

Shun Tak (0242.HK)

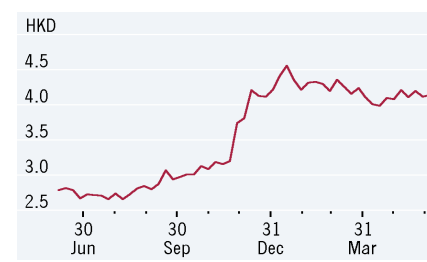
Alert: Acquiring a 33.3% Stake in Jetstar Hong Kong

- What Happened** — Shun Tak announced the group has entered into an agreement to acquire 33.3% of the equity in Jetstar Hong Kong Airways. The total investment cost will be US\$66m (or ~HK\$515m). Qantas Airways Limited (QAN.AX; A\$1.48; 1) and China Eastern Airlines (0670.HK; HK\$2.52; 1H) will each hold another 33.3% of shareholding interest. The initial fleet of Jetstar HK is expected to reach 18 (acquired/leased) Airbus A320s over the first three years of operation.
- Details** — Shun Tak will initially contribute HK\$245m within 10 business days after signing of the agreement, subject to completion of filings with relevant governmental authorities. The remainder will be contributed by the parties in equal shares, subject to satisfaction of certain conditions.
- Uncertain Economics, but immaterial; Maintain Buy** — The operation of Jetstar Hong Kong still needs government approval, as such we do not incorporate any changes to our NAV at this stage. The investment is just ~2% of our estimated NAV. We maintain our Buy rating with an unchanged TP of HK\$5.10. The stock is now trading at ~47% discount to our NAV of HK\$7.81 (vs. a historical average of 35%).
- Industry Background** — With a fleet of A320s, we expect Jetstar HK will be focused on Asian destinations within five hours (e.g. China, Japan, South Korea and SE Asia). There are no Hong Kong-based low-cost carriers (LCCs) now, but the major LCCs based outside HK have multiple daily flights into HK from Singapore, Malaysia, Thailand, Japan and the Philippines. Together, these foreign-based LCCs make up ~6% market share in HK – low when compared to the Asia-wide LCCs penetration rate of 25%. While we believe the relative low LCC penetration in the HK market provides an opportunity for new entrants, the high landing, route and staffing costs in HK make it really challenging for a LCC to succeed in our view. Further, HK's third runway will not be built until 2020, according to news reports. With an 89% utilization rate in place currently, the HK International Airport authorities will have limited incentive to add new LCCs. That said, with Jetstar's extensive LCC experience in different markets (and one of the only successful LCCs operated by a hub carrier), we believe Jetstar HK can greatly leverage its expertise and align the network between its full-service JV partners. Note, Jetstar already competes against Cathay Pacific (0293.HK; HK\$14.56; 2) in markets such as Singapore, while Qantas operates within the One World Alliance alongside CX.

The analyst briefing is scheduled to start at 1830 HKT today.

Buy	1
Price (06 Jun 13)	HK\$4.10
Target price	HK\$5.10
Expected share price return	24.4%
Expected dividend yield	1.7%
Expected total return	26.1%
Market Cap	HK\$12,287M
	US\$1,583M

Price Performance (RIC: 0242.HK, BB: 242 HK)



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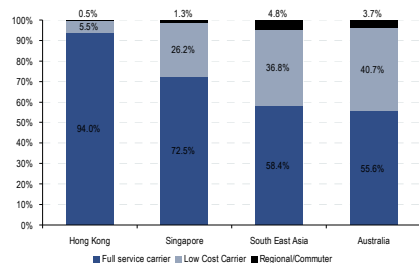
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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 1. LCC penetration in Asian markets



Source: CAPA, Citi Research

The low-cost carrier market appears relatively under-penetrated in HK and China but these are not new to HK. HK witnessed the high-profile failure of Oasis HK Airlines, a long-haul low-cost airline which served London Gatwick and Vancouver but ceased operations in early 2008 due to high jet fuel costs and weakening demand. Below we provide the highlight of important sector angles regarding Jetstar HK. For details, please refer to [Global Aviation: Merge or Die? \(Not Exactly\). Views on Global Airline M&A](#) published on 23 July 2012 and [LCC Adventure into Hong Kong Market](#) published on 25 March 2012

Aggressive scalability: Jetstar HK plans to scale up to 18 aircraft. Effectively, it aims to be almost as large as Tiger Airways Singapore, AirAsia Thailand, and AirAsia Indonesia within 2 years of operations, when it took these airlines between 7-8 years to reach similar scale. While the low LCC penetration rate in HK may justify such an aggressive expansion strategy, Jetstar HK's success (and impact on other airlines) also depends on the extent it can stimulate new demand in HK in addition to attracting "trading down" demand from full service carriers.

Mutual benefits: Presumably, we think the "meeting of the minds" occurred when Qantas offered its expertise in setting up low-cost Jetstar-branded airlines in Pan-Asia in exchange for local knowledge on market access in the Greater China region from CEA. Both CEA and Jetstar have started allocating people to the project and the new entity is already looking at issues such as aircraft allocation, AOC requirements and recruitment. A commercial team is assessing potential routes and the airline believes it can allocate its Jetstar Japan start-up team to the project in order to aid the process further – a significant point demonstrating Qantas' unique ability to export the low-cost model across Asia.

Cost advantage: We believe the relatively high cost base and fuel price environment could limit the ability for Jetstar HK to offer lower fare prices over an extended period of time. Therefore it may be difficult for Jetstar HK to under-cut prices offered by foreign LCCs flying into HK which could take advantage of much lower operating costs in their respective home countries (such as Malaysia, Thailand or the Philippines). However, Jetstar HK may rely on its cost advantage relative to Cathay Pacific or Dragonair (through more efficient aircraft turnaround times, higher seat density) to outdo its full-service competitors.

Slot advantage: While Jetstar HK may not enjoy a low-cost structure by virtue of being based in HK, it may pursue a more aggressive strategy within the Greater China region subject to slots availability. Jetstar HK may be able to tap on CEA's deep knowledge of the region and network of industry contacts. Deeper access and a denser network into Greater China may help to offset Jetstar HK's cost disadvantage relative to regional non-Hong Kong-based LCCs.

Figure 2. Jetstar has been the only successful LCC operated by a hub carrier thus far

Parent Brand	LCC Brand	Existing time	Result
United Airlines	Shuttle by United	from 1994 to 2001	Declared bankruptcy in 2002
United Airlines	Ted	from 2003 to 2009	Discontinued caused by spiking fuel prices
US Airways	Metrojet	from 1998 to 2001	Closed operation since 911 in 2011
Delta Air Lines	Delta Express	from 1996 to 2003	Replaced by Song in 2003
Delta Air Lines	Song	from 2003 to 2006	Incorporated into Delta mainline in 2006 to avoid bankruptcy
Continental Airlines	Continental Lite	from 1993 to 1995	Folded in 1995 after significant losses
Air Canada	Tango	from 2001 to 2003	Ceased operation in 2003
Qantas	Jetstar	Since 2004	Established Jetstar Asia, Jetstar Pacific; To launch Jetstar Japan and Jetstar Hong Kong

Source: Company reports; Citi Research

Shun Tak

Valuation

We derive our new target price of HK\$5.10 by applying the historical average NAV discount of ~35% to our NAV, consistent with other conglomerates in our coverage universe. Historically, we valued Shun Tak's Harbour Mile project at investment cost because little progress was made since the project was announced in 2004. With the increased likelihood of the group being gazetted for the Harbour Mile project in the next 6-12 months (as most casino projects in Macau Cotai have been gazetted that make us believe the Land, Public Works and Transport Bureau (DSSOPT) will shift its focus to clear the backlog in non-casino projects), we now value the project in our NAV by discounting the future cash flow, consistent with our valuation method with other investment properties.

Risks

Key downside risks that would prevent the stock from reaching our target price include: 1) Delay of the property sales schedule, especially the bulk of its columbarium sales; 2) Both NAV and earnings are heavily dependent on the relative stability of the property market in HK and Macau; 3) Unfavorable changes in visa policies in China; and 4) Surging oil prices hit the earning of the ferry business. These risks could impede the stock from achieving our target price.

Qantas Airways Limited

(QAN.AX; A\$1.48; 1)

Valuation

Our \$2.30 valuation and target price for Qantas is based on an Adj EV/ EBITDAR methodology. Using 12 month forward EBITDAR, and operating leases capitalised at 7.5x, we believe Qantas should trade closer to its recent Adj / EBITDAR multiple of 4.85x (3 year average), albeit below the long term average multiple of 5.1x. At a 4.85x multiple our 12 month valuation is \$2.30 per share, or a P/B of 0.86x.

Risks

The main stock specific risks facing Qantas which may impede the share price reaching our target price include:

- A continuation of the aggressive price war with Virgin Australia domestically;
- A lower than expected uplift from the Alliances with Emirates given increased competitor behavior;
- Lack of demand by business or first class passengers which could impact yield mix and Qantas International profitability;
- Economic downturn domestically, resulting in lower business and leisure demand;
- Delay in achieving break even at Jetstar Japan and Jetstar Hong Kong;
- A spike in the AUD cost of oil which is not recoverable from passengers; and

- An air accident involving an aircraft type used by Qantas or Jetstar.

China Eastern Airlines

(0670.HK; HK\$2.52; 1H)

Valuation

Our target price for CEA of HK\$4.26 is based on 1.45x 2013E book value of Rmb2.33/share, the historical average of the last cycle during 2009~2012, which we feel is appropriate given improving traffic trends. We choose the P/B methodology to derive our target price because we believe P/E and EV/EBITDAR methodologies cannot sufficiently encompass the China airline industry's volatile earnings.

Risks

We think High Risk is more appropriate for airline stocks in the current volatile market, given its cyclical nature and high Beta. Key upside risks to our target price include: 1) Stronger than expected air fare hikes on tight capacity; and 2) Capital injection from potential strategic investor or financial investor. Key downside risks to our target price include: 1) Higher-than-expected air traffic diversion to high speed rail; and 2) Hikes in fuel prices.

Cathay Pacific

(0293.HK; HK\$14.56; 2)

Valuation

Our HK\$14.25 TP reflects ~1.20x our FY12 Tangible P/B of HK\$12.38/share (which is a half standard deviation discount to its mean tangible P/B multiple of 1.43x). We are using a discounted multiple to reflect the deteriorating fundamentals within the company's premium passenger and cargo operations.

Risks

Major downside risks that could cause the stock to trade below our fair value include: rising fuel prices (specifically a oil shock associated with a military incursion in Iran); declining yields (net of fuel) due to weakening passenger demand; continued poor airfreight utilization rates, weaker contribution from its associates (Air China, 19.5% held by Cathay, contributed ~30% of FY11 earnings).

Upside risks include, better premium business demand; an increase in air cargo tonnage and; improvement in the European macro outlook.

Appendix A-1

Analyst Certification

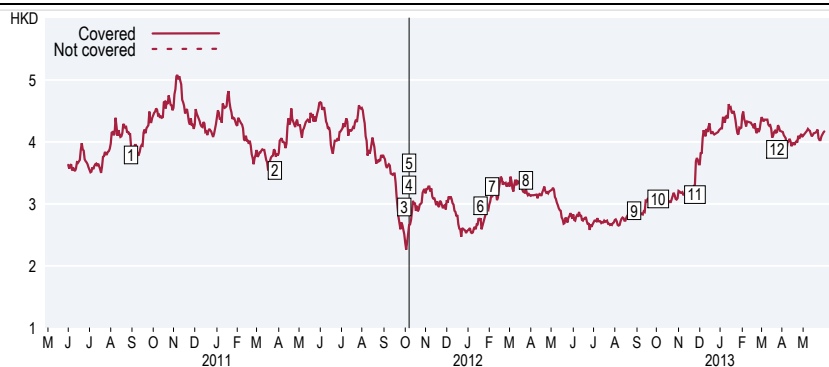
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IMPORTANT DISCLOSURES

Shun Tak (0242.HK)

Ratings and Target Price History Fundamental Research

Analyst: Anil Daswani



	Date	Rating	Target Price	Closing Price
1	31-Aug-10	3H	*3.58	3.94
2	28-Mar-11	3H	*3.53	3.86
3	30-Sep-11	*1H	3.53	2.51
4	7-Oct-11	Stock rating system changed		

* Indicates change

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	*1	3.53	2.66
6	19-Jan-12	1	*2.87	2.77
7	6-Feb-12	1	*3.25	3.11
8	26-Mar-12	1	*3.65	3.24

	Date	Rating	Target Price	Closing Price
9	29-Aug-12	1	*3.35	2.85
10	3-Oct-12	1	*3.65	2.98
11	26-Nov-12	1	*4.75	3.31
12	25-Mar-13	1	*5.10	4.16

Rating/target price changes above reflect Eastern Standard Time

Shun Tak (0242.HK)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Anil Daswani



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD LP	-	4.02

* Indicates change

	Date	Rating	Target Price	Closing Price
2	7-May-12	*REM LP	-	3.11

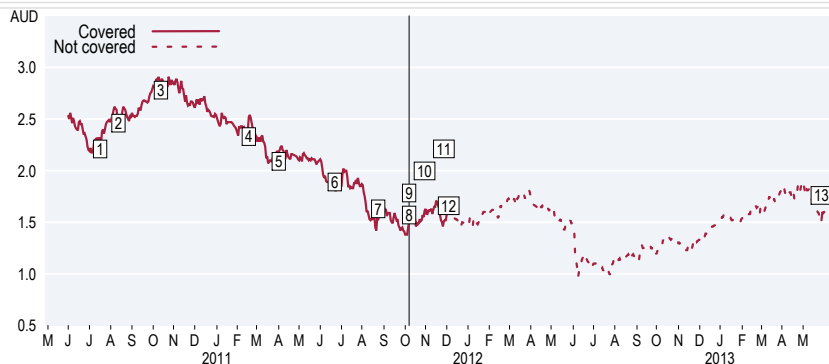
Rating/target price changes above reflect Eastern Standard Time

Qantas Airways Limited (QAN.AX)

Ratings and Target Price History Fundamental Research

Analyst: Anthony Moulder

Covered since May 28 2013



	Date	Rating	Target Price	Closing Price
1	16-Jul-10	1H	*3.40	2.32
2	12-Aug-10	1H	*3.55	2.48
3	13-Oct-10	1H	*3.70	2.86
4	17-Feb-11	1H	*3.55	2.52
5	1-Apr-11	1H	*3.25	2.18

* Indicates change

	Date	Rating	Target Price	Closing Price
6	22-Jun-11	1H	*2.95	1.83
7	24-Aug-11	1H	*2.75	1.52
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*1	2.75	1.50
10	31-Oct-11	1	*2.50	1.61

	Date	Rating	Target Price	Closing Price
11	28-Nov-11	1	*2.40	1.51
12	4-Dec-11	Coverage terminated		
13	28-May-13	1	*2.30	1.52

Rating/target price changes above reflect Eastern Standard Time

Qantas Airways Limited (QAN.AX)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Anthony Moulder

Covered since May 28 2013



	Date	Rating	Target Price	Closing Price
1	15-May-11	*ADD MP	-	2.12

* Indicates change

	Date	Rating	Target Price	Closing Price
2	4-Dec-11	*REM MP	-	1.61

	Date	Rating	Target Price	Closing Price
3	30-May-13	*ADD MP	-	1.59

Rating/target price changes above reflect Eastern Standard Time

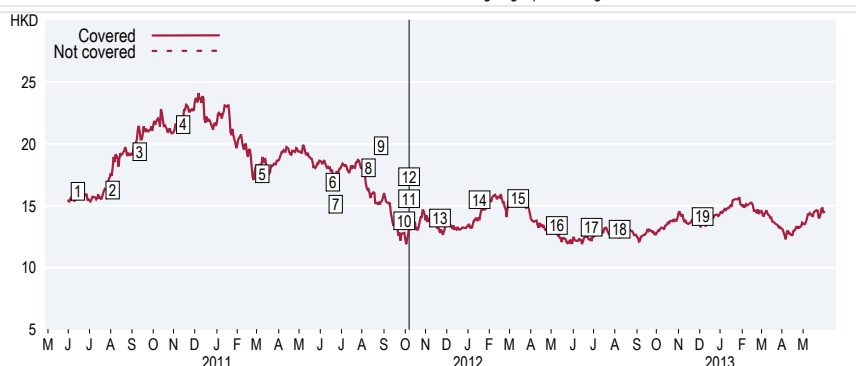
Cathay Pacific (0293.HK)

Ratings and Target Price History

Fundamental Research

Analyst: Michael Beer

Covered since March 9 2011



	Date	Rating	Target Price	Closing Price
1	15-Jun-10	3M	*15.80	15.70
2	4-Aug-10	*2L	*19.50	18.08
3	12-Sep-10	2L	*22.00	21.45
4	15-Nov-10	2L	*23.75	22.05
5	9-Mar-11	2L	*19.50	18.94
6	19-Jun-11	2L	*19.00	17.92
7	23-Jun-11	2L	*18.50	16.90

* Indicates change

	Date	Rating	Target Price	Closing Price
8	10-Aug-11	2L	*17.00	16.34
9	28-Aug-11	2L	*16.50	15.18
10	30-Sep-11	2L	*13.00	12.80
11	7-Oct-11	Stock rating system changed		
12	7-Oct-11	*2	13.00	13.20
13	22-Nov-11	*3	*10.50	12.80
14	18-Jan-12	3	*11.00	13.92

	Date	Rating	Target Price	Closing Price
15	14-Mar-12	*1	*17.50	15.14
16	9-May-12	1	*15.25	13.36
17	28-Jun-12	1	*15.00	12.14
18	8-Aug-12	1	*14.25	12.36
19	6-Dec-12	*2	14.25	13.70

Rating/target price changes above reflect Eastern Standard Time

Cathay Pacific (0293.HK)

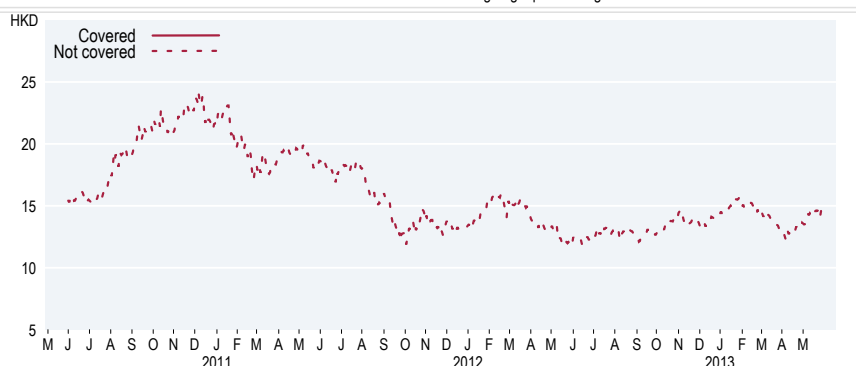
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Michael Beer

Covered since March 9 2011



* Indicates change

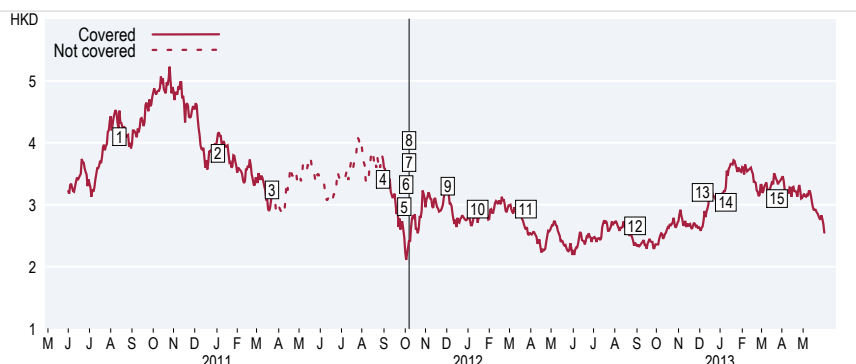
Rating/target price changes above reflect Eastern Standard Time

China Eastern Airlines (0670.HK)

Ratings and Target Price History Fundamental Research

Analyst: Vivian Tao

Covered since August 31 2011



	Date	Rating	Target Price	Closing Price
1	13-Aug-10	*2L	5.00	4.52
2	4-Jan-11	2L	*4.40	4.15
3	23-Mar-11	Coverage terminated		
4	31-Aug-11	2L	*4.07	3.73
5	30-Sep-11	2L	*2.81	2.48

* Indicates change

	Date	Rating	Target Price	Closing Price
6	4-Oct-11	2L	*2.59	2.11
7	7-Oct-11	Stock rating system changed		
8	7-Oct-11	*2H	2.59	2.43
9	2-Dec-11	2H	*3.54	3.18
10	15-Jan-12	2H	*2.87	2.85

	Date	Rating	Target Price	Closing Price
11	25-Mar-12	2H	*2.72	2.63
12	30-Aug-12	2H	*2.69	2.39
13	6-Dec-12	2H	*3.07	2.65
14	9-Jan-13	*1H	*4.19	3.28
15	25-Mar-13	1H	*4.26	3.39

Rating/target price changes above reflect Eastern Standard Time

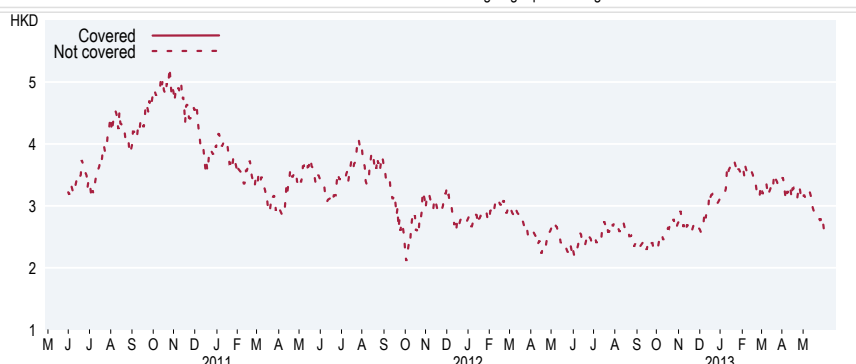
China Eastern Airlines (0670.HK)

Ratings and Target Price History Best Ideas Research

Relative Call (3 Month)

Analyst: Vivian Tao

Covered since August 31 2011



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Citi Research Global Fundamental Coverage	48%	39%	12%	7%	87%	7%
% of companies in each rating category that are investment banking clients	53%	49%	43%	65%	49%	51%

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Anthony Moulder

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