

Cathay Pacific (293.HK)

Transformation plan begins to make progress

Hong Kong | Air | Update Report

13 July 2018

Investment summary

We expect overall demand of Cathay to recover moderately, while cost reductions continue to work, but rising financial expenditure might erode some of the savings. Based on the latest profit forecast, we will give the company a 12-month target price of HK\$14.3, corresponding to an expected P/B of 0.9/0.85 times for 2018/2019, and upgrade to the "accumulate" rating. (Closing price as at 11 July 2018)

2017 Result Updates

Cathay Pacific recorded a loss of HK\$1,259 million in 2017, which is double the annual loss in the previous year, with a loss of 32 cents per share, maintaining a dividend of 5 cents per share. The results represented a loss but was better than market expectations. This was particularly marked in the second half of last year when the profit went out of the red, earning HK\$792 million.

Oil prices rose, but fuel hedging losses decreased. Fuel costs increased by 11.3% during the period as the average aviation gasoline price went up by 23% and the fuel consumption by 2.9%. However, some of the increase was offset by a 24.6% reduction in fuel hedging losses.

Financial expenditure grew fast while JVs contributed more earnings. The net financial expenditure increased by 35% to HK\$1.76 billion, mainly due to the interest expenses for the financing of newly introduced aircraft. In 2017, the company received 12 A350 aircraft. In 2018, it plans to receive a further 10. Currently, the company holds 84 aircraft orders, including 32 new orders added in September 2017. Its attributable profits from the affiliated companies climbed by 28% to HK\$2.63 billion, which was an important driver of the recovery in 2017H2, primarily due to the increase in attributable profit contributed by Air China Cargo and Air China.

The passenger yield is still under pressure. During the period, the revenue from passenger transport fell by 0.8% YoY to HK\$66,408 million, reflecting the ongoing intense competition in the market, but the decline was narrowed. The passenger yield of most routes of Cathay Pacific is still squeezed. North American (-5%), Southwest Pacific (-3.2%) and North Asian routes (-2.8%) have weaker yields, but good performances in first-class and business class cabins partially offset the drop in the economy class cabins. The overall passenger yield declined by 3.3% YoY to HK\$52.3 cents, and the passenger load factor dropped slightly by 0.1 ppts to 84.4% YoY.

Cargo business rebounded strongly. The company's cargo business finally recovered from a two-year decline. Its revenue rose 19% YoY to HK\$23,903 million, which reflected the increase in demand from mainland China, and restoration of fuel surcharges in Hong Kong. The freight yield increased 11.3% to HK\$1.77, and the freight load factor increased by 3.4 ppts to 67.8%. The company is raising the number of freight flights to seize the growth opportunities in the freight market. We expect cargo business will go on to enjoy an optimistic prospect based on the continued recovery of the global economy.

The three-year transformation plan begins to make progress

In response to the competition, Cathay Pacific officially set in motion a three-year corporate transformation plan from 2017H1, including reducing cost redundancy, improving efficiency and strengthening brand status. The goal is to become a more streamlined and more profitable airline with a view to keeping a long-term rebound in profit performances. The positive results of the corporate transformation plan began to emerge in 2017H2. The cost per ATK (excluding fuel) increased by only 0.9%, from HK\$2.12 to HK\$2.14.

Accumulate (Upgrade)

CMP HKD 12.08

(Closing price as at 11 July 2018)

TARGET HKD 14.30 (+18%)

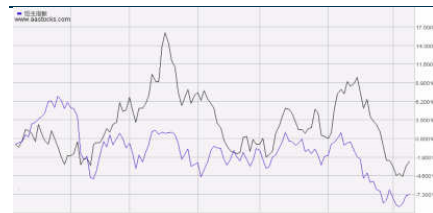
COMPANY DATA

O/S SHARES (MN) :	3934
MARKET CAP (HKD MN) :	48544
52 - WK HI/LO (HKD):	14.82/ 11.18

SHARE HOLDING PATTERN, %

Swire Pacific Limited	45
AC	29.99
QATAR	9.94

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

HKD mn	FY16	FY17	FY18E	FY19E
Net Sales	92,751	97,284	103,853	108,290
Net Profit	-575	-1,259	1,069	3,805
EPS, HKD	-0.15	-0.32	0.27	0.97
P/E, x	(84.3)	(38.5)	45.3	12.7
BVPS, HKD	14.07	15.53	15.89	16.73
P/BV, x	0.9	0.8	0.8	0.7
DPS (HKD)	0.05	0.05	0.05	0.15
Div. Yield (%)	0.4%	0.4%	0.4%	1.2%

Source: Company reports, Phillip Securities Est.

Research Analyst

ZhangJing

(+ 86 51699400-103)

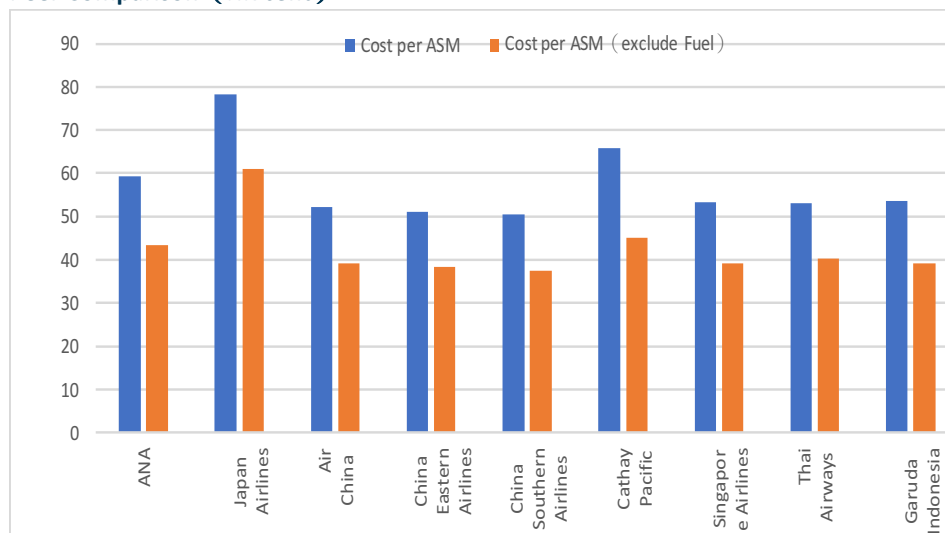
zhangjing@phillip.com.cn

Valuation and Rating

In the first five months of 2018, Cathay Pacific’s operating data showed that the passenger load factor of the mainland China and North America routes increased by 2.2 and 2.5 pts respectively, while the passenger load factor of the Australia/Europe/South Asia route decreased by 2.5-3.4 pts. Except mainland Chian routes, other routes are basically in line with the distribution of capacity. For the cargo business, the F L/F rate increased by 2 pts to 67.8%, and demand growth continued to be stronger than capacity.

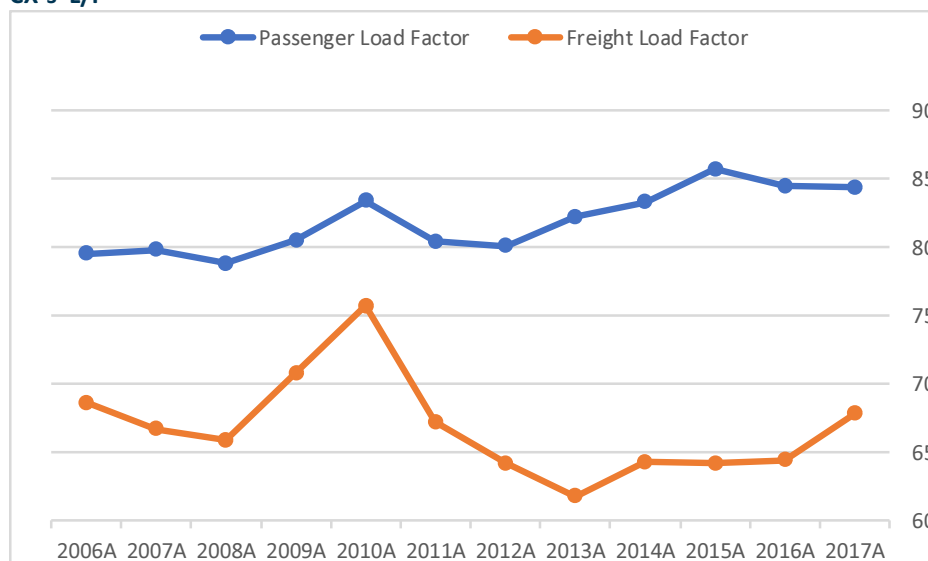
So we expect overall demand of Cathay to recover moderately, while cost reductions continue to work, but rising financial expenditure might erode some of the savings. Based on the latest profit forecast, we will give the company a 12-month target price of HK\$14.3, corresponding to an expected P/B of 0.9/0.85 times for 2018/2019, and upgrade to the “accumulate” rating. (Closing price as at 11 July 2018)

Peer Comparison (HK cent)



Source: Bloomberg, Phillip Securities Hong Kong Research

CX's L/F



Source: Company, Bloomberg, Phillip Securities Hong Kong Research

CX's P/B Band



Source: Company, Wind, Phillip Securities Hong Kong Research

Financials

FYE DEC	FY14	FY15	FY16	FY17	FY18F	FY19F
Valuation Ratios						
P/E (X), adj.	15.4	8.1	(84.3)	(38.5)	45.3	12.7
P/B (X)	0.937	1.011	0.875	0.793	0.775	0.737
Dividend Yield (%)	2.9%	4.3%	0.4%	0.4%	0.4%	1.2%
Per share data (HK\$)						
EPS, reported	0.801	1.525	(0.146)	(0.320)	0.272	0.967
EPS, adj.	0.801	1.525	(0.146)	(0.320)	0.272	0.967
DPS	0.36	0.53	0.05	0.05	0.05	0.15
BVPS	13.15	12.18	14.07	15.53	15.89	16.73
Growth & Margins (%)						
Growth						
Revenue	5.5%	-3.4%	-9.4%	4.9%	6.8%	4.3%
EBIT	13.2%	65.7%	-82.3%	-77.0%	1028.1%	89.1%
Net Income, adj.	20.2%	90.5%	-109.6%	NA	NA	256.0%
Margins						
EBIT margin	4.9%	8.4%	1.6%	0.4%	3.8%	6.9%
Net Profit Margin	3.0%	5.9%	-0.6%	-1.3%	1.0%	3.5%
Key ratios						
ROE	5.5%	12.0%	-1.1%	-2.2%	1.7%	5.9%
Dividend payout ratio	45.0%	34.8%	-34.2%	-15.6%	18.4%	15.5%
Income Statement (HK\$ mn)						
Revenue	105,991	102,342	92,751	97,284	103,853	108,290
Operating expenses	(101,556)	(95,678)	(93,276)	(99,563)	(102,700)	(103,742)
-Jet fuel cost	(40,299)	(32,968)	(27,953)	(31,112)	(33,233)	(33,786)
Profit from operations	4,435	6,664	-525	-2,279	1,153	4,548
Financial costs	(1,158)	(1,164)	(1,301)	(1,761)	(2,155)	(2,401)
Share of profits and losses of associates	772	1,965	2,049	2,630	2,807	2,940
Profit before tax	4,049	7,465	223	(580)	1,805	5,087
Tax	(599)	(1,157)	(497)	(308)	(278)	(763)
Profit for the period	3,450	6,308	(274)	(888)	1,527	4,324
Minority interests	(300)	(308)	(301)	(371)	(458)	(519)
Net profit	3,150	6,000	(575)	(1,259)	1,069	3,805

Source: PSR

(Financial figures as at 11 July 2018)

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

GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2018 Phillip Securities (Hong Kong) Limited

Contact Information (Regional Member Companies)
SINGAPORE
Phillip Securities Pte Ltd

250 North Bridge Road, #06-00 Raffles City Tower,
Singapore 179101
Tel : (65) 6533 6001 Fax: (65) 6535 3834
www.phillip.com.sg

INDONESIA
PT Phillip Securities Indonesia

ANZ Tower Level 23B, Jl Jend Sudirman Kav 33A,
Jakarta 10220, Indonesia
Tel (62) 21 5790 0800 Fax: (62) 21 5790 0809
www.phillip.co.id

THAILAND
Phillip Securities (Thailand) Public Co. Ltd.

15th Floor, Vorawat Building, 849 Silom Road,
Silom, Bangrak, Bangkok 10500 Thailand
Tel (66) 2 2268 0999 Fax: (66) 2 2268 0921
www.phillip.co.th

UNITED STATES
Phillip Futures Inc.

141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel (1) 312 356 9000 Fax: (1) 312 356 9005

MALAYSIA
Phillip Capital Management Sdn Bhd

B-3-6 Block B Level 3, Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur
Tel (60) 3 2162 8841 Fax (60) 3 2166 5099
www.poems.com.my

CHINA
Phillip Financial Advisory (Shanghai) Co. Ltd.

No 436 Heng Feng Road, Green Tech Tower Unit 604
Shanghai 200 070
Tel (86) 21 5169 9400 Fax: (86) 21 6091 1155
www.phillip.com.cn

FRANCE
King & Shaxson Capital Ltd.

3rd Floor, 35 Rue de la Bienfaisance
75008 Paris France
Tel (33) 1 4563 3100 Fax : (33) 1 4563 6017
www.kingandshaxson.com

AUSTRALIA
PhillipCapital Australia

Level 10, 330 Collins Street
Melbourne VIC 3000
Tel (+61) 3 8633 9803 Fax (+61) 3 8633 9899
www.phillipcapital.com.au

HONG KONG
Phillip Securities (HK) Ltd

11/F United Centre 95 Queensway Hong Kong
Tel (852) 2277 6600 Fax: (852) 2868 5307
www.phillip.com.hk

JAPAN
Phillip Securities Japan, Ltd

4-2 Nihonbashi Kabutocho, Chuo-ku
Tokyo 103-0026
Tel: (81) 3 3666 2101 Fax: (81) 3 3664 0141
www.phillip.co.jp

INDIA
PhillipCapital (India) Private Limited

No. 1, 18th Floor, Urmi Estate, 95 Ganpatrao Kadam Marg,
Lower Parel West, Mumbai 400013
Tel: (9122) 2300 2999 Fax: (9122) 6667 9955
www.phillipcapital.in

UNITED KINGDOM
King & Shaxson Ltd.

6th Floor, Candlewick House, 120 Cannon Street
London, EC4N 6AS
Tel (44) 20 7929 5300 Fax: (44) 20 7283 6835
www.kingandshaxson.com

SRI LANKA
Asha Phillip Securities Limited

Level 4, Millennium House, 46/58 Navam Mawatha,
Colombo 2, Sri Lanka
Tel: (94) 11 2429 100 Fax: (94) 11 2429 199
www.ashaphillip.net/home.htm