

19 August 2014
Cathay Pacific (293.HK)
2014H Result Brief Takeaways

HONG KONG | AIR TRANSPORTATION | COMPANY UPDATES

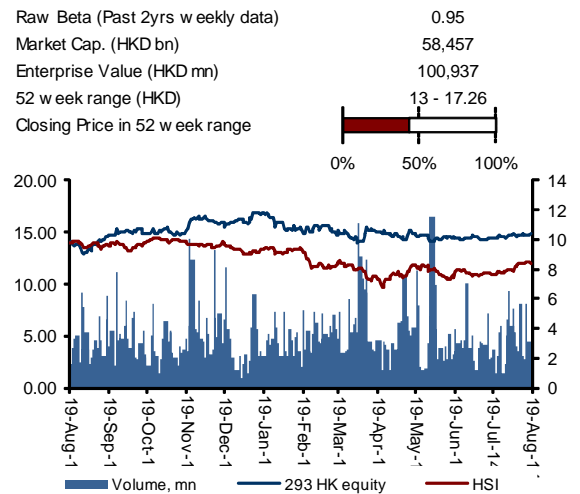
Rating: **Accumulate**

Maintained at Accumulate

Target Price (HKD)	16.84
Forecast Dividend (HKD)	0.36
Closing Price (HKD)	14.86
Potential Return	15.7%

- The 1H turnover increased by 4.6%, reaching 50.84 billion Yuan. The net profit increases by 13.46 times yearly, reaching 347 million Yuan, with the earnings per share of 8.8 cents. Interim dividend per share stood 10 cents, slightly lower than our and the market's consistent expectation.
- On the whole, the passenger business tends to improve. The load factors increased by 2.3%, reaching 83.6%. The passenger volume rose by 8.3%. While the yield is under pressure all sidedly, dropping by 2.4 cents, reaching 0.666 Hong Kong dollars.
- Freight business keeps weak. The weight of carried cargos and mails increased by 8.5% yearly, reaching 8.04 billion tons. The cargo load factor slightly increases by 0.08%, reaching 63.2%. But the yield dropped by 16 cents or 6.9%, reaching 2.17 Hong Kong dollars.
- Benefiting from 1.02 billion hedge earnings brought by the company's hedged operation when the oil price dropped, the ratio of net amount of fuel cost in the total operation amount decreased by 0.09%, reaching 37.9%, making the cost per ATK with fuel decreased by 3.3%, reaching 3.57 Hong Kong dollars, which significantly boosts the performance.
- The company recorded a loss of 265 million in investment earning, which is because that Air China, 20.13% of whose stock is held by Cathay Pacific Airways, is severely hit by the downturn of domestic industry and the depreciation of RMB exchange rate since the beginning of the year changing from appreciation.

Company Description
As a member of Oneworld Alliance, Cathay Pacific (CX) is the major airline in HK, operating 184 aircrafts. CX ranks as the global 7th largest airline by operating profit and the 4th in freight ton km. CX holds 20.13% shares in Air China, and its wholly owned Air HK and Dragonair provide all cargo service and flights between HK and key mainland respectively.



How we view this

While from the middle of the year, the exchange rate of RMB begins to appreciate slightly. It is supposed to repair the exchange earning of Air China, so as to benefit the investment premium of the company to rebound in the second half year. However, the slowdown of domestic macroeconomic increase and the weakening of official business demand will be negative factors to restrict the thorough rebound of earnings of Air China. On the other hand, as the airline business enters the traditional peak period, there is space for the increase speed of the demand of international airline to continuously improve. For example, America routes will continue to benefit from American economic recovery; the demand for travels to Southeast Asian countries like Thailand is expected to recover with the political stability. The expectation should not be too high.

Major Shareholders

1. Swire Pacific Limited	45.00%
2. China National Aviation Holding Company	29.99%

Valuation Method
PE&PB

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Investment Action

From the revised financial forecast, we revised our target price to HK\$16.84, based on 17.5/13.3xP/E in 2014/2015, and the suggestions of "Accumulate" rating be given.

Key Financial Summary

FYE	12/12	12/13	12/14F	12/15F
Revenue (HK\$ mn)	99,376	100,484	106,785	114,654
Net Profit, adj. (HK\$ mn)	916	2,620	3,793	4,965
EPS, adj. (HK\$)	0.23	0.67	0.96	1.26
P/E (X), adj.	63.8	22.3	15.4	11.8
BVPS (HK\$)	14.57	15.99	16.61	17.51
P/B (X)	1.0	0.9	0.9	0.8
DPS (HK\$)	0.08	0.22	0.36	0.48
Div. Yield (%)	0.5%	1.5%	2.4%	3.2%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Earn 13.5 times more than before, reaching 350 million in the middle stage, but lower than expectation

Cathay Pacific Airways announced the performance of half a year by the end of June this year. The turnover increased by 4.6%, reaching 50.84 billion Yuan. The net profit increases by 13.46 times yearly, reaching 347 million Yuan, with the earnings per share of 8.8 cents. Interim dividend per share increased by 4 cents yoy, stood 10 cents. There is a clear rise in the performance (because the cardinal number of last year is very low), but the performance is still not reach our and the market's consistent expectation.

Fig 1. Brief view of CX's 2014H Result

Group Financial Statistics				
		2014	2013	Change
Results		Six months ended 30th June		
Turnover	HK\$ million	50,840	48,584	+4.6%
Profit attributable to the shareholders of Cathay Pacific	HK\$ million	347	24	+1,345.8%
Earnings per share	HK cents	8.8	0.6	+1,366.7%
Dividend per share	HK\$	0.10	0.06	+66.7%
Profit margin	%	0.7	0.1	+0.6%pt
Financial position		30th June	31st December	
Funds attributable to the shareholders of Cathay Pacific	HK\$ million	60,830	62,890	-3.3%
Net borrowings	HK\$ million	41,448	39,316	+5.4%
Shareholders' funds per share	HK\$	15.5	15.9	-2.5%
Net debt/equity ratio	Times	0.69	0.63	+0.05 times

Source: Company, PSR

Passenger transportation demand continues to improve, only the yield is under pressure all sidedly

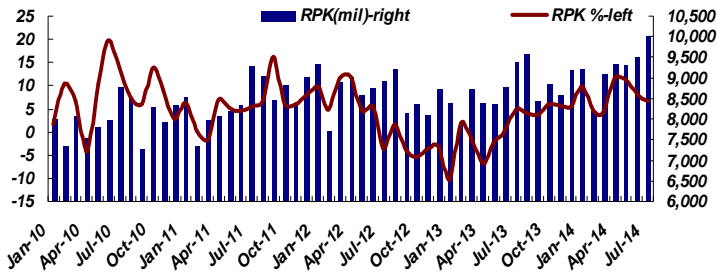
In the first half year, the company carried 15.437 million passengers, increasing by 6.5% yearly. The passenger volume rose by 8.3%. On the whole, the passenger business tends to improve. The load factors increased by 2.3%, reaching 83.6%. But all airlines performed differently: there is a great demand for tours from Hong Kong; a strong demand continuously appears in tours to North Asia (Japan, Korea and Taiwan), commercial business trips, students' trips and leisure trips to London, and airlines from North America. Due to local political unrest or fierce competition or other factors, airlines to and from Southeast Asia, South Africa, the Middle East, Canada, India, etc., are adversely affected. The yield is under pressure all sidedly, dropping by 2.4 cents, reaching 0.666 Hong Kong dollars. The load capacity of the first half year is 5.3% higher than that of the corresponding period of last year, reflecting the new airlines entering the market and the rising number of long-haul routes. Cathay Pacific Airways still maintains 6-7% for the load capacity increase index this year.

Fig 2. 2014H Operation Statistics

		2014	2013	Change
		Six months ended 30th June		
Available tonne kilometres ("ATK")	Million	13,545	12,520	+8.2%
Available seat kilometres ("ASK")	Million	65,474	62,187	+5.3%
Revenue passengers carried	'000	15,437	14,497	+6.5%
Passenger load factor	%	83.6	81.3	+2.3%pt
Passenger yield	HK cents	66.6	69.0	-3.5%
Cargo and mail carried	'000 tonnes	804	741	+8.5%
Cargo and mail load factor	%	63.2	62.4	+0.8%pt
Cargo and mail yield	HK\$	2.17	2.33	-6.9%
Cost per ATK (with fuel)	HK\$	3.57	3.69	-3.3%
Cost per ATK (without fuel)	HK\$	2.20	2.23	-1.3%
Aircraft utilisation	Hours per day	12.0	11.6	+3.4%
On-time performance	%	70.7	77.7	-7.0%pt

Source: Company, PSR

Fig 3. Monthly Passenger traffic

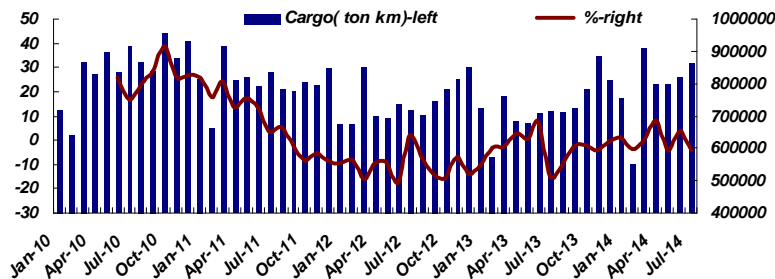


Source: Company, PSR

Freight business keeps weak

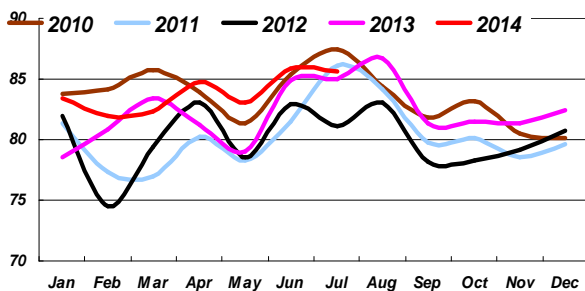
The freight business of the company has been weak since 2011. In this first half year, the weight of carried cargos and mails increased by 8.5% yearly, reaching 8.04 billion tons. The cargo load factor slightly increases by 0.08%, reaching 63.2%. But the yield dropped by 16 cents or 6.9%, reaching 2.17 Hong Kong dollars. The main reasons are excessive supply and increasing number of self-equipped freight carriers of logistic companies. In order to improve the efficiency, the company puts back 6 747-400F freight carriers. Now 13 747-8F freight carriers, which consume fuel more economically, are put into operation. New freight stations have started to handle goods for external customers since May. We expect that it will accelerate the lessening of loss in this business.

Fig 4. Monthly Freight traffic



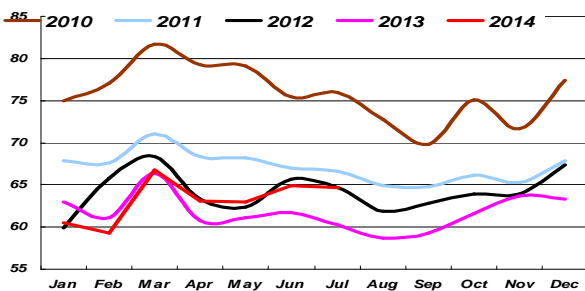
Source: Company, PSR

Fig 5. Passenger Load Factor of Cathay (%)



Source: Company, PSR

Fig 6. Cargo Load Factor of Cathay (%)



Source: Company, PSR

Hedging gains assisting the percentage of fuel cost continues to decrease

Benefiting from quickening the decommissioning of old types and introducing new types of better fuel efficiency, the total volume of fuel cost increased by 5.2% compared to the same period, lower than the rate of increase in passenger capacity and load capacity. What's more, benefiting from 1.02 billion hedge earnings brought by the company's hedged operation when the oil price dropped, the ratio of net amount of fuel cost in the total operation amount decreased by 0.09%, reaching 37.9%, making the cost per ATK with fuel decreased by 3.3%, reaching 3.57 Hong Kong dollars, which significantly boosts the performance. The hedging will last till 2017. For this year and next year, hedge ratio is about 44-47%. In 2016 and 2017, it will be about 25%. The benefit of cost control of the company continues to appear, out of a 0.9% decrease of cost per ATK without fuel, which is 2.16 Hong Kong dollars.

Fig 7. Fuel hedging

Fuel expenditure and hedging

A breakdown of the Group's fuel cost is shown below:

	Six months ended 30th June	
	2014	2013
	HK\$M	HK\$M
Gross fuel cost	19,954	18,974
Fuel hedging gains	(1,024)	(300)
Net fuel cost	18,930	18,674

Source: Company, PSR

The investment premium from Air China is expected to bounce back

In the period, the company is recorded a loss of 265 million in affiliated company, which is the worst since the financial crisis in 2008. The performance of Air China, 20.13% of whose stock is held by Cathay Pacific Airways, is severely hit by the downturn of domestic industry and the depreciation of RMB exchange rate since the beginning of the year changing from appreciation. It is a negative impact on the investment premium of the company. While from the middle of the year, the exchange rate of RMB begins to appreciate slightly. It is supposed to repair the exchange earning of Air China, so as to benefit the investment premium of the company to rebound in the second half year. However, the slowdown of domestic macroeconomic increase and the weakening of official business demand will be negative factors to restrict the thorough rebound of earnings of Air China. The expectation should not be too high.

Valuation and Rating

As the airline business enters the traditional peak period, there is space for the increase speed of the demand of international airline to continuously improve. For example, America routes will continue to benefit from American economic recovery; the demand for travels to Southeast Asian countries like Thailand is expected to recover with the political stability. The risk of going down lies in the remaining fierce industrial competition, or the pressure posed by the improvement of yield. After overall consideration, according to the latest earnings predict, we adjust the target price of the company of 12 months to 16.84 Hong Kong dollars, corresponding to 17.5/13.3 times of 2014/2015 prospective PE ratio, 1.0/1.0 times of prospective price-to-book. The valuation is at a historically low level, reiterating "accumulate" rating.

Fig 8. Peer's comparison

名称	NAME	TICKER	P/E Est	P/BV	Market Cap (US\$)
国泰航空	CATHAY PACIFIC AIRWAYS	293 HK Equity	12.52	0.86	7481146368
达美航空有限公司	DELTA AIR LINES INC	DAL US Equity	10.72	2.04	32481019904
美国航空集团公司	AMERICAN AIRLINES GROUP	AAL US Equity	6.18	4.90	28220829696
西南航空	SOUTHWEST AIRLINES CO	LUV US Equity	15.29	2.44	20389771264
联合大陆控股公司	UNITED CONTINENTAL HOLDI	UAL US Equity	8.65	2.94	17188165632
瑞安航空股份有限公司	RYANAIR HOLDINGS PLC	RYA ID Equity	13.41	2.42	12586602496
国际统一航空集团	INTL CONSOLIDATED AIRLINE	IAG LN Equity	8.12	1.59	11340508160
新加坡航空公司	SINGAPORE AIRLINES LTD	SIA SP Equity	24.25	0.87	9331424256
全日空控股有限公司	ANA HOLDINGS INC	9202 JP Equity	21.61	1.13	8675063808
易捷航空公司	EASYJET PLC	EZJ LN Equity	10.22	2.03	8556401664
中国国航	AIR CHINA LTD-A	601111 CH Equity	12.48	0.83	7933796864
中国国航	AIR CHINA LTD-H	753 HK Equity	12.48	0.83	7924519424
德国汉莎航空公司	DEUTSCHE LUFTHANSA-REG	LHA GR Equity	6.33	0.89	7890556416
东方航空	CHINA EASTERN AIRLINES C	600115 CH Equity	10.28	0.80	4899825664
东方航空	CHINA EASTERN AIRLINES C	670 HK Equity	10.28	0.80	4898233344
南方航空	CHINA SOUTHERN AIRLINES	600029 CH Equity	9.60	0.58	3826171648
南方航空	CHINA SOUTHERN AIRLINES	1055 HK Equity	9.60	0.58	3824929280
海南航空	HAINAN AIRLINES CO-A	600221 CH Equity	10.45	1.01	3655703296
捷蓝航空公司	JETBLUE AIRWAYS CORP	JBLU US Equity	14.34	1.39	3476060160
AIR FRANCE-KLM	AIR FRANCE-KLM	AF FP Equity	9.16	0.91	2952759552
澳大利亚航空有限公司	QANTAS AIRWAYS LTD	QAN AU Equity	N.A.	0.61	2618728704
加拿大航空公司	AIR CANADA-CLASS A	AC/A CN Equity	4.78	N.A	2102055168
亚洲航空有限公司	AIRASIA BHD	AIRA MK Equity	9.22	1.11	2091201152
大韩航空有限公司	KOREAN AIR LINES CO LTD	003490 KS Equity	42.80	0.76	1930302592
华航	CHINA AIRLINES LTD	2610 TT Equity	27.80	1.00	1728877952
长荣航	EVA AIRWAYS CORP	2618 TT Equity	16.51	1.17	1582857088
马来西亚航空系统有限	MALAYSIAN AIRLINE SYSTEM	MAS MK Equity	N.A.	1.77	1351061888
维珍澳大利亚控股有限	VIRGIN AUSTRALIA HOLDING	VAH AU Equity	N.A.	1.25	1244142848
泰国国际航空股份有限	THAI AIRWAYS INTERNATION	THAI TB Equity	N.A.	0.74	1109396608
韩亚航空	ASIANA AIRLINES	020560 KS Equity	38.67	1.01	867926144
JET AIRWAYS INDIA L	JET AIRWAYS INDIA LTD	JETIN IN Equity	N.A.	N.A	440828768

Source: Bloomberg, PSR

FYE DEC	FY11	FY12	FY13	FY14F	FY15F
Valuation Ratios					
P/E (X), adj.	10.6	63.8	22.3	15.4	11.8
P/B (X)	1.0	1.0	0.9	0.9	0.8
Dividend Yield (%)	3.5%	0.5%	1.5%	2.4%	3.2%
Per share data (HK\$)					
EPS, reported	1.40	0.233	0.666	0.964	1.262
EPS, adj.	1.40	0.233	0.666	0.964	1.262
DPS	0.52	0.08	0.22	0.36	0.48
BVPS	14.19	14.57	15.99	16.61	17.51
Growth & Margins (%)					
Growth					
Revenue	9.9%	1.0%	1.1%	6.3%	7.4%
EBIT	-47.1%	-66.3%	89.3%	34.6%	24.0%
Net Income, adj.	-60.8%	-83.3%	186.0%	44.8%	30.9%
Margins					
EBIT margin	7.3%	2.4%	4.6%	5.8%	6.7%
Net Profit Margin	5.6%	0.9%	2.6%	3.6%	4.3%
Key ratios					
ROE	10.0%	1.6%	4.4%	5.9%	7.4%
Dividend payout ratio	37.2%	34.4%	33.0%	37.3%	38.0%
Income Statement (HK\$ mn)					
Revenue	98,406	99,376	100,484	106,785	114,654
Operating expenses	(92,906)	(97,588)	(96,724)	(101,439)	(107,981)
-Jet fuel cost	(38,877)	(40,470)	(38,132)	(39,037)	(41,390)
Profit from operations	5,500	1,788	3,760	5,346	6,673
Financial costs	(744)	(884)	(1,019)	(1,152)	(1,273)
Share of profits and losses of associates	1,717	641	838	843	1,003
Profit before tax	6,473	1,545	3,579	5,037	6,403
Tax	(803)	(417)	(675)	(942)	(1,121)
Profit for the period	5,670	1,128	2,904	4,095	5,282
Minority interests	(169)	(212)	(284)	(302)	(317)
Net profit	5,501	916	2,620	3,793	4,965

Source: PSR



PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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