

Airlines	Last Close HK\$12.92	Target Price HK\$15.50	Upside +20.0%	25 May 2018
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Cathay Pacific Airways (293 HK)

Prudence pays off amidst surging oil price

⊕ **Cautious over capacity growth:** Compared to PRC airlines that recorded double-digit RPK growth on their international routes, RPK growth of Cathay Pacific Airways (CPA) was moderate at only 2.7% YoY for 4M18. Meanwhile, ASK rose 3.1% YoY only during the same period, as CPA management pursues the policy of profitability improvement, rather than relentless market share expansion. 4M18 RPK growth of its European routes was, however, high, rising 7.1% YoY, as CPA stepped up to introduce more direct flights to new tourist destinations with lesser direct competition. Meanwhile, as a leading air freight operator, RFTK remained strong in 4M18, up 7.7% YoY. Last year, CPA's cargo yield rose 11.3% YoY. Industry sources suggested that industry cargo yield surged further in 1Q18 on the back of robust demand.

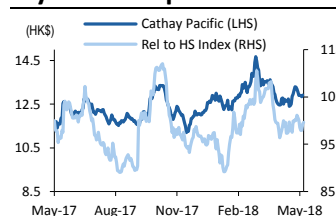
⊕ **Loss-making hedge book now becomes a blessing:** CPA was on the wrong end of its hedging activities in the last two years with losses of HK\$8.6bn/6.4bn in FY16/17, respectively. About 45% of this year's estimated fuel consumption has been hedged at about US\$80/bbl (Brent oil price) as mentioned by management in the last results announcement. While the strike price of these contracts is still higher than the prevailing Brent crude oil, we estimate the hedging loss this year will be substantially lower YoY. We raise our jet fuel price assumption of this year from US\$69/bbl to US\$84/bbl. Our earnings forecast for FY18E is revised marginally, largely due to the protection from its hedging books. Nevertheless, our earnings forecast for FY19 changes more significantly as the hedged volume for FY19 is much smaller under our current forecasts.

⊕ **Maintain Buy:** Compared to CPA, we believe the PRC airlines will be disadvantaged in 2Q18, and probably in the rest of the year if oil price stays persistently at the current level while no hedging measures are taken. We revise our FY18-19 earnings forecasts for CPA and introduce our FY20 forecast. We maintain our **Buy** call and target price of HK\$15.50, which is equivalent to 1.0x FY18E P/B.

Stock Rating

BUY

1-year stock performance



Source: Bloomberg

Stock data

52w high (HK\$)	14.82
52w low (HK\$)	11.18
Market cap (HK\$ m)	50,825.3
Avg daily vol (m)	65.24
YTD change (%)	6.6
200d MA (HK\$)	12.5

Source: Bloomberg

Geoffrey Cheng, CFA

geoffrey.cheng@bocomgroup.com
(852) 3766 1809

Financial highlights

Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Revenue (HK\$ m)	92,751	97,284	104,484	111,056	117,949
YoY growth (%)	(9.4)	4.9	7.4	6.3	6.2
Net profit (HK\$ m)	(575)	(1,259)	1,724	3,922	5,538
EPS (HK\$)	(0.146)	(0.320)	0.438	0.997	1.408
YoY growth (%)	-109.6	119.0	NA	127.6	41.2
Previous EPS (HK\$)			0.446	1.780	
Change (%)			(1.8)	(44.0)	
P/E (x)	NA	NA	29.49	12.96	9.18
BVPS (HK\$)	14.1	15.5	15.9	16.7	17.7
P/B (x)	0.92	0.83	0.81	0.78	0.73
Dividend yield (%)	0.39	0.39	1.12	2.55	3.60

Source: Company data, BOCOM Int'l estimates

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Financial Statements

Income statement (HK\$ m)

Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Revenue	92,751	97,284	104,484	111,056	117,949
Operating expenses	(84,621)	(89,097)	(94,660)	(96,474)	(100,759)
EBIT	(420)	(1,167)	(193)	3,943	5,928
EBIT margin (%)	(0.5)	(1.2)	(0.2)	3.6	5.0
Interest income	155.0	180.0	174.5	147.0	170.7
Interest expense	(1,561)	(2,223)	(2,609)	(3,169)	(3,348)
Net interest inc (exp)	(1,406)	(2,043)	(2,434)	(3,022)	(3,177)
Associates/JV	2,049	2,630	5,153	4,258	4,468
Profit before tax	223	(580)	2,526	5,178	7,219
Tax paid	(497)	(308)	(417)	(854)	(1,263)
Effective tax rate (%)	222.9	(53.1)	16.5	16.5	17.5
Minorities	(301.0)	(371.0)	(385.8)	(401.3)	(417.3)
Net profit	(575.0)	(1,259.0)	1,724	3,922	5,538
% YoY	(109.6)	119.0	(236.9)	127.6	41.2

Balance sheet (HK\$ m)

As of 31 Dec	2016	2017	2018E	2019E	2020E
Fixed assets					
Tangible	106,456	111,182	115,913	120,021	123,508
Intangible	10,934	11,221	10,673	10,125	9,577
Associates/JV	23,298	28,144	33,297	37,555	42,023
Investment	0	0	0	0	0
Others	5,341	4,996	4,996	4,996	4,996
Current assets					
Cash & equivs	20,290	19,094	16,082	18,677	22,638
A/C receivable/debtors	9,557	11,361	12,202	12,969	13,774
Inventories	1,514	1,515	1,627	1,729	1,837
Other current assets	31	865	865	865	865
Current liabilities					
Current debts	7,217	4,823	4,323	4,823	5,323
Finance lease, current portion	4,046	4,065	4,065	4,065	4,065
A/C payable	19,104	17,057	18,319	19,472	20,680
Others	13,725	15,333	16,036	18,073	20,085
Non-current liabilities					
Long term debts	36,125	49,071	54,321	59,571	64,821
Obligations under finance lease	22,781	20,435	19,435	18,435	17,435
Other	18,897	16,322	16,322	16,322	16,322
Net assets	55,526	61,272	62,833	66,177	70,487
Financed by:					
Share capital	17,106	17,106	17,106	17,106	17,106
Reserves	38,259	43,995	45,325	48,428	52,487
Shareholders' funds	55,365	61,101	62,431	65,534	69,593
Minority interest	161	171	403	643	894
Net assets	55,526	61,272	62,833	66,177	70,487

Source: Company data, BOCOM Int'l estimates

Cash flow statement (HK\$ m)

Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Pretax profit	223	(580)	2,526	5,178	7,219
Depreciation/amortisation	8,550	9,354	10,017	10,639	11,262
Associate adjustment	(1,627)	(2,259)	(5,153)	(4,258)	(4,468)
Change in working capital	(7,854)	(7,261)	1,343	1,226	1,285
Tax paid/credited	(750)	(783)	(747)	239	(241)
Profit/loss on asset/inv't disposals	79	(657)	0	0	0
Other operating	7,909	6,880	0	0	0
Operating cash flow	6,530	4,694	7,986	13,025	15,057
Capital expenditure (-)	(14,886)	(16,926)	(15,000)	(15,000)	(15,000)
Investments (-)	(12)	0	0	0	0
Asset/invest disp at selling price	1,854	2,016	800	800	800
Equity raised	0	0	0	0	0
Dividend paid	(1,447)	(453)	(548)	(980)	(1,646)
Other investment/equity	540	1,248	0	0	0
Change in net cash/(debt)	(7,421)	(9,421)	(6,762)	(2,156)	(789)

Financial ratios

Y/E 31 Dec	2016	2017	2018E	2019E	2020E
EPS - headline	(0.146)	(0.320)	0.438	0.997	1.408
DPS	0.050	0.050	0.145	0.329	0.465
BVPS	14.07	15.53	15.87	16.66	17.69
CFPS	1.660	1.193	2.030	3.311	3.828
Change (% YoY)					
Revenue	(9.4)	4.9	7.4	6.3	6.2
EBITDA	(47.6)	0.7	20.0	48.4	17.9
EBIT	(106.3)	177.9	(83.5)	(2,147.2)	50.4
Net profit	(109.6)	119.0	(236.9)	127.6	41.2
Margin analysis (%)					
EBITDA margin	8.8	8.4	9.4	13.1	14.6
EBIT margin	(0.5)	(1.2)	(0.2)	3.6	5.0
Net margin	(0.6)	(1.3)	1.6	3.5	4.7
Profitability ratio (%) - year-end basis					
ROA	(0.3)	(0.7)	0.9	1.9	2.5
ROE	(1.0)	(2.1)	2.8	6.0	8.0
ROCE	(0.3)	(0.8)	(0.1)	2.5	3.5
ROIC	7.5	5.2	3.0	2.6	3.6
Others					
Net debt to equity ratio (%)	90.1	97.1	105.8	104.1	99.2
ST debt/total debt (%)	20.0	9.8	8.0	8.1	8.2
Total debt/Total asset (%)	39.5	41.6	42.0	42.0	41.8
EBITDA/gross interest expenses (x)	5.2	3.7	3.8	4.6	5.1
Dividend payout (%)	NA	NA	33.0	33.0	33.0
Total debt/EBITDA (x)	8.6	9.6	8.4	6.0	5.3
Accounts receivable turnover (days)	37.6	42.6	42.6	42.6	42.6

25 May 2018

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BOCOM International

10/F, Man Yee Building, 68 Des Voeux Road Central, Central, Hong Kong
Main: (852) 3766 1899 Fax: (852) 2107 4662

Rating System

Analyst Stock Ratings:

Buy: The stock's total return is expected to **exceed** that of the corresponding industry over the next 12 months.

Neutral: The stock's total return is expected to be **in line with** that of the corresponding industry over the next 12 months.

Sell: The stock's total return is expected to be **below** that of the corresponding industry over the next 12 months.

Not-Rated: The analyst **does not have conviction** regarding the outlook of the stock's total return relative to that of the corresponding industry over the next 12 months.

Analyst Industry Views:

Outperform: The analyst expects the industry coverage universe to be **attractive** relative to the relevant broad market benchmark over the next 12 months.

Market perform: The analyst expects the industry coverage universe to be **in line with** the relevant broad market benchmark over the next 12 months.

Underperform: The analyst expects the industry coverage universe to be **unattractive** relative to the relevant broad market benchmark over the next 12 months.

Broad market benchmark for Hong Kong is **the Hang Seng Composite Index**, for China A-shares is the **MSCI China A Index**, for US-listed Chinese companies is **S&P US Listed China 50 (USD) Index**.

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