

Cathay Pacific

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DBS Group Research . Equity

11 Aug 2022

HOLD

Last Traded Price (10 Aug 2022): HK\$8.60 (HSI : 19,611)
Price Target 12-mth: HK\$9.00 (5% upside) (Prev HK\$6.80)

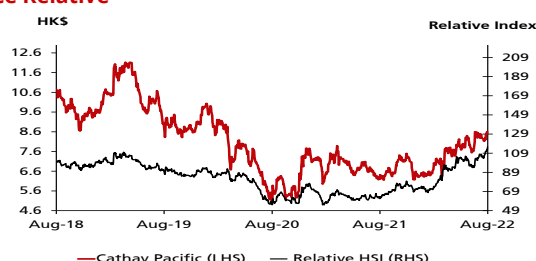
Analyst

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What's New

- 1HFY22 results were slightly better than expected; steep losses largely attributable to drag from associates
- Near-term outlook has turned brighter with Hong Kong progressively easing COVID-19 travel measures
- FY22/23F earnings estimates revised higher, but risks are skewed to the downside
- Maintain HOLD but with a higher TP of HK\$9.00

Price Relative



Forecasts and Valuation

FY Dec (HK\$m)	2020A	2021A	2022F	2023F
Turnover	46,934	45,587	53,314	87,274
EBITDA	1,434	10,351	11,516	19,084
Pre-tax Profit	(22,321)	(6,057)	(3,736)	3,680
Net Profit	(21,876)	(6,123)	(4,293)	2,609
Net Pft (Pre Ex) (core profit)	(15,437)	(5,130)	(4,293)	2,609
Net Profit Gth (Pre-ex) (%)	N/A	66.8	16.3	N/A
EPS (HK\$)	(3.40)	(0.95)	(0.67)	0.41
EPS Gth (%)	N/A	72.0	29.9	N/A
Diluted EPS (HK\$)	(3.40)	(0.95)	(0.67)	0.41
DPS (HK\$)	0.00	0.00	0.00	0.00
BV Per Share (HK\$)	8.35	8.19	7.68	8.17
PE (X)	nm	nm	nm	21.2
CorePE (X)	nm	nm	nm	21.2
P/Cash Flow (X)	nm	6.3	3.8	3.1
P/Free CF (X)	nm	8.3	6.6	10.5
EV/EBITDA (X)	103.6	14.0	11.9	7.0
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	1.0	1.0	1.1	1.1
Net Debt/Equity (X)	1.0	1.0	0.9	0.8
ROAE(%)	(37.5)	(11.5)	(8.4)	5.1
Earnings Rev (%)			n.m.	177
Consensus EPS (HK\$)			(0.67)	0.31
Other Broker Recs:		B:8	S:1	H:6

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Dark clouds are gradually dissipating

Investment Thesis

Return to normalcy is still quite far away. CX's passenger traffic is expected to recover at a slower pace compared to regional peers due to its lack of a domestic market, Hong Kong's dynamic-zero COVID strategy, and the airline's considerable exposure to long-haul flights and business travellers.

Lack of visibility on the Greater China market's reopening timeline will remain a drag. Delays to Hong Kong's reopening will pose downside risks to our earnings forecasts. Furthermore, Air China will likely hinder CX's turnaround if China does not shift away from its COVID-zero policy.

Risk-to-reward set-up is balanced. We view the group's valuation at 6.8x EV/EBITDA (FY23F) as fair considering its recovery prospects, given that it is on-par with regional peers and in line with its pre-COVID19 average.

Valuation:

Our TP of HK\$9.00 is based 7.4x (consistent with 2-year pre-COVID19 average) EV/EBITDA (blended FY22/23F). We switched our valuation multiple to EV/EBITDA from P/BV as CX's earnings profile will likely stabilise from 2HFY22 and it enables better comparison with peers with differing capital structures.

Where we differ:

While our FY22/23F earnings are in line with consensus, we are more conservative on valuation given the acute lack of clarity on the Greater China market's reopening trajectory.

Key Risks to Our View:

Key risks to our neutral view include: 1) faster-than-anticipated normalisation of CX's passenger volumes; and 2) passenger and cargo yields holding up better than expected.

At A Glance

Issued Capital (m shrs)	6,437
Mkt Cap (HKm/US\$m)	54,843 / 6,986
Major Shareholders (%)	
Swire Pacific Ltd	45.0
Air China Ltd	22.7
Qatar Airways (Q.C.S.C.)	10.0
China National Aviation Corporation Ltd.	7.3
Free Float (%)	15.0
3m Avg. Daily Val. (US\$m)	9.8
GICS Industry: Industrials / Transportation	



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WHAT'S NEW

1HFY22 was slightly better than anticipated; positive adjustments to FY22/23F earnings estimates

Results highlights

- **1HFY22 results were slightly better than expected.** While net losses attributable to common shareholders were still fairly significant at HK\$5,299m (vs HK\$7,654m in 1HFY21), CX's core operating loss shrank to HK\$1,253m in 1HFY22 from HK\$4,532m a year ago. Air China's (CX's largest associate) poorer performance weighed on CX, leading the airline to book negative contribution of HK\$2,726m from associates during the period (against net loss of HK\$1,509m in 1HFY21).
- **Passenger services revenue declined by 42.2% h-o-h to HK\$2,086m** as passenger traffic fell by 45.7% amid stringent quarantine requirements imposed on CX's crew and tighter travel restrictions during the period, though this was offset by a sequential 5.7% uptick in passenger yields.
- **Cargo revenue similarly fell by 40.2% h-o-h to HK\$13,830m** as cargo volumes declined by 56.8% h-o-h, though this was mitigated by a steep 32.4% increase in cargo yields during the period.
- **Operating cash burn was better than expected** at <HK\$0.1bn per month in 1HFY22, as compared to HK\$0.9bn per month in 1HFY22. CX was likely cash-generative from June-22.
- **Adjusted net gearing was stable at 0.74x in 1HFY22**, against 0.75x in 2HFY21 and 0.82x in 1HFY21, while CX's liquidity position continued to be robust at HK\$26.7bn as of June-22.
- **CX should have adequate manpower to ramp up capacity going forward** as the airline has started a comprehensive recruitment plan to hire more than 4,000 front-line employees.
- **Management shared that it is unlikely for cargo demand in 2HFY22 to be as exceptional as 2HFY21** due to macroeconomic headwinds and sustained supply chain disruptions.
- **Cumulative dividends payable on its preference shares stood at HK\$1,124m as of June-22.** The company will have to fully repay all deferred dividends upon redemption of the preference shares and cannot distribute dividends to common shareholders or repurchase its shares until all deferred dividends have been paid out. While the rate on CX's preferred stock will step up to 5% per annum from Aug-23 from 3% currently, we believe that it will be challenging for CX to fully redeem all preferred stock before the step-up date, and the airline will likely do so in tranches.

Earnings revision and recommendation

Other highlights

- **Group passenger and cargo capacity is projected to reach 25% and 65% of pre-pandemic levels by Dec-22**, up from 11% and 56% in June-22 respectively. The management is unable to provide any guidance beyond Dec-22 due to a lack of visibility on China and Hong Kong's reopening timeline and easing of quarantine requirements on its aircrew.
- **CX has limited fuel hedges in place after 1Q2024.** CX has hedged about 30-40% of its projected fuel consumption over 3QFY22 and 2QFY23, but the airline's hedging ratio gradually falls off to c.5.0% over the subsequent quarters.
- **We now expect CX to return to profitability in 2HFY22, and project CX to post a moderately narrower net loss of HK\$4.3bn in FY22F** (as compared to HK\$5.1bn loss previously) as we lift our passenger and cargo yield, and passenger load factor assumptions, though this is partly offset by steeper losses from Air China at the associate level.
- **Additionally, we now project CX to report a net profit of HK\$2.6bn in FY23F**, up from HK\$0.9bn previously, underpinned by our expectation of passenger yields holding at elevated levels (20% above pre-COVID19 levels) as pent-up travel demand is unleashed and CX strong cost control. Our estimate is premised on Hong Kong removing mandatory quarantine (currently at 3 days) for all inbound travellers and air crew in 1QFY23, with passenger traffic hitting 55-60% of pre-pandemic levels in FY23F. Hence, any delays on the reopening front would pose downside risks to our forecast.
- **Maintain HOLD with a higher TP of HK\$9.00.** We are switching our valuation methodology from forward P/BV to forward EV/EBITDA given that it is more

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straightforward to benchmark valuations on an EV/EBITDA basis as it is capital-structure neutral, and CX's earnings profile will likely stabilise from 2HFY22F as it progressively returns to normality. Our new TP is based on 7.4x blended FY22/23F EBITDA (consistent with 2-year average prior to the pandemic), as compared to 0.9x blended FY22/23F book value previously. Details can be found in the valuation table below. CX's stock price performance in 2022 has certainly exceeded our expectations, but we believe that upside is limited from hereon given the uncertainty surrounding Hong Kong and China's reopening trajectory.

Company Background

CX is a Hong Kong-headquartered international airline with scheduled passenger and cargo services to 198 destinations worldwide. It recently acquired HK Express, a low-cost carrier also based in Hong Kong. It is ranked among the top 20 airlines globally by capacity as measured by Available Passenger Kilometres (ASK), while its cargo arm is ranked among the top 3. It was listed on the Hong Kong Stock Exchange in 1986.

Valuation table

(In HK\$ millions unless specified otherwise)	Value	Comments
EBITDA	16,650	Blended FY22/23F
EV/EBITDA multiple peg	7.4x	Consistent with 2-year pre-COVID19 average
Enterprise value	122,379	
Less: net debt	62,734	As at December-22
Less: preferred stock	19,500	As at December-22
Less: deferred dividends on preferred stock	1,433	As at December-22
Less: minority interest	5	As at December-22
Add: non-operating assets	18,929	As at December-22
Equity value	57,636	
Number of shares outstanding (millions)	6,437.2	
Value per share (HK\$)	9.00	

Source: Company, DBS HK

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Regional Airlines Valuation Table

Company	Market cap (US\$m)	P/E		EV-to-EBITDA		P/BV		ROE (%)	
		CY22F	CY23F	CY22F	CY23F	CY22F	CY23F	CY22F	CY23F
Air China	17,368	nm	17.8x	103.3x	9.4x	1.7x	1.5x	-29.2%	6.9%
China Southern	13,773	nm	26.5x	25.6x	8.7x	1.1x	1.1x	-16.5%	3.7%
China Eastern	11,450	nm	47.6x	36.6x	9.0x	1.2x	1.1x	-39.7%	3.2%
Singapore Airlines	11,747	17.7x	15.4x	5.5x	5.0x	1.2x	1.1x	5.2%	6.7%
ANA Holdings	9,319	42.4x	14.7x	9.4x	6.8x	1.4x	1.3x	3.6%	9.0%
Japan Airlines	7,770	31.6x	13.7x	6.6x	4.8x	1.2x	1.2x	3.5%	9.0%
Korean Air	7,249	6.1x	10.2x	3.7x	3.8x	1.1x	1.0x	20.1%	10.4%
Cathay Pacific	7,055	nm	27.6x	10.2x	6.8x	1.0x	0.9x	-6.4%	4.2%
Spring Airlines	6,510	nm	22.6x	43.7x	12.5x	3.3x	2.9x	-4.8%	12.0%
EVA Airways	6,211	14.3x	7.3x	4.4x	3.3x	47.8x	9.6x	237.4%	275.9%
China Airlines	5,573	14.3x	10.1x	4.8x	4.0x	1.8x	1.7x	10.8%	19.8%
Qantas Airways	4,350	10.0x	6.6x	4.1x	3.1x	1.6x	1.4x	18.3%	20.6%
Juneyao Airlines	4,029	nm	21.5x	nm	9.6x	3.0x	2.6x	-16.8%	12.9%
Air New Zealand	1,406	50.0x	8.9x	4.4x	3.1x	1.2x	1.1x	1.9%	13.1%
Asiana Airlines	854	nm	34.7x	nm	nm	2.5x	1.5x	-0.3%	4.3%
Sector Median		17.7x	16.6x	8.0x	6.8x	1.4x	1.3x	1.9%	9.0%

Source: Bloomberg Finance L.P., DBS HK

Historical PB band



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Passenger ASK (m)	163,244.0	34,609.0	13,227.6	19,544.9	98,915.4
Passenger Load Factor (%)	82.3	58.0	31.1	72.5	80.8
Passenger Yield (HK cts)	53.7	56.3	105.5	90.0	64.0
Jet Fuel Price (US\$ per barrel)	75.4	46.1	73.9	115.0	106.0

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (HK\$ m)					
Passenger Services	73,985	11,950	4,357	12,857	51,719
Cargo Services	23,810	27,890	35,814	34,932	28,373
Catering, recoveries & other services	9,178	7,094	5,416	5,524	7,182
Total	106,973	46,934	45,587	53,314	87,274

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	106,973	46,934	45,587	53,314	87,274
Cost of Goods Sold	(103,646)	(58,639)	(46,037)	(50,839)	(81,891)
Gross Profit	3,327	(11,705)	(450)	2,474	5,384
Other Opng (Exp)/Inc	0	0	0	0	0
Operating Profit	3,327	(11,705)	(450)	2,474	5,384
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	1,643	(1,282)	(1,985)	(3,500)	800
Net Interest (Exp)/Inc	(2,939)	(2,895)	(2,629)	(2,710)	(2,503)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	114	(6,439)	(993)	0	0
Pre-tax Profit	2,145	(22,321)	(6,057)	(3,736)	3,680
Tax	(454)	674	531	39	(475)
Minority Interest	0	(1)	(1)	0	0
Preference Dividend	0	(228)	(596)	(596)	(596)
Net Profit	1,691	(21,876)	(6,123)	(4,293)	2,609
Net Profit before Except.	1,577	(15,437)	(5,130)	(4,293)	2,609
EBITDA	19,192	1,434	10,351	11,516	19,084
Growth					
Revenue Gth (%)	(3.7)	(56.1)	(2.9)	16.9	63.7
EBITDA Gth (%)	26.6	(92.5)	621.8	11.3	65.7
Opg Profit Gth (%)	(7.5)	(451.8)	(96.2)	(649.8)	117.6
Net Profit Gth (%)	(27.9)	N/A	72.0	29.9	N/A
Margins & Ratio					
Gross Margins (%)	3.1	(24.9)	(1.0)	4.6	6.2
Opg Profit Margin (%)	3.1	(24.9)	(1.0)	4.6	6.2
Net Profit Margin (%)	1.6	(46.6)	(13.4)	(8.1)	3.0
ROAE (%)	2.7	(37.5)	(11.5)	(8.4)	5.1
ROA (%)	0.8	(10.4)	(3.1)	(2.2)	1.4
ROCE (%)	1.6	(6.5)	(0.3)	1.5	2.9
Div Payout Ratio (%)	41.9	N/A	N/A	N/A	0.0
Net Interest Cover (x)	1.1	(4.0)	(0.2)	0.9	2.2

Source: Company, DBS HK

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Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	140,114	131,925	123,990	118,021	118,193
Invt in Associates & JVs	27,055	26,489	24,532	21,032	21,832
Other LT Assets	20,063	18,593	19,208	18,635	18,062
Cash & ST Invt	14,864	19,379	19,332	19,120	17,816
Inventory	1,812	1,719	1,269	1,333	1,587
Debtors	10,608	6,469	8,296	8,886	10,909
Other Current Assets	0	0	0	0	0
Total Assets	214,516	204,574	196,627	187,027	188,400
ST Debt	20,752	24,249	22,350	22,350	22,350
Creditors	18,218	12,376	10,095	10,663	13,427
Other Current Liab	17,892	10,099	10,690	13,765	15,765
LT Debt	76,508	68,880	67,504	59,504	53,504
Other LT Liabilities	18,370	15,709	13,739	11,789	11,289
Shareholder's Equity	62,773	73,257	72,244	68,951	72,060
Minority Interests	3	4	5	5	5
Total Cap. & Liab.	214,516	204,574	196,627	187,027	188,400
Non-Cash Wkg. Capital	(23,690)	(14,287)	(11,220)	(14,209)	(16,696)
Net Cash/(Debt)	(82,396)	(73,750)	(70,522)	(62,734)	(58,038)
Debtors Turn (avg days)	39.4	66.4	59.1	58.8	41.4
Creditors Turn (avg days)	73.2	126.3	123.3	98.9	63.7
Inventory Turn (avg days)	7.4	14.6	16.4	12.4	7.7
Asset Turnover (x)	0.5	0.2	0.2	0.3	0.5
Current Ratio (x)	0.5	0.6	0.7	0.6	0.6
Quick Ratio (x)	0.4	0.6	0.6	0.6	0.6
Net Debt/Equity (X)	1.3	1.0	1.0	0.9	0.8
Net Debt/Equity ex MI (X)	1.3	1.0	1.0	0.9	0.8
Capex to Debt (%)	12.4	5.7	2.4	7.3	16.5
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	2,145	(22,321)	(6,057)	(3,736)	3,680
Dep. & Amort.	14,222	14,421	12,786	12,542	12,901
Tax Paid	(285)	(923)	(991)	(911)	(475)
Assoc. & JV Inc/(loss)	(1,643)	1,282	1,985	3,500	(800)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	2,584	(9,429)	(3,855)	2,989	2,486
Other Operating CF	(1,681)	2,679	4,967	0	0
Net Operating CF	15,342	(14,291)	8,835	14,384	17,792
Capital Exp.(net)	(12,037)	(5,265)	(2,164)	(6,000)	(12,500)
Other Invt.(net)	(1,757)	(2)	(17)	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	394	675	0	0	0
Other Investing CF	1,796	(7,166)	2,674	0	0
Net Investing CF	(11,604)	(11,758)	493	(6,000)	(12,500)
Div Paid	(1,496)	0	0	0	0
Chg in Gross Debt	(973)	(7,830)	(6,932)	(8,000)	(6,000)
Capital Issues	0	31,216	0	0	0
Other Financing CF	42	(23)	(8)	3	3
Net Financing CF	(2,469)	23,309	(6,932)	(8,596)	(6,596)
Currency Adjustments	(41)	25	11	0	0
Chg in Cash	1,228	(2,715)	2,407	(212)	(1,304)
Opg CFPS (HK\$)	2.83	(0.76)	1.97	1.77	2.38
Free CFPS (HK\$)	0.73	(3.04)	1.04	1.30	0.82

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	Target Price	Rating
1	12-Aug-21	HK\$6.42	HK\$6.00	HOLD
2	12-Jan-22	HK\$6.46	HK\$5.50	FV
3	10-Mar-22	HK\$6.64	HK\$6.80	HOLD

Source: DBS HK

Analyst: Paul YONG

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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