BEA securities

EAST ASIA SECURITIES COMPANY LIMITED
9/F, 10 Des Voeux Road Central, Hong Kong.
Dealing: 2308 8200 Research: 3608 8098 Facsimile: 3608 6113

Analyst: Kelvin Li

HONG KONG RESEARCH
19th March, 2015

CATHAY PACIFIC AIRWAYS LIMITED (國泰航空)

Sector	:	Transportation	Chairman	:	John SLOSAR
Stock Code	:	00293			
Market Price	:	HK$17.08 (19/03/2015)	Chief Executive	:	Ivan CHU
HSI	:	24,468.89 (19/03/2015)			
Shares Issued	:	3,933.84 million			
Market Cap	:	HK$67,190 million			
52-week Hi / Lo	:	HK$18.30/ HK$13.56			

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2014

Final Results Highlights

	FY2014 HK$ million	FY2013 HK$ million	*Change*
• Turnover	105,991	100,484	*+5.5%*
• Operating expenses	(101,556)	(96,724)	*+5.0%*
• Operating profit/(loss)	4,435	3,760	*+18.0%*
• Share of profits/(loss) of associated companies	772	838	*-7.9%*
• **Profit/(loss) attributable to shareholders**	**3,150**	**2,620**	***+20.2%***
• EPS – basic (HK$)	0.801	0.666	*+20.3%*
• DPS – interim (HK$)	0.100	0.060	*+66.7%*
• DPS – final (HK$)	0.260	0.160	*+62.5%*
• DPS – total (HK$)	0.360	0.220	*+63.6%*

	Cathay Pacific and Dragonair		
	FY2014	**FY2013**	*Change*
Traffic			
• Revenue passenger kilometres (RPK)	112,257 million	104,571 million	*+7.3%*
• Passengers carried ('000)	31,570	29,920	*+5.5%*
• Revenue cargo/mail tonne km (RTK)	10,044 million	8,750 million	*+14.8%*
• Cargo & mail carried ('000 tonnes)	1,723	1,539	*+12.0%*
• Number of flights	75,451	71,875	*+5.0%*
Capacity, Load Factor and Yield			
• Available seat kilometres (ASK)	134,711 million	127,215 million	*+5.9%*
• Passenger load factor	83.3%	82.2%	*+1.1 ppts*
• Passenger yield (HK$)	0.673	0.685	*-1.8%*
• Cargo & mail load factor	64.3%	61.8%	*+2.5 ppts*
• Cargo & mail yield (HK$)	2.19	2.32	*-5.6%*
• Available tonne kilometres (ATK)	28,440 million	26,259 million	*+8.3%*

Sources: Company Data

- Cathay Pacific Airways ("Cathay" or the "Group") reported net profit of HK$3.15 billion for the year ended 31st December 2014, up 20.2% y-o-y, thanks to solid growth in its passenger and cargo businesses as well as effective cost control such as lower maintenance charges following retirement of old aircraft. However, the Group's bottom line lagged behind consensus forecast of HK$3.4 billion, owing to fuel hedging losses (mainly in 2H14) and lower-than-expected benefit from dropping crude oil prices.
- EPS for FY14 was HK$0.801, compared with HK$0.666 a year earlier. A final dividend of HK$0.26 per share was proposed, bringing the full-year DPS at HK$0.36 or payout ratio of 45% (FY13: 33%).

Turnover breakdown

	FY2014		FY2013		
	HK$ million	%	HK$ million	%	*Change*
Passenger services	75,734	71.5%	71,826	71.5%	*+5.4%*
Cargo services	25,400	24.0%	23,663	23.5%	*+7.3%*
Catering, recoveries & other services	4,857	4.6%	4,995	5.0%	*-2.8%*
Total	**105,991**	**100.0%**	**100,484**	**100.0%**	***+5.5%***

  - **Passenger** revenue rose 5.4% y-o-y to HK$75.7 billion in FY14, supported by a 7.3% y-o-y increase in passenger traffic (in terms of RPK (revenue passenger kilometres)). Passenger yield stayed under pressure, which was down by 1.8% y-o-y in 2014, owing to keen competition and weak foreign currencies (like the Japanese yen). The Group carried 31.6 million passengers in FY14, up 5.5% from a year earlier, while passenger load factor strengthened by 1.1 percentage points (ppts) y-o-y to 83.3% in 2014.
  - The Group expanded its overall passenger capacity by 5.9% (in terms of ASK (available seat km)) in 2014. Most capacity increase (in terms of ASK) was added in North America (+19.1% y-o-y) and North Asia (+4.2% y-o-y). Passenger load factors generally improved in most regions. Only the North America market reported a drop (-2.7 ppts) in passenger load factor, as it took time to absorb the sharp increase in capacity.
  - Business momentum in the Group's air **cargo** segment finally picked up in 2014. The cargo segment reported revenue growth of 7.3% in FY14, supported by a 14.8% y-o-y rise in cargo traffic (in terms of revenue cargo/mail tonne km). Cargo yield was down by 5.6% y-o-y, which was mainly dragged by sluggish market environment during the first quarter.

- Operating expenses rose 5.0% y-o-y to HK$101.6 billion in FY14, lifted by higher staff (+6.3% y-o-y) and fuel (+5.7% y-o-y) costs as well as increased aircraft depreciation charges (+9.2% y-o-y). The Group reported increased depreciation expenses, as it speeded up retirement of its Airbus 340-300 aircraft. In fact, thanks to early retirement of Airbus 340 and Boeing 747-400 aircraft, the Group reported 6.2% y-o-y decline in aircraft maintenance expenses. Meanwhile, the Group's gross fuel cost was up by only 0.7% y-o-y, as a 4.7% drop in average fuel price helped offset a 5.6% rise in fuel consumption volume. However, owing to a HK$911 million jet fuel hedging loss recorded in FY14, the Group's net fuel costs still went up by 6% y-o-y despite dropping crude oil prices. Overall, the Group's cost per ATK fell 2.2% y-o-y while the ex-fuel cost per ATK was down by 1.9% from a year earlier.

- The Group recorded share of profit of associates of HK$772 million in FY14, compared with profit of HK$838 million a year earlier, which mainly reflected weaker earnings in the Group's 20.13%-owned Air China (00753) during the period from Oct 2013 to Sep 2014 (on depressed yield on rivalry and foreign exchange loss amid a weaker RMB). In fact, the Group's share of profit of associates rebounded to HK$1.04 billion in 2H14 when compared with a loss of HK$265 million in 1H14, thanks to better results from Air China on dropping jet fuel prices as well as earnings recovery in Air China Cargo (the 49%-interested cargo joint venture with Air China).

Outlook & Prospect

- ***Update on new cargo terminal*** 2014 marked the first full year of operation of the Group's Cathay Pacific Services, operator of the new Cathay Pacific Cargo Terminal (CPCT). The terminal handled 1.45 million tonnes of cargo in 2014, slightly higher than the target of 1.4 million tonnes (revised up from the original estimate of 1.1 million tonnes during 1H14 results). The terminal is seen making a minor loss in FY14, as the cargo volume was still below breakeven level of 1.6 million tonnes. Nonetheless, financial results should continue to improve in 2015, as the Group would introduce the service to more third-party air carriers in order to enhance cargo volume and turnover. In fact, management said strong recovery in the air cargo market since 2H14 has extended into Q1 2015, which would also help speed up business development of the new cargo terminal.

- ***Warning over potential losses from fuel hedging*** The Group has been hedging its jet fuel consumption over the past years. Owing to sharp decline in crude oil prices, Cathay made a hedging loss of HK$2.0 billion in 2H14, compared with a gain of HK$1.0 billion in 1H14. In fact, based on Brent oil price of about US$57 per barrel as of the end of 2014, the Group's jet fuel hedging programme (2015-2018) would lead to unrealized hedging loss of HK$12.5 billion (the losses would be realized in the next few years if Brent crude oil prices stay at US$57/barrel or lower). Nevertheless, investors should not overlook such hefty loss, as dropping crude oil prices could help Cathay save more than HK$10 billion of jet fuel expense a year. Management reiterated that Cathay Pacific will benefit from lower oil prices despite the losses from its hedging operation.

- ***Better operating environment in 2015*** Global crude oil price meltdown in 2H14 did not transform into exciting earnings in Cathay, as the air carrier bought its fuel one month in advance (which delayed the oil price drop benefit) and made loss from fuel hedging. In fact, the one-way dive of crude oil prices in 2H14 led to a hard time for Cathay to adjust its hedging operation (high options premium amid sharp volatility). Cathay should find a better occasion to re-adjust its hedging position over the last couple of months, as crude oil prices moved sideway around US$50-US$60. Overall, we remained optimistic at Cathay, as it would benefit from low fuel prices in 2015 and its strong presence in the North America market amid continued economic recovery in the US. Trading at inexpensive valuation of 10.9x FY15E P/E and 1.09x forward P/B ratio, we keep a 'BUY' rating on the counter accordingly.

Recommendation: BUY

Important Disclosure / Analyst Declaration / Disclaimer

This report is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (“BEA”).

Each research analyst primarily responsible for the content of this report (whether in part or in whole) certifies that (i) the views on the companies and securities mentioned in this report accurately reflect his/her personal views; and (ii) no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. This report is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. The analysis or opinions expressed in this report only reflect the views of the relevant analyst as at the date of the release of this report which are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific recipient. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Investments involve risks and investors should exercise prudence in making their investment decisions and obtain separate legal or financial advice, if necessary. East Asia Securities Company Limited and / or The Bank of East Asia Group accepts no liability whatsoever for any direct or consequential loss arising from any use of or reliance on this report or further communication given in relation to this report.

At the time of preparing this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein, while BEA along with its affiliates/associates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its affiliates/associates, their directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates/associates may beneficially own a total of 1% or more of any class of common equity securities of the company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the company or companies mentioned in the report.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.