

AIRLINES STOCKS COULD RECEIVE A MEDIUM-TERM BOOST FROM THE RELAXATION OF SECTOR FOREIGN OWNERSHIP LIMITS

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Vietnam Airlines' major shareholders

Ministry of Transport	86.16%
ANA Holdings	8.77%
Vietcombank	1.40%

Vietjet Air's major shareholders

Chairwoman & relatives	45.00%
GIC (Singapore)	4.97%

Source: VNDIRECT

Open skies policy demands freedom of ownership

The Ministry of Transport (MoT) has proposed to raise the foreign ownership limit (FOL) for airlines from the current 30% to 49%. Aside from increasing FOL, the draft decree would also remove the difference in minimum charter capital requirements between international and domestic flight operators, thus leveling the playing field.

Under existing legislation, an airline operating between 11 to 30 aircraft is required to have a minimum capital of VND1,000bn (~US\$44m) if providing international services and VND600bn (~US\$26.4m) if operating domestically. However, the new decree recommends all airlines operating from 11 to 30 aircraft must have at least VND1,000bn (~US\$44m), while airlines with over 30 airplanes are required to have VND1,300bn (~US\$57.3m), irrespective of whether they operate international or domestic routes.

In addition, the new draft decree requires that a Vietnamese national or legal entity owns the biggest share of charter capital in the domestic entity of a foreign-invested airline that is operating domestic flights within Vietnam. The draft decree also removed the requirement for an airline's legal representative to be a Vietnamese national.

We believe the draft decree reflects the Government's efforts to broaden its engagement with the ASEAN Single Aviation Market (ASAM), better known as ASEAN Open Skies agreement which has been fully ratified by member countries since April 2016. ASAM is a regional aviation policy aiming to establish an integrated aviation market in Southeast Asia. The policy is devised to fully liberalize international air travel within Southeast Asia.

The two most fundamental features of open skies are the freeing-up of market access to all carriers of ASAM parties and the relaxation of airline ownership and control rules. Most ASEAN countries hitherto applied some degree of control, which was largely a political instrument to ensure a stronger grip on airlines and the development of the aviation market, overall. However, restrictions on foreign ownership in the aviation industry can bring certain harmful consequences. They might limit potential investment in airlines, thereby increasing the cost of capital, in our view.

Neighboring countries, Singapore and Thailand have already taken significant steps to fully liberalize their respective limits on foreign participation in locally-based airlines. Meanwhile, Indonesia, Malaysia and Cambodia have raised their FOL on local airlines up to 49%.

Figure 1: Airline foreign ownership limits of ASEAN countries

Country	Maximum percentage of FOL permitted by national statute
Singapore	100%
Thailand	100%
Indonesia	49%
Cambodia	49%
Malaysia	45%
Philippines	40%
Vietnam	30%

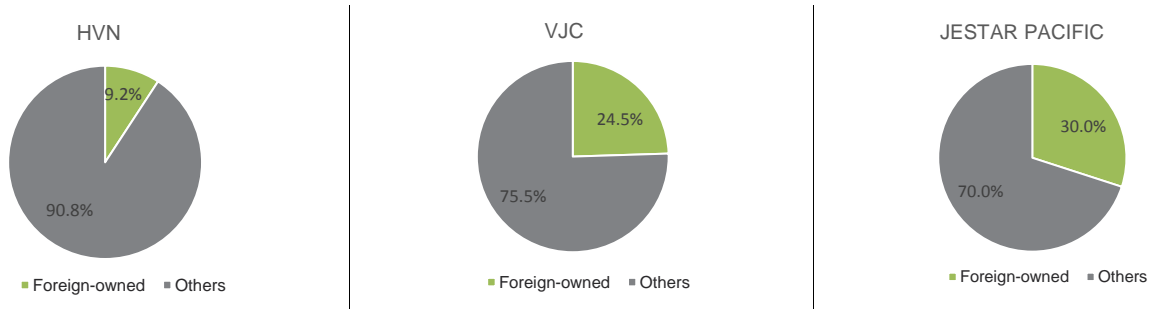
Source: IDEAS, May 2018

A diversified capital base could prolong the health of the Vietnam airline industry

Vietnam is one of the most dynamic aviation markets in Asia-Pacific, with passenger volume rising by a 4-year CAGR (2013-17) of 19.9%. We believe a relaxation on FOL of domestic airlines would decrease capital costs, allowing airlines to scale up their fleets, thereby allowing them to reap economies of scale and network effects from route expansion. A change in foreign ownership could also allow smaller upstarts such as Bamboo Airlines (Unlisted) to partner with foreign airlines and potentially grab market share from the incumbents.

Among the current 4 domestic airlines, Jetstar Pacific (unlisted) is a JV between Vietnam Airlines (HVN VN) and Quantas Airways in which the latter holds a 30% stake; ANA Holdings (Japan) is a strategic partner of HVN with 8.8% stake; Vietjet Air (VJC VN) so far has no strategic investors but foreign ownership is approaching the limit largely due to participation from overseas financial investors.

Figure 2: Foreign ownership of current locally-based airlines (as of June 2018)

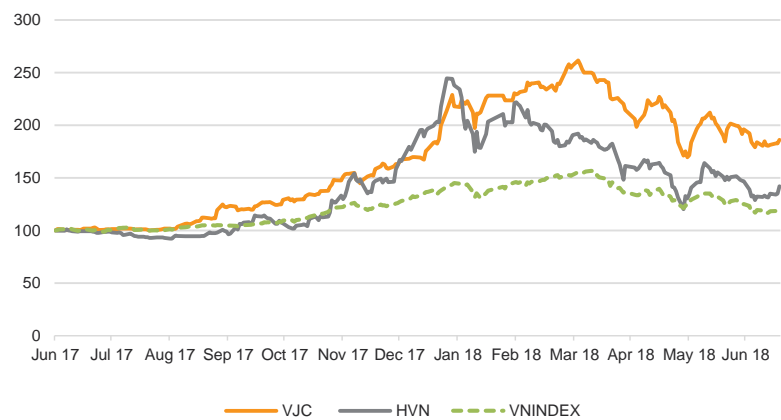


Source: VNDIRECT

VJC recently got approval from shareholders to raise its foreign ownership limit to 49% at the AGM on April 20th (once the new regulation becomes effective). If the State does approve the new FOL, VJC will be one step closer to listing on an overseas stock market. Meanwhile, higher FOL will create an opportunity for HVN to sell additional stake to ANA of Japan and meet the state’s objectives of reducing its stake to 51.0% from 86.1% by 2020.

Relaxing foreign ownership limit might bolster airlines stocks in the near-to-medium term

Figure 3: VJC and HVN price performance vs. VNINDEX benchmark (in 1 year)



Source: VNDIRECT

The recent slump in airlines stock prices was in line with market performance, due to strong profit-taking activities in the large cap space. Although rising aviation fuel prices create earnings headwinds for airlines, top line growth prospects remain robust; in 1H2018, Vietnam’s air passenger traffic grew by 16.8% yoy to reach 35.4mn with domestic airlines seeing 15.0% yoy growth and garnering 70.9% market share.

Select airline stocks, such as HVN, could receive a sentiment boost from the imminent liberalization of the foreign ownership limits as it creates the opportunity for key strategic investor ANA to ramp up its stake in the company by paying a strategic premium to purchase additional shares. Also, the rising involvement of a large international carrier like ANA also bodes well for improved efficiencies in HVN’s operations, going forward.

In the long-term, however, liberalization could create more competition for the existing incumbents by attracting more foreign airlines into the domestic market.

Figure 4: Sector comparison (as of 19 Jul 2018)

Company	Bloomberg Ticker	Market Cap (US\$m)	P/E (x)		P/BV (x)		EV/EBITDA (x)		ROE%		Dividend yield (%)	
			CY18F	CY19F	CY18F	CY19F	CY18F	CY19F	CY18F	CY19F	CY18F	CY19F
Cathay Pacific	293 HK	9,237	42.2	14.8	0.8	0.7	10.3	8.8	1.9%	5.1%	0.4%	2.7%
Singapore Airlines	SIA SP	9,237	19.0	17.3	0.9	0.9	6.5	6.9	4.8%	5.4%	2.3%	1.9%
Vietjet Air	VJC VN	3,440	14.1	11.6	5.5	4.2	12.3	10.1	37.1%	34.3%	2.3%	2.2%
AirAsia Group Berhad	AAGB MK	2,643	13.0	14.5	1.3	1.3	4.5	9.1	10.2%	8.8%	2.9%	5.3%
Vietnam Airlines	HVN VN	2,058	21.7	NA	3.1	NA	7.6	NA	14.4%	NA	2.4%	NA
Thai Airways	THAI TB	873	8.8	7.5	0.9	0.8	6.6	6.6	10.1%	11.0%	0.3%	0.3%
Garuda	GIAA IJ	417	NA	16.1	0.5	0.5	7.1	6.2	NA	2.9%	0.0%	0.0%
<i>Peer average</i>			19.8	13.6	1.9	1.4	7.8	7.9	13.1%	11.2%	1.5%	2.1%
<i>Peer median</i>			16.6	14.7	0.9	0.9	7.1	7.9	10.2%	8.8%	1.9%	2.1%

Source: BLOOMBERG, VNDIRECT

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Description:	Excellent	Very Good	Good	N/A	

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RECOMMENDATION FRAMEWORK

Stock Ratings

Definition:

- Add The stock's total return is expected to reach 15% or higher over the next 12 months.
- Hold The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
- Reduce The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

- Overweight An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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