

**Industrials**  
**Airlines**  
**Equity – Hong Kong**

## Overweight

Target price (HKD)	21.50
Share price (HKD)	16.60
Forecast dividend yield (%)	2.4
Potential return (%)	31.9

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	-3.5	-3.8	9.4
Relative <sup>A</sup> (%)	0.0	-7.0	-1.1

Index<sup>A</sup>                      HANG SENG INDEX

RIC                                      0293.HK  
 Bloomberg                            293 HK

Market cap (USDm)                      8,405  
 Market cap (HKDm)                      65,302

Enterprise value (HKDm)                110389  
 Free float (%)                              25

Note: (V) = volatile (please see disclosure appendix)

**16 March 2015**

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# Cathay Pacific (293 HK)

OW: Robust cargo drives strong start to 2015

- ▶ **February traffic release provides clearer picture of underlying traffic – the performance was strong, particularly for cargo which rose 39% y-o-y in Feb and +24% y-t-d**
- ▶ **Commentary positive and far more upbeat than January**
- ▶ **Maintain Overweight rating at an unchanged TP of HKD21.5; an Asia Super Ten portfolio stock**

**February traffic robust.** February's passenger load factor was 84.9%, up 3.0pts y-o-y (vs -0.7pts in January). Passenger traffic (RPK) rose 12% y-o-y (vs +6% in Jan). To remove the impact of the different timing of the Lunar New Year this year, Jan-Feb combined passenger load factor was 83.7%, up 1.0pt y-o-y (vs +1.2ppt y-o-y in Dec). Passenger traffic (RPK) grew 9% y-o-y (vs +8% y-o-y in Dec). February's cargo load factor was 65.5%, up 6.2pts y-o-y (vs +2.9pts in Jan). Cargo traffic soared – up 39% y-o-y in February (vs +14% in Jan). Jan-Feb's cargo load factor was 64.4%, up 4.4pts y-o-y (vs +5pt y-o-y in Dec); cargo traffic (FTK) rose 24% y-o-y (vs +15% y-o-y in Dec).

**Positive commentary.** In its commentary, Cathay stated on passenger: "...traffic in February was boosted by the CNY holiday, which fell in January in the previous year. It was a very strong peak in terms of leisure demand, with new... uplift records set for both airlines. The key routes this year were North Asia, and Japan in particular, and the major holiday destinations in Southeast Asia. Demand on the Southwest Pacific routes to Australia and New Zealand was robust throughout the month...the holiday period led to a dip in demand in the premium cabins." On cargo, Cathay stated: "The high y-o-y... growth reflects the overall improvement in the world's air cargo markets compared to early 2014, along with the extra capacity added by Cathay Pacific in response to the increase in demand. February's figures were spurred by a surge in exports prior to mainland factories shutting down for the CNY holidays. Demand fell away over the holiday period, as expected, but saw quite a rapid pick-up, particularly on the North American lanes."

**Reiterate OW with an unchanged target price of HKD21.5.** Since 2000, Cathay Pacific has traded at an average one-year forward book value of 1.25x, and given our forecast of normalising ROE, we believe Cathay's PB level should return to this average; hence, we set our target price of HKD21.5 at this level. We believe earnings momentum, a key share price driver, remains positive; the key downside risk is further US dollar strength.

## Financials & valuation

### Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Profit &amp; loss summary (HKDm)</b>				
Revenue	100,484	106,004	108,353	113,786
EBITDA	11,337	13,578	16,847	19,839
Depreciation & amortisation	-7,577	-8,057	-8,562	-9,032
Operating profit/EBIT	3,760	5,521	8,285	10,807
Net interest	-1,019	-1,255	-1,294	-1,247
PBT	3,579	4,884	8,504	11,503
HSBC PBT	3,579	4,884	8,504	11,503
Taxation	-675	-640	-1,049	-1,434
Net profit	2,620	3,940	7,134	9,721
HSBC net profit	2,620	3,940	7,134	9,721

### Cash flow summary (HKDm)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Cash flow from operations	14,097	20,828	9,704	14,936
Capex	-18,234	-12,100	-12,100	-7,100
Cash flow from investment	-13,235	-12,100	-12,100	-7,100
Dividends	-865	-1,576	-3,032	-4,131
Change in net debt	5,947	1,230	-1,446	-8,364
FCF equity	-5,510	-1,024	2,781	10,929

### Balance sheet summary (HKDm)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Intangible fixed assets	0	0	0	0
Tangible fixed assets	94,935	98,978	102,516	100,584
Current assets	39,185	38,483	40,192	49,164
Cash & others	27,847	26,626	28,072	36,436
Total assets	171,575	175,305	181,651	190,112
Operating liabilities	30,559	29,995	31,043	32,907
Gross debt*	91,476	91,485	91,485	91,485
Net debt*	63,629	64,859	63,413	55,049
Shareholders funds	62,888	56,879	67,854	78,103
Invested capital*	99,193	94,328	103,081	103,892

\*Includes capitalised operating leases

### Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Y-o-y % change</b>				
Revenue	1.1	5.5	2.2	5.0
EBITDA	27.5	19.8	24.1	17.8
Operating profit	110.3	46.8	50.1	30.4
PBT	131.7	36.4	74.1	35.3
HSBC EPS	186.0	50.4	81.1	36.3

### Ratios (%)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Revenue/IC (x)	1.1	1.1	1.1	1.1
ROIC	4.6	6.4	8.7	10.5
ROE	4.4	6.6	11.4	13.3
ROA	2.3	3.1	4.8	6.0
EBITDA margin	11.3	12.8	15.5	17.4
Operating profit margin	3.7	5.2	7.6	9.5
EBITDA/net interest (x)	11.1	10.8	13.0	15.9
Net debt/equity	101.0	113.2	92.4	69.5
Net debt/EBITDA (x)	5.6	4.8	3.8	2.8
CF from operations/net debt	22.2	32.1	15.3	27.1

### Per share data (HKD)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EPS reported (fully diluted)	0.67	1.00	1.81	2.47
HSBC EPS (fully diluted)	0.67	1.00	1.81	2.47
DPS	0.22	0.40	0.77	1.05
Book value	15.99	14.46	17.25	19.85

### Key forecast drivers

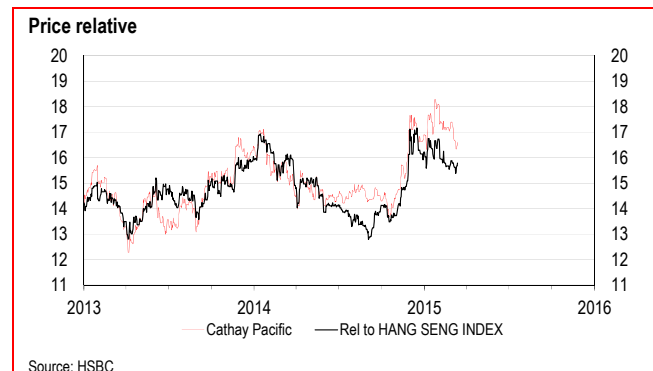
Year to	12/2013a	12/2014e	12/2015e	12/2016e
Capacity growth (ATK) %, y-o-y	0	8	6	5
Traffic (RTK) %, y-o-y	0	10	7	6
Overall load factor	71.8	72.8	73.4	74.1
Change in overall yield %, y-o	0.0	-4.2	-4.7	-1.2
Change in unit costs per ATK %	-1.9	-3.9	-6.3	-2.2
Spot jet fuel price (USD/bbl)	123	117	80	80

### Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	1.1	1.0	1.0	0.9
EV/EBITDAR	7.6	6.6	5.4	4.3
EV/IC	1.2	1.1	1.1	1.0
PE*	24.9	16.6	9.2	6.7
P/NAV	1.0	1.1	1.0	0.8
REP**	1.8	1.3	0.9	0.7
Dividend yield (%)	1.3	2.4	4.6	6.3

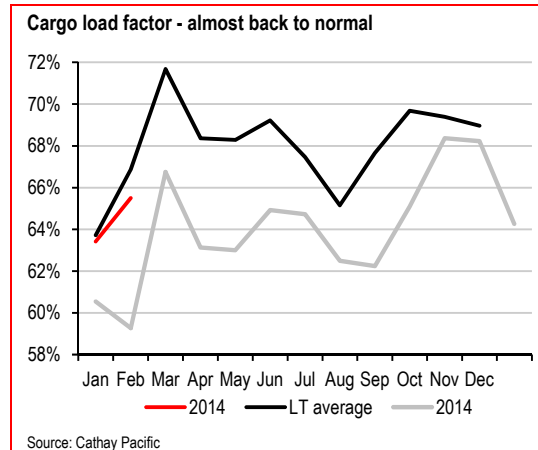
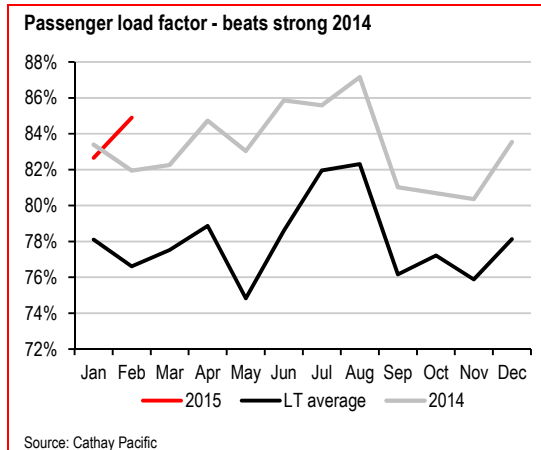
\*Based on HSBC EPS (diluted)

\*\*REP = EV/IC divided by ROIC/WACC



Note: price at close of 13 Mar 2015

## February traffic – a very strong cargo performance



## Valuation and risks

### Reiterate OW with a target price of HKD21.50

Our target price of HKD21.50 is based on a 1.25x one-year forward book value, which is the average trading range since 2000; given our forecast of normalising ROE, we believe Cathay's PB level should return to this average. We argue that Cathay Pacific's strong home base, which we believe is the best positioned gateway into Southern China, and its greater exposure to North America, mean that the carrier has a stronger medium-term outlook than its Asian competitors.

**Key downside risks** to our rating and forecasts include lower-than-expected Asian and global GDP growth, a sharp decline in business confidence, and a further material strengthening of the US dollar.

# Disclosure appendix

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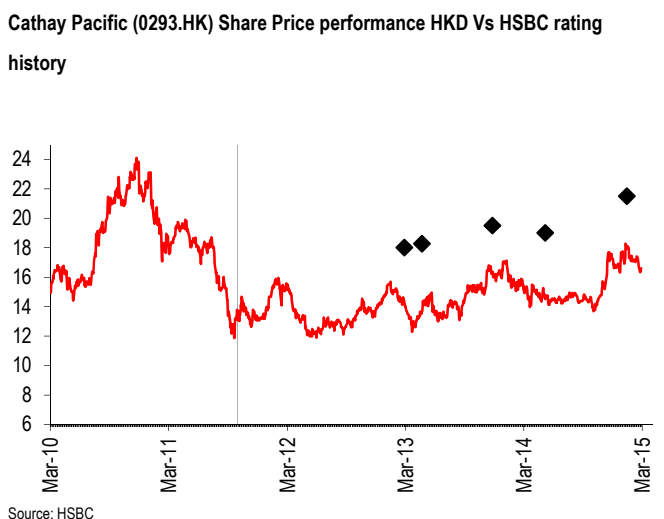
\*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

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## Share price and rating changes for long-term investment opportunities



### Recommendation & price target history

From	To	Date
Neutral	Overweight	14 October 2011
Target Price	Value	Date
Price 1	18.00	13 March 2013
Price 2	18.25	06 May 2013
Price 3	19.50	09 December 2013
Price 4	19.00	21 May 2014
Price 5	21.50	28 January 2015

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
CATHAY PACIFIC	0293.HK	16.60	13-Mar-2015	6, 7

Source: HSBC

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