

Equity Research | China | Tourism

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## Strategic Reorganisation of its Parent

- The pace of SOE reform in China's tourism sector is set to accelerate.
- The reorganisation involves HKCTS and CITS Group on the parent company's level, which we expect would involve the duty-free and travel agency business.
- We reiterate our **Outperform** rating on CTII and PT of HKD3.60, which implies 12.6x ex-cash P/E for FY16E, as SOE reform raises the likelihood of acceleration of M&A activities of CTII.

**Strategic reorganisation involving HKCTS and CITS Group:** CTII announced yesterday after market close that its controlling shareholder, China National Travel Service (HK) Group (HKCTS Group) (港中旅集团) and China International Travel Service Group (CITS Group) (中国国旅集团) are contemplating on strategic reorganisation. The finalised proposal will be subject to the approval of the relevant supervising authority. Details of the plan were not announced.

**Duty-free shops and travel agency business:** HKCTS Group's major lines of business include travel agency, tourist attractions, hotels, logistics & transportation, industrials, real estate and finance, with a total asset value of RMB98bn. CITS Group engages in travel agency, duty-free shops and transport business, with a total asset value of RMB12bn. Given that CITS Group and HKCTS Group both carry licenses to operate duty-free shops in China and are engaged in the travel agency business, we expect the asset restructuring program will likely be focused on these two segments.

**Listed company levels:** HKCTS Group currently holds two listed companies, namely CTII (308 HK) and CTS International Logistics (603128 CH), whereas CITS Group owns China International Travel Service Corp Ltd. (CITS) (601888 CH). Although we are uncertain of the benefits to be derived from the parent-level asset restructuring that could be fed onto the listco's level at this stage, we believe such a program will enhance operating efficiency from synergies among similar lines of business. This will create a clearer picture of the potential assets that are likely to be injected into CTII, which is the only tourism listco for HKCTS Group.

**Valuation:** CTII trades at 12.6x 16E PER (based on recurring fully-diluted EPS) and 0.9x PBR, the cheapest among its peers. We maintain our Outperform rating and DCF-based price target of HKD3.60, which implies a 17.2x 16E PER (or 12.6x ex-cash).

## China Travel International Investment Limited (CTII) (308 HK)

### Outperform

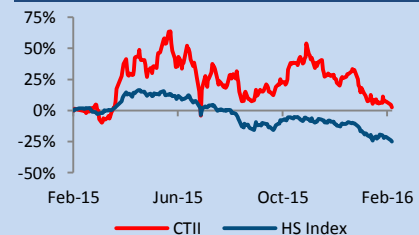
(unchanged)

<b>Price Target</b> (upside)	<b>HKD3.60</b> (34%)
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Close price	HKD2.68
Market cap.	HKD14,720mn
Free float	42%
52-week range	HKD2.08 – 4.04
3-mth ave. T/O	HKD29.9mn

Price as of 23 February 2016

#### Stock rel HSI performance (%)



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**Figure 1: Major business lines – HKCTS Group Vs. CITS Group**

Tourism SOEs	Total asset value	Major business lines:
HKCTS (港中旅集團)	RMB98bn	Travel Agency Tourist Attractions (i.e. Splendid China, The World Miniature) Hotels Logistics & transportation Industrials - iron & steel, electric power. Real estate Finance
CITS Group (中國國旅集團)	RMB12bn	Travel Agency Duty-free business Transport

Source: CSCI Research

**Income statement (HKDm)**

Year end: Dec	2013	2014	2015E	2016E	2017E
Revenue	4,360	4,475	4,717	5,389	5,932
COGS	(2,276)	(2,417)	(2,454)	(2,749)	(2,967)
Gross profit	2,084	2,058	2,264	2,640	2,965
Selling and marketing expenses	(588)	(504)	(531)	(606)	(668)
General and administrative	(992)	(996)	(1,050)	(1,199)	(1,320)
Other operating expenses	-	-	-	-	-
Other income	208	184	194	222	244
<b>EBITDA</b>	<b>1,194</b>	<b>1,255</b>	<b>1,417</b>	<b>1,672</b>	<b>1,900</b>
Depreciation & Amortization	(482)	(512)	(540)	(617)	(679)
<b>EBIT</b>	<b>712</b>	<b>743</b>	<b>877</b>	<b>1,056</b>	<b>1,222</b>
Net interest	92	110	131	122	112
Non-recurring items	317	934	532	200	200
JVs and associates	357	389	389	389	389
<b>Pretax profit</b>	<b>1,479</b>	<b>2,175</b>	<b>1,929</b>	<b>1,766</b>	<b>1,922</b>
Taxation	(225)	(310)	(267)	(239)	(266)
Minority interests	(102)	(126)	(131)	(137)	(142)
<b>Net profit</b>	<b>1,152</b>	<b>1,739</b>	<b>1,530</b>	<b>1,390</b>	<b>1,514</b>
Net profit (*adjusted)	826	899	1,023	1,158	1,281
Basic EPS (HKD)	0.20	0.31	0.27	0.25	0.27
Basic EPS (HKD) - (adjusted)	0.15	0.16	0.18	0.21	0.23
Diluted EPS (HKD)	0.20	0.31	0.27	0.25	0.27
Diluted EPS (HKD) - (adjusted)	0.14	0.16	0.18	0.21	0.23
DPS (HKD)	0.06	0.12	0.10	0.09	0.10

**Balance sheet (HKDm)**

Year end: Dec	2013	2014	2015E	2016E	2017E
Cash	1,967	3,327	3,024	3,118	3,626
Short term investments	893	1,420	1,420	1,420	1,420
Accounts receivables	274	188	243	277	306
Inventory	143	138	142	159	172
Other current assets	1,727	1,484	1,422	1,420	1,422
<b>Total current assets</b>	<b>5,004</b>	<b>6,558</b>	<b>6,251</b>	<b>6,394</b>	<b>6,946</b>
PP&E	9,231	9,948	10,611	11,198	11,523
Intangible Assets	189	185	182	178	175
Associates and JVs	1,131	1,061	1,450	1,838	2,227
Other long term assets	3,673	3,200	3,230	3,313	3,381
<b>Total long term assets</b>	<b>14,224</b>	<b>14,393</b>	<b>15,473</b>	<b>16,528</b>	<b>17,306</b>
<b>TOTAL ASSETS</b>	<b>19,228</b>	<b>20,951</b>	<b>21,724</b>	<b>22,923</b>	<b>24,252</b>
Short term debt	512	62	62	62	62
Accounts payables	378	301	344	385	416
Other current liabilities	1,685	1,678	1,741	1,958	2,156
<b>Total current liabilities</b>	<b>2,575</b>	<b>2,040</b>	<b>2,147</b>	<b>2,404</b>	<b>2,635</b>
Long term debt	20	806	744	682	620
Deferred tax	513	402	346	310	345
Convertible bonds	-	-	-	-	-
Other long term liabilities	793	1,070	1,039	1,039	1,039
<b>Total long term liabilities</b>	<b>1,326</b>	<b>2,278</b>	<b>2,130</b>	<b>2,031</b>	<b>2,004</b>
<b>TOTAL LIABILITIES</b>	<b>3,901</b>	<b>4,318</b>	<b>4,277</b>	<b>4,435</b>	<b>4,639</b>
Shareholders' funds	14,493	15,542	16,225	17,129	18,113
Minority Interests	834	1,091	1,222	1,359	1,501
<b>TOTAL LIAB AND EQUITY</b>	<b>19,228</b>	<b>20,951</b>	<b>21,724</b>	<b>22,923</b>	<b>24,252</b>
Net cash / (debt)	1,434	2,459	2,217	2,374	2,944

\*Adjusted net profit excludes fair value changes on investment properties, gains/losses from the disposal of subsidiaries & PP&E. Adjusted for MI and taxes.

Source: Company data, CSCI estimates

**Cash flow statement (HKDm)**

Year end: Dec	2013	2014	2015E	2016E	2017E
<b>EBIT</b>	<b>712</b>	<b>743</b>	<b>877</b>	<b>1,056</b>	<b>1,222</b>
Depreciation & amortisation	482	512	540	617	679
Net interest expenses/ (income)	(92)	(110)	(131)	(122)	(112)
Taxes paid	(225)	(310)	(267)	(239)	(266)
Changes in working capital	(25)	(63)	20	125	119
Others	621	1,043	739	406	459
<b>Cash flow from operations</b>	<b>1,473</b>	<b>1,814</b>	<b>1,777</b>	<b>1,843</b>	<b>2,100</b>
Capex	(1,497)	(1,653)	(1,200)	(1,200)	(1,000)
Acquisitions	(384)	1,415	-	-	-
Disposals	2	59	-	-	-
Others	11	8	59	-	-
<b>Cash flow from investing</b>	<b>(1,867)</b>	<b>(171)</b>	<b>(1,141)</b>	<b>(1,200)</b>	<b>(1,000)</b>
Dividends	(338)	(674)	(536)	(487)	(530)
Issue of shares	8	56	(342)	-	-
Change in debt	13	336	(62)	(62)	(62)
Others	-	-	-	-	-
<b>Cash flow from financing</b>	<b>(317)</b>	<b>(282)</b>	<b>(940)</b>	<b>(549)</b>	<b>(592)</b>
<b>Change in cash</b>	<b>(712)</b>	<b>1,360</b>	<b>(303)</b>	<b>94</b>	<b>508</b>
Cash and cash equivalents at Beg	2,678	1,967	3,327	3,024	3,118
<b>Cash and cash equivalents at E</b>	<b>1,967</b>	<b>3,327</b>	<b>3,024</b>	<b>3,118</b>	<b>3,626</b>
Free cash flow	(71)	108	515	666	787

**Key ratios**

Year end: Dec	2013	2014	2015E	2016E	2017E
<b>Operating ratios</b>					
Gross margin	47.8	46.0	48.0	49.0	50.0
EBIT margin (%)	16.3	16.6	18.6	19.6	20.6
EBITDA margin (%)	27.4	28.0	30.0	31.0	32.0
Effective tax rate (%)	15.2	14.3	13.9	13.5	13.9
Revenue growth (%)	(6.6)	2.6	5.4	14.2	10.1
Net income growth (%)	43.3	51.0	(12.0)	(9.1)	8.9
Net income (adjusted) growth (%)	39.2	8.8	13.8	13.1	10.7
Basic EPS growth adj (%)	39.9	9.3	14.7	14.3	10.7
DPS growth (%)	20.0	103.4	(19.9)	(8.2)	8.9
<b>Efficiency ratios</b>					
ROE (%)	5.7	5.8	6.3	6.8	7.1
ROCE (%)	4.3	3.9	4.5	5.1	5.7
Asset turnover (x)	0.2	0.2	0.2	0.2	0.2
Op cash / EBIT (x)	2.1	2.4	2.0	1.7	1.7
Depreciation / CAPEX (x)	0.3	0.3	0.4	0.5	0.7
Inventory turnover days	19.8	21.2	21.2	21.2	21.2
Accounts receivable days	22.2	18.8	18.8	18.8	18.8
Accounts payable days	57.2	51.2	51.2	51.2	51.2
<b>Leverage ratios</b>					
Net cash/ equity (%)	(9.9)	(15.8)	(13.7)	(13.9)	(16.3)
Net debt / EBITDA (x)	N/A	N/A	N/A	N/A	N/A
Interest cover (x)	N/A	N/A	N/A	N/A	N/A
Current ratio (x)	1.9	3.2	2.9	2.7	2.6
<b>Valuation</b>					
PER (x)	13.1	8.7	9.8	10.6	9.8
PER (x) - fully-diluted and adj. EP	18.6	16.8	14.6	12.8	11.6
EV/EBITDA (x)	12.1	10.8	9.7	8.2	7.0
PBR (x)	1.0	0.9	0.9	0.8	0.8
Dividend yield (x)	2.2	4.5	3.6	3.3	3.6



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## Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

<b>Outperform</b>	Relative Performance >10%
<b>Neutral</b>	Relative Performance is -10% to 10%
<b>Underperform</b>	Relative Performance <10%

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