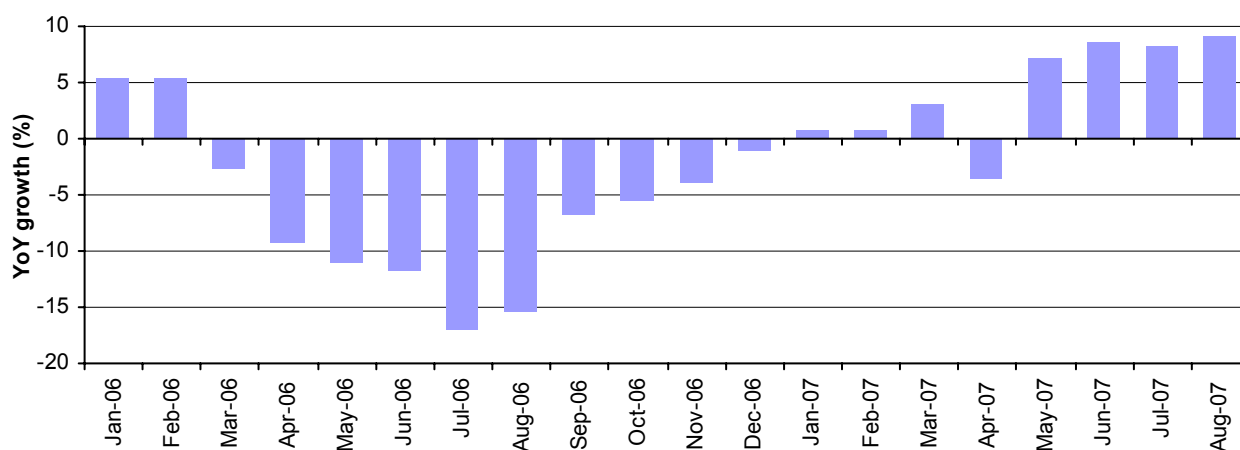
Source: Company data

History of Hainan Meilan Int'l Airport. Opened in May 1999, Hainan Meilan International Airport is located around 25km southeast of provincial capital Haikou. After its Phase II expansion at the end of 2005, the facility can now handle 9.3m passengers and 135,000 tones of cargo/mail a year. The airport has 3rd, 4th, and 5th air traffic freedom rights, granted by the CAAC in 24 Mar 2003. Hainan has another international airport, Sanya International Airport, located in Tianya Haijiao.

Solid increase in passenger growth. HMIA has been experiencing strong passenger growth fuelled by China's tourism boom and Hainan's emerging reputation as a holiday destination. Its passenger volume rose from 3.6m in 1999 to 6.7m in 2006, representing a CAGR of 9.3%. There was some decline in passenger volume between 2005 and 2006 mainly due to diversion to Sanya Airport. However, we note that passenger growth has recovered in 2007, with increases each month (except Apr) between January and August. In fact, passenger volume grew an exceptional 9.1% YoY in August 2007 to 519,900, driven by a robust tourism environment and increased air traffic movements.

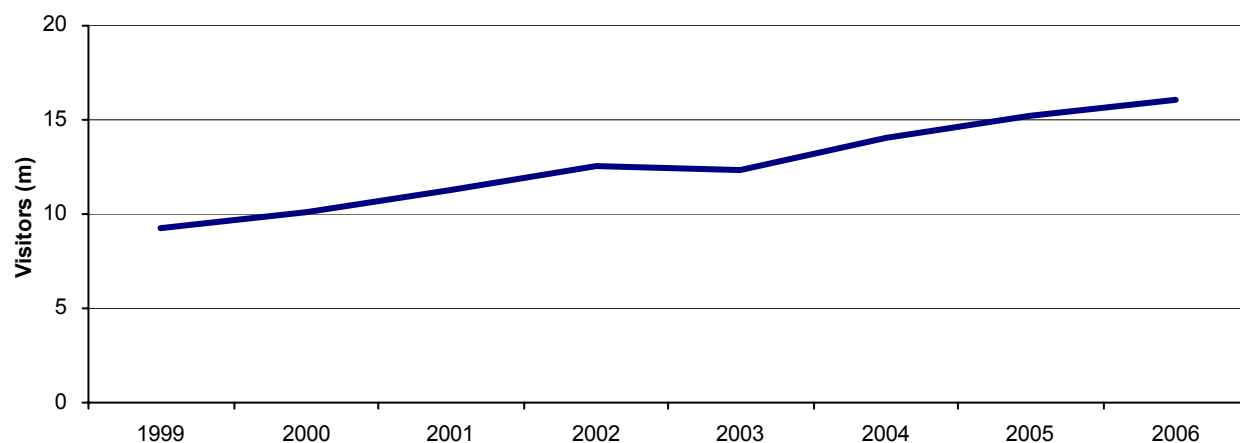
Chart 1: HMIA passenger volume growth

Source: Company data

Chart 2: HMIA monthly passenger growth

Source: Company data

Tourism mecca. Hainan has been at the centre of China's tourism boom. Between 1999 and 2006, the number of visitors recorded a CAGR of 8.1%. In the first two months of 2007, visitors to Hainan totaled 3.5m, up 15.6% YoY. Around 65% of them travel to the province by air and the rest by bus and rail. Though air travel is more expensive than land-based transport options, it offers the advantages of shorter traveling time and greater flexibility, given the greater frequency of flights. For example, flights from Guangzhou to Hainan depart 5-6 times daily, while buses and trains depart 1-2 times daily.

Chart 3: Hainan visitor volumes

Source: Company data, Hainan Government Statistics

Sanya Airport acquisition. In order to reduce competition and fully capture Hainan's tourism growth potential, HMIA plans to acquire Sanya Airport, which is 69.0%-owned by HMIA's parent, Haikou Meilan International Airport Co. Ltd. The remainder is owned by the local government. HMIA could potentially get the Sanya Airport stake by way of an asset injection from its parent. The deal has been in the works for some time and the market took the exit of HMIA's 20.0% shareholder, Copenhagen Airport (stake sold to Oriental Patron Resources), this June as a sign that the acquisition was nearing completion. We estimate that traffic at Sanya Airport totaled 3.9m pax in 2006.

Benefits from sector reforms. With the conclusion of the 17th CPC National Congress, we expect China's reforms in various sectors, including aviation, to accelerate. While airport tariff reforms such as reduction of landing fees and personal handling charges may lead to a one-off correction in HMIA's earnings, other reforms such as deregulation of ticket pricing may lead to lower air ticket prices, spurring tourism and air travel demand. We expect the reforms to make air travel a much more attractive option for domestic tourists, leading to market share gains over other modes of transport.

Table 2: Aviation reforms

Reform items	Description
Airport tariff	<ul style="list-style-type: none"> □ Classification of airports into 3 classes and 2 sub groups □ Reduction of landing fees on domestic routes (currently, only domestic airlines fly domestic) □ Reduction of landing fees for international airlines on international routes, coupled with an increase of landing fees for domestic airlines on international routes (currently, international airlines pay a much higher landing fee) □ Reduction in personal handling charges
Ticket price	<ul style="list-style-type: none"> □ Instead of maintaining a "published" fare for each route, with actual ticket prices only allowed to fluctuate within a certain band range, new policy aims to maintain a "cap" on ticket prices for each route, while removing the floor price
Jet fuel price	<ul style="list-style-type: none"> □ Gradually bring domestic fuel price in line with spot fuel price

Source: Company data

Further catalyst in removal of air space block. The Civil Aviation Administration of China's (CAAC) new regulations, effective on 30 August 2007, will allow direct flights from Hainan to Southeast Asia, bypassing Hong Kong or the Guangxi Zhuang Autonomous Region airspace. This will reduce traveling time and costs, resulting in a strong incentive for airlines to open new routes, or expand capacity on existing routes, between Hainan and Southeast Asian countries. Hainan's provincial government plans to take advantage of this opportunity by offering subsidies to airlines that open new flights to the Haikou area.

Interim results - rebound in passenger traffic. HMIA's 1H FY12/07A net profit rose 9.4% YoY to RMB87.1m thanks to internal cost controls. Revenue fell 1.0% YoY to RMB174.9m but aeronautical revenue rose 2.8% YoY to RMB126.1m, led by a 2.2% rebound in passenger throughput and a 0.5% increase in aircraft movement. The 9.4% YoY decline in non-aeronautical revenue was largely due to the move to outsource its travel agency business, which contributed RMB11.8m in the previous year. Excluding this segment, non-aeronautical revenue actually rose 6.1% YoY. The outsourcing of the low margin travel agency business allowed HMIA to save on SG&A expenses, which helped it improve its operating margin by 5.4 pcp to 53.1% in the period. The company paid out an interim dividend of HK\$0.20 per share, after zero dividend payout for 2006. Its net cash position increased to RMB467.2m (c.f. RMB355.0m as of 31 Dec 2006).

Valuation. Trading at 30.0x FY12/07F and 26.5x FY12/08F P/E based on consensus estimates HMIA is at a discount to other China airports, which are trading at an average of 39.5x and 38.6x current-year and one-year forward estimated P/E. Asia Pacific comparable peers are trading at an average of 30.5x and 25.9x P/E of the same two periods.

Corporate governance issues. Haikou Meilan International Airport Co. Ltd. is HMIA's largest shareholder, with a 52.1% stake. Other majority shareholders include Oriental Patron Resources (20.0%), UBS AG (5.4%) and Farallon Capital Management (3.0%). On 30 Jul 2007, Haikou Meilan International Airport Co. Ltd. said it had pledged 157.5m shares (33.0% of HMIA's total issued capital) as a security for a short-term loan of RMB400m (representing a pledge value of around HK\$2.39/share).

Risks. 1) Passenger traffic decline from further diversion to Sanya Airport; 2) planned acquisition of Sanya Airport and 3) shocks from any economic slowdown or outbreak of communicable diseases.

Table 3: P&L

Year to Dec (RMBm)	04A	05A	06A	1H 06A	1H 07A
Turnover					
Aeronautical	259.8	248.4	230.8	122.7	126.1
Non-aeronautical	100.3	86.5	103.6	53.8	48.8
	360.0	334.8	334.4	176.6	174.9
Business tax and levies	(13.9)	(11.6)	(12.3)	(6.4)	(6.5)
Cost of sales	(106.3)	(99.1)	(125.3)	(55.8)	(55.8)
Gross profit	239.8	224.1	196.8	114.4	112.7
Selling and distribution costs	(3.0)	(2.9)	(2.7)	(1.5)	(0.2)
Administrative expenses	(56.1)	(62.2)	(61.5)	(28.6)	(19.6)
Other gains - net	-	0.2	0.3	-	-
Operating profit	180.8	159.2	132.8	84.3	92.9
Finance income	4.8	4.5	4.1	3.5	3.2
Finance costs	-	-	(3.9)	(1.5)	(1.6)
Profit before taxation	185.7	163.7	133.1	86.3	94.4
Taxation	-	(12.2)	(10.1)	(6.6)	(7.4)
Profit after tax	185.6	151.4	123.0	79.7	87.1
Minority interests	-	0.4	-	-	-
Profit attributable to shareholders	185.7	151.8	123.0	79.6	87.1
Dividends	(84.2)	(39.8)	-	-	(92.1)

Source: Company data

Table 4: Peer comparison

Company name	Ticker	Market Cap (US\$m)	Last Price (Local)	Historical	P/E (x)		ROE (%)
					Est Cur-Yr	Est 1-yr Fwd	
China							
Beijing Capital Int'l Airport	694 HK	7,932.3	HK\$14.76	52.3	50.4	66.6	12.1
Hainan Meilan Int'l Airport	357 HK	630.6	HK\$9.93	35.9	30.0	26.5	8.5
Shanghai Int'l Airport	600009 CH	9,241.0	RMB36.39	43.3	38.8	39.5	15.7
Guangzhou Baiyun Int'l Airport	600004 CH	2,351.9	RMB17.38	50.9	44.8	30.0	7.2
Xiamen Int'l Airport	600897 CH	714.3	RMB17.99	36.0	33.3	30.7	10.5
Average				43.6	39.5	38.6	10.8
Asia Pacific							
Japan Airport Terminal	9706 JP	223,966.6	JPY2,555.0	103.6	67.7	57.1	2.2
Malaysia Airports Hldgs	MAHB MY	948.3	MYR2.89	15.7	16.1	13.7	6.3
Auckland Int'l Airport	AIA NZ	2,876.9	NZD3.11	41.2	34.9	31.1	4.9
Macquarie Airports	MAP AU	6,953.4	AUD4.41	12.5	7.4	20.2	15.0
Airports of Thailand	AOT TH	2,799.5	THB62.0	55.7	49.3	26.4	15.4
Average				36.5	30.5	25.9	11.7

Source: Bloomberg