

# China / Hong Kong Company Update

## Cathay Pacific

Bloomberg: 293 HK EQUITY | Reuters: 0293.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

18 Jan 2024

### BUY

Last Traded Price (17 Jan 2024): HK\$7.80 (HSI : 15,277)  
Price Target 12-mth: HK\$11.00 (41% upside) (Prev HK\$12.00)

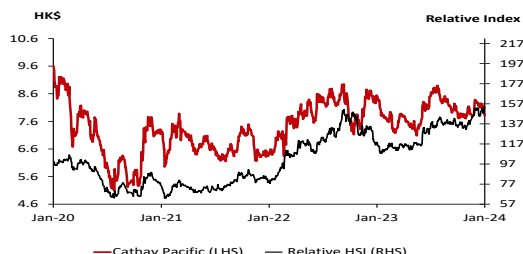
#### Analyst

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#### What's New

- Passenger yields and load factors have been surprising on the upside; we expect to see higher-for-longer passenger yields
- Manpower shortage has remained a challenge for CX since the pandemic, though aggressive hiring plans are in place
- Trim our FY24F EBITDA forecast on more gradual resumption of international passenger capacity, partially offset by higher yields
- Maintain BUY with revised TP of HK\$11.00

#### Price Relative



#### Forecasts and Valuation

FY Dec (HK\$m)	2022A	2023F	2024F	2025F
Turnover	51,036	91,480	111,435	125,040
EBITDA	15,735	24,000	22,415	23,269
Pre-tax Profit	(6,040)	10,742	7,709	8,327
Net Profit	(7,162)	8,904	6,434	7,134
Net Profit Gth (Pre-ex)(%)	(39.6)	N/A	(4.9)	10.9
EPS (HK\$)	(1.11)	1.38	1.00	1.11
Core EPS (HK\$)	(1.11)	1.05	1.00	1.11
EPS Gth (%)	(17.0)	N/A	(27.7)	10.9
Core EPS Gth (%)	(39.6)	N/A	(4.9)	10.9
DPS (HK cts)	0.00	0.00	40.00	42.00
BV Per Share (HK\$)	6.89	8.04	9.04	9.75
PE (X)	nm	5.6	7.8	7.0
CorePE (X)	nm	7.4	7.8	7.0
P/Cash Flow (X)	2.8	2.2	2.8	2.5
P/Free CF (X)	3.5	3.0	5.5	4.6
EV/EBITDA (X)	8.2	4.8	4.7	4.1
Net Div Yield (%)	0.0	0.0	5.1	5.4
P/Book Value (X)	1.1	1.0	0.9	0.8
Net Debt/Equity (X)	0.9	0.9	0.9	0.7
ROAE(%)	(14.7)	18.5	11.7	11.8
Earnings Rev (%):		30	Nil	New
Consensus EPS (HK\$)		1.29	1.05	0.99
Other Broker Recs:		B:12	S:0	H:0

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

### Sustained optimism on CX

#### Investment Thesis

**Premium network carrier with an enviable position in one of Asia's leading aviation hubs.** CX's broad global network, coupled with its strategic hub in Hong Kong (which serves as a gateway to China and is advantageously located between Asia and other regions), enables the group to effectively capture a vast customer base. The ongoing development of the Greater Bay Area further augments CX's advantage, promising to enhance connectivity between the region and Hong Kong, thereby substantially expanding the airline's catchment area. Additionally, CX also has a strong reputation for providing high-quality service and a popular loyalty programme, which helped the group build a significant presence in the corporate travel market and retain customers.

**Anticipate stellar earnings over the next two years on traffic recovery and resilient passenger load factors and yields.** We believe the carrier will continue to deliver above pre-pandemic levels of profitability in the near term, underpinned by favourable supply-demand dynamics. Passenger yields and load factors should remain at elevated levels for an extended period of time, given that the group is a key beneficiary of the sluggish reinstatement of international capacity by the Chinese airlines. Although CX's operating profits could peak in FY23, we still expect sound bottom-line growth with increased contribution from Air China at the associate level.

**Attractive valuation on promising earnings outlook; reinstatement of dividends to underpin share price re-rating.** We view CX's current valuation of 4.7x EV/EBITDA (FY24F) as undemanding, considering that the group is priced below the sector average and close to 1.5SD below its five-year pre-COVID-19 average, despite its promising earnings outlook. Additionally, an imminent reinstatement of its dividend programme in FY24F after the redemption of all its preference shares by July-24, should also act as a re-rating catalyst.

**Maintain BUY with revised TP of HK\$11.00,** as we roll over our valuations to FY24F, with an unchanged valuation peg of 5.4x (c.0.5SD below its five-year pre-pandemic average) FY24F EBITDA (previously: Blended FY23F/24F EBITDA).

#### Key Risks

**Macroeconomic headwinds** could curb CX's passenger traffic recovery and suppress yields, **manpower shortages** could hinder capacity addition, and **elevated jet fuel prices** could impede margin expansion.

#### At A Glance

Issued Capital (m shrs)	6,437
Mkt Cap (HKm/US\$m)	50,209 / 6,420
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)	4.9
GICS Industry: Industrials / Transportation	

## Cathay Pacific

### WHAT'S NEW

#### Sustained optimism on CX

Our 2024 outlook report for the [airline sector](#) highlights that macroeconomic indicators still largely favour the sector, though we expect to see a diverging earnings outlook across regions and business segments. This underpins our expectation of global passenger traffic hitting 105%-110%/115%-120% of 2019's level in 4Q24/4Q25. Across the three major regions, we are most positive about airlines in Asia Pacific, as we expect them to demonstrate stronger earnings momentum, underpinned by relatively higher capacity growth and wider margins, with the Chinese airlines likely to see the biggest upswing in earnings. While the valuation multiples for Asian airlines might appear high, they are commensurate with the region's stronger earnings potential. Our top picks are Cathay Pacific (CX) and China Southern Airlines (CSA).

We anticipate stellar earnings over the next two years for CX, following record operating profits in FY23, as passenger load factors and yields remain resilient for the group on the back of favourable supply-demand dynamics. While the manpower shortage has been a key issue at CX, resulting in operational challenges and slower-than-expected capacity reinstatement, the group has a significant presence in the North Asian region and remains a key beneficiary of the sluggish restoration of international capacity by the Chinese airlines. Hence, we maintain

our optimistic view on CX, despite prevailing doubts about its capacity restoration plan, as we anticipate any passenger traffic deficits could be offset by robust passenger yields, fuelled by still-strong pent-up travel demand. In addition, at the associate level, Air China had a remarkable showing in 3Q23 and should see a turnaround in profitability in FY24, which will be positive for CX's bottom line.

**Maintain BUY with revised TP of HK\$11.00** as we roll over our valuations, with an unchanged valuation peg of 5.4x (c.0.5SD below its five-year pre-pandemic average) FY24F EBITDA (previously: Blended FY23F/24F EBITDA).

#### 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 three. It was listed on the Hong Kong Stock Exchange in 1986.

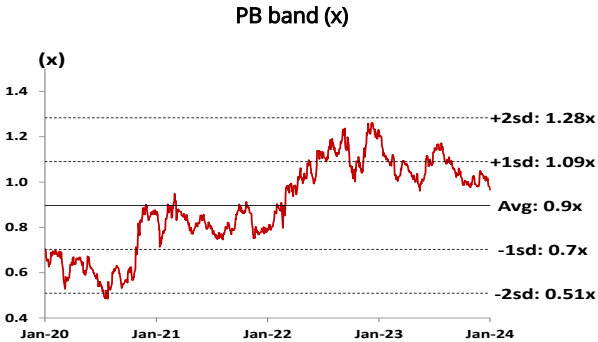
#### Valuation table

(in HK\$ millions unless specified otherwise)	Value	Comments
EBITDA	22,415	FY24F
EV/EBITDA multiple peg (x)	5.4	0.5 standard deviation below five-year pre-pandemic average
Enterprise value	120,145	
Less: net debt	(44,565)	As at June 23
Less: preferred stock	(19,500)	As at June 23
Less: minority interest	(6)	As at June 23
Add: non-operating assets	14,634	
Equity value	70,708	
Number of shares outstanding (m)	6,437.2	
Value per share (HK\$)	11.00	

Source: DBS Bank estimates

Cathay Pacific

Historical PB band



Source: Thomson Reuters, DBS HK

## Cathay Pacific

### Key Assumptions

FY Dec	2021A	2022A	2023F	2024F	2025F
Passenger ASK (m)	13,227.6	20,056.3	84,037.4	136,833.0	166,507.6
Passenger Load Factor (%)	31.1	73.6	86.5	85.2	85.0
Passenger Yield (HK cts)	105.5	92.7	73.0	61.7	58.0
Jet Fuel Price (US\$ per barrel)	73.9	124.0	105.0	100.0	105.0

Source: Company, DBS HK

### Segmental Breakdown (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
<b>Revenues (HK\$ m)</b>					
Passenger Services	4,357	14,333	58,582	78,001	88,459
Cargo Services	35,814	30,554	25,519	24,579	26,841
Catering, recoveries & other services	5,416	6,149	7,379	8,855	9,740
<b>Total</b>	<b>45,587</b>	<b>51,036</b>	<b>91,480</b>	<b>111,435</b>	<b>125,040</b>

Source: Company, DBS HK

### Income Statement (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenue	45,587	51,036	91,480	111,435	125,040
Cost of Goods Sold	(46,037)	(47,490)	(80,017)	(102,037)	(115,286)
<b>Gross Profit</b>	<b>(450)</b>	<b>3,546</b>	<b>11,463</b>	<b>9,398</b>	<b>9,754</b>
Other Opng (Exp)/Inc	0	0	0	0	0
<b>Operating Profit</b>	<b>(450)</b>	<b>3,546</b>	<b>11,463</b>	<b>9,398</b>	<b>9,754</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	(1,985)	(6,677)	(35)	963	1,098
Net Interest (Exp)/Inc	(2,629)	(2,909)	(2,823)	(2,652)	(2,525)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	(993)	0	2,137	0	0
<b>Pre-tax Profit</b>	<b>(6,057)</b>	<b>(6,040)</b>	<b>10,742</b>	<b>7,709</b>	<b>8,327</b>
Tax	531	(507)	(1,123)	(1,113)	(1,193)
Minority Interest	(1)	(1)	0	0	0
Preference Dividend	(596)	(614)	(715)	(163)	0
<b>Net Profit</b>	<b>(6,123)</b>	<b>(7,162)</b>	<b>8,904</b>	<b>6,434</b>	<b>7,134</b>
Net Profit before Except.	(5,130)	(7,162)	6,767	6,434	7,134
EBITDA	12,336	15,735	24,000	22,415	23,269
<b>Growth</b>					
Revenue Gth (%)	(2.9)	12.0	79.2	21.8	12.2
EBITDA Gth (%)	354.2	27.6	52.5	(6.6)	3.8
Opg Profit Gth (%)	(96.2)	(888.0)	223.3	(18.0)	3.8
Net Profit Gth (%)	72.0	(17.0)	N/A	(27.7)	10.9
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	(1.0)	6.9	12.5	8.4	7.8
Opg Profit Margin (%)	(1.0)	6.9	12.5	8.4	7.8
Net Profit Margin (%)	(13.4)	(14.0)	9.7	5.8	5.7
ROAE (%)	(11.5)	(14.7)	18.5	11.7	11.8
ROA (%)	(3.1)	(3.8)	5.0	3.7	4.0
ROCE (%)	(0.3)	2.2	7.0	5.7	5.9
Div Payout Ratio (%)	N/A	N/A	0.0	40.0	37.9
Net Interest Cover (x)	(0.2)	1.2	4.1	3.5	3.9

Source: Company, DBS HK

## Cathay Pacific

## Balance Sheet (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Net Fixed Assets	123,990	118,855	112,878	109,422	105,468
Invt in Associates & JVs	24,532	16,492	18,257	18,921	19,719
Other LT Assets	19,208	19,231	18,907	18,346	17,785
Cash & ST Invt	19,332	18,278	15,012	14,553	23,165
Inventory	1,269	1,137	1,663	2,026	2,273
Debtors	8,296	6,921	10,164	11,144	12,504
Other Current Assets	0	0	0	0	0
<b>Total Assets</b>	<b>196,627</b>	<b>180,914</b>	<b>176,882</b>	<b>174,411</b>	<b>180,915</b>
ST Debt	22,350	14,643	14,643	14,643	14,643
Creditors	10,095	11,199	14,074	15,919	17,863
Other Current Liab	10,690	17,560	21,023	20,023	20,024
LT Debt	67,504	62,463	54,463	54,463	54,463
Other LT Liabilities	13,739	11,165	11,165	11,165	11,165
Shareholder's Equity	72,244	63,878	61,508	58,192	62,751
Minority Interests	5	6	6	6	6
<b>Total Cap. &amp; Liab.</b>	<b>196,627</b>	<b>180,914</b>	<b>176,882</b>	<b>174,411</b>	<b>180,915</b>
Non-Cash Wkg. Capital	(11,220)	(20,701)	(23,269)	(22,773)	(23,109)
Net Cash/(Debt)	(70,522)	(58,828)	(54,094)	(54,553)	(45,941)
Debtors Turn (avg days)	59.1	54.4	34.1	34.9	34.5
Creditors Turn (avg days)	123.3	110.1	68.4	61.5	60.6
Inventory Turn (avg days)	16.4	12.4	7.6	7.6	7.7
Asset Turnover (x)	0.2	0.3	0.5	0.6	0.7
Current Ratio (x)	0.7	0.6	0.5	0.5	0.7
Quick Ratio (x)	0.6	0.6	0.5	0.5	0.7
Net Debt/Equity (X)	1.0	0.9	0.9	0.9	0.7
Net Debt/Equity ex MI (X)	1.0	0.9	0.9	0.9	0.7
Capex to Debt (%)	2.4	4.8	8.7	13.0	13.0
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

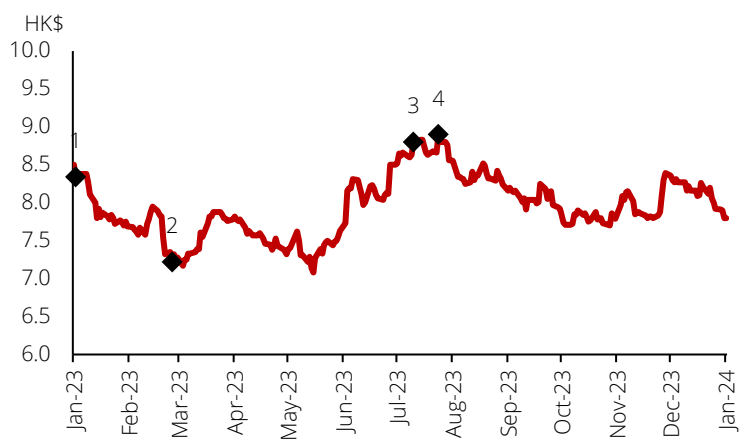
## Cash Flow Statement (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Profit	(6,057)	(6,040)	10,742	7,709	8,327
Dep. & Amort.	12,786	12,189	12,538	13,017	13,515
Tax Paid	(991)	(1,457)	(1,123)	(1,113)	(1,193)
Assoc. & JV Inc/(loss)	1,985	6,677	35	(963)	(1,098)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(3,855)	8,223	2,568	(496)	337
Other Operating CF	4,967	(1,756)	(2,137)	0	0
<b>Net Operating CF</b>	<b>8,835</b>	<b>17,836</b>	<b>22,623</b>	<b>18,154</b>	<b>19,888</b>
Capital Exp.(net)	(2,164)	(3,679)	(6,000)	(9,000)	(9,000)
Other Invt.(net)	(17)	(17)	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	100	300	300
Other Investing CF	2,674	936	0	0	0
<b>Net Investing CF</b>	<b>493</b>	<b>(2,760)</b>	<b>(5,900)</b>	<b>(8,700)</b>	<b>(8,700)</b>
Div Paid	0	0	0	0	(2,575)
Chg in Gross Debt	(6,932)	(16,236)	(8,000)	0	0
Capital Issues	0	0	(9,750)	(9,750)	0
Other Financing CF	(8)	76	3	4	5
<b>Net Financing CF</b>	<b>(6,932)</b>	<b>(16,236)</b>	<b>(19,989)</b>	<b>(9,913)</b>	<b>(2,575)</b>
Currency Adjustments	11	(73)	0	0	0
Chg in Cash	2,407	(1,233)	(3,266)	(459)	8,613
Opg CFPS (HK\$)	1.97	1.49	3.12	2.90	3.04
Free CFPS (HK\$)	1.04	2.20	2.58	1.42	1.69

Source: Company, DBS HK

**Cathay Pacific**

**Target Price & Ratings 12-mth History**



S.No.	Date	Closing Price	Target Price	Rating
1	19-Jan-23	HK\$8.50	HK\$10.50	BUY
2	14-Mar-23	HK\$7.35	HK\$9.80	BUY
3	27-Jul-23	HK\$8.63	HK\$12.00	BUY
4	10-Aug-23	HK\$8.66	HK\$12.00	BUY

Source: DBS HK

Analyst: Paul YONG

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**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

Completed Date: 18 Jan 2024 17:08:26 (HKT)

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

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