

17 September 2013 | 14 pages

Airlines (GICS) | Airlines (Citi)
Asia | Hong Kong

Cathay Pacific (0293.HK)

Solid Aug Traffic Growth and 86.7% LF, but Fuel a Headwind in 3Q

- **Aug Pax Traffic +3.9%; Pax LF Up 360bp to 86.7%** — CX Pax traffic improved 3.9% in August (vs -1.4% YTD), driven by better traffic trends across most markets (with the exception of SE Asia). Traffic to/from Europe improved 11.3% YoY off of a low base (vs +2% YTD), while traffic to/from China and India each improved over 7% (vs +4.5% and -4.3% YoY YTD, respectively). North America Traffic -3.6% YoY in August (vs -10.3% YTD), likely weighing on the overall length of haul (with total passenger growth modestly outpacing RPKs). Premium/business demand remained relatively soft, but may improve into the traditional peak period for corporate travel, according to mgmt. With easier 2H comps on the pax side and continued optimization of the fleet (with 777 replacing most of the 747s at this stage), we expect sequential improvement in addition to seasonal effects (although fuel is likely to be a drag in 3Q as fuel surcharges lag the 6% QoQ jet fuel price increase).

Sub-2009 Cargo Load Factor in Aug, but New Product Launches May Provide Peak Season Support — While Cathay Air Cargo traffic/tonnage only improved modestly YoY in August, the positive inflection this month was the first YoY growth observed in the last six months. Unfortunately, the 6.9% increase in Capacity led to a sub-GFC cargo load factor of 58.7%. With new tech product launches from Microsoft, Sony and Apple over the next few months, CX and other large players may benefit. However, last year we witnessed similar enthusiasm around new peak season product launches, which failed to materialize to the extent many had hoped at CX, although the added demand for regional airfreight capacity did push up rates. With CX' new air cargo facility still ramping, full 4Q data will provide a far cleaner picture of the ongoing market share split in HK, but the August data point alone maybe an early indicator as CX' tonnage as a % of HACTL volume rose to 65% (from 56% YTD and in 2012 on average).

Neutral	2
Price (16 Sep 13)	HK\$14.58
Target price	HK\$15.70
Expected share price return	7.7%
Expected dividend yield	1.0%
Expected total return	8.7%
Market Cap	HK\$57,355M US\$7,396M

Price Performance
(RIC: 0293.HK, BB: 293 HK)



Statistical Abstract

Year to 31 Dec	Net Profit (HK\$M)	Diluted EPS (HK\$)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2011A	5,751	1.46	-50.6	10.0	1.0	10.4	3.6
2012A	1,949	0.50	-66.1	29.4	1.0	3.5	0.5
2013E	2,945	0.75	51.1	19.5	1.0	5.2	1.0
2014E	4,722	1.20	60.4	12.1	0.9	7.9	1.7
2015E	5,688	1.45	20.5	10.1	0.9	8.9	2.4

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

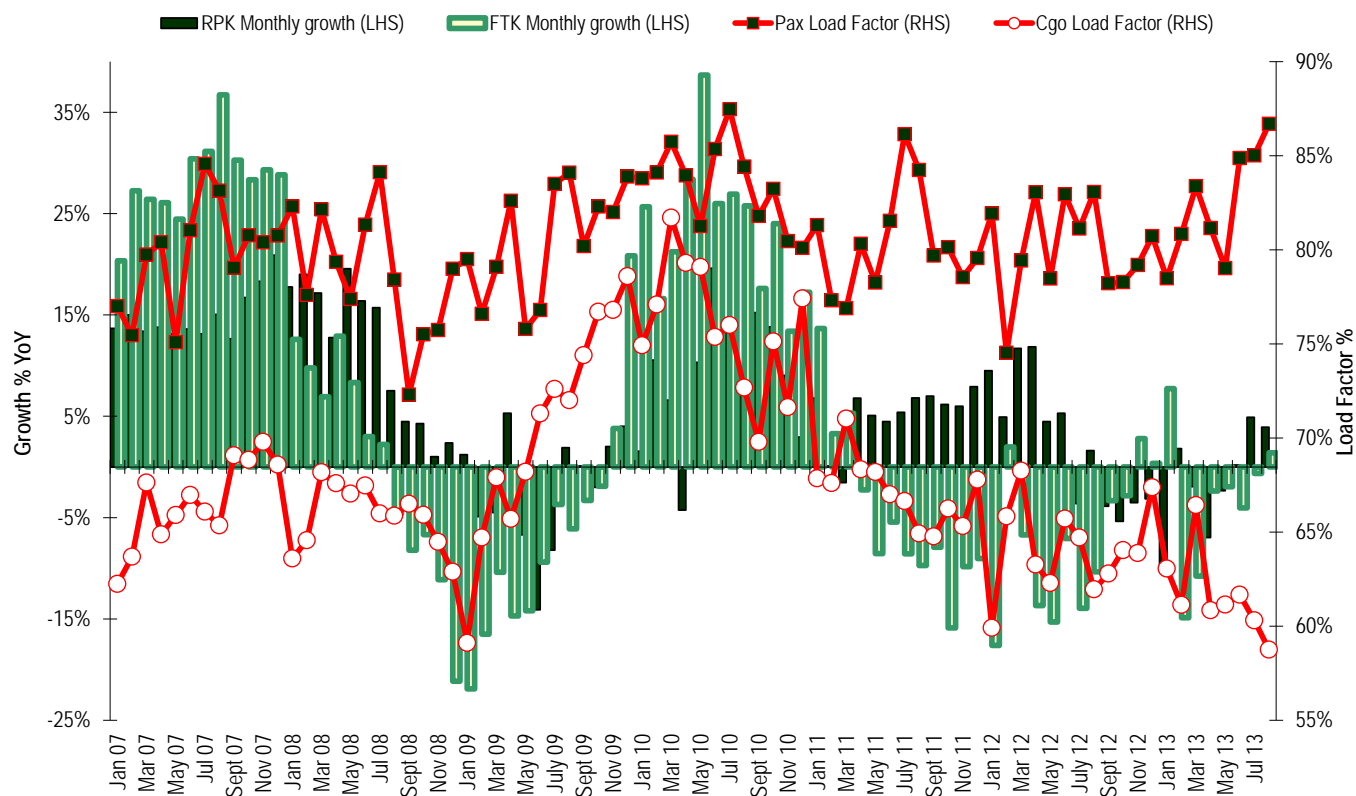
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0293.HK: Fiscal year end 31-Dec						Price: HK\$14.58; TP: HK\$15.70; Market Cap: HK\$57,355m; Recomm: Neutral					
Profit & Loss (HK\$m)	2011	2012	2013E	2014E	2015E	Valuation ratios	2011	2012	2013E	2014E	2015E
Sales revenue	98,406	99,376	99,760	105,030	109,904	PE (x)	10.0	29.4	19.5	12.1	10.1
Cost of sales	-92,656	-96,838	-96,127	-99,489	-103,608	PB (x)	1.0	1.0	1.0	0.9	0.9
Gross profit	5,750	2,538	3,633	5,540	6,296	EV/EBITDA (x)	4.6	6.3	6.1	5.3	4.9
Gross Margin (%)	5.8	2.6	3.6	5.3	5.7	FCF yield (%)	-6.2	-22.8	-8.0	-4.9	-2.2
EBITDA (Adj)	13,947	11,417	12,725	14,869	16,246	Dividend yield (%)	3.6	0.5	1.0	1.7	2.4
EBITDA Margin (Adj) (%)	14.2	11.5	12.8	14.2	14.8	Payout ratio (%)	36	16	20	21	24
Depreciation	-8,197	-8,879	-9,093	-9,328	-9,950	ROE (%)	10.0	1.6	4.2	7.9	8.9
{001763}	0	0	0	0	0	Cashflow (HK\$m)	2011	2012	2013E	2014E	2015E
EBIT (Adj)	5,750	2,538	3,633	5,540	6,296	EBITDA	13,947	11,417	12,725	14,869	16,246
EBIT Margin (Adj) (%)	5.8	2.6	3.6	5.3	5.7	Working capital	17,455	5,321	9,365	12,478	14,195
Net interest	-744	-884	-1,093	-1,328	-1,496	Other	-17,342	-8,859	-11,219	-13,885	-15,432
Associates	1,717	924	1,104	1,445	1,931	Operating cashflow	14,060	7,879	10,871	13,461	15,010
Non-op/Except	-250	-1,033	-550	0	0	Capex	-17,610	-20,975	-15,450	-16,300	-16,300
Pre-tax profit	6,473	1,545	3,094	5,658	6,730	Net acq/disposals	-449	1,607	0	0	0
Tax	-803	-417	-419	-695	-792	Other	4,581	-1,357	0	0	0
Extraord./Min.Int./Pref.div.	-169	-212	-280	-240	-250	Investing cashflow	-13,478	-20,725	-15,450	-16,300	-16,300
Reported net profit	5,501	916	2,395	4,722	5,688	Dividends paid	0	0	0	0	0
Net Margin (%)	5.6	0.9	2.4	4.5	5.2	Financing cashflow	4,724	17,617	500	500	0
Core NPAT	5,751	1,949	2,945	4,722	5,688	Net change in cash	5,306	4,771	-4,079	-2,339	-1,290
Per share data	2011	2012	2013E	2014E	2015E	Free cashflow to s/holders	-3,550	-13,096	-4,579	-2,839	-1,290
Reported EPS (\$)	1.40	0.23	0.61	1.20	1.45						
Core EPS (\$)	1.46	0.50	0.75	1.20	1.45						
DPS (\$)	0.52	0.08	0.15	0.25	0.35						
CFPS (\$)	3.57	2.00	2.76	3.42	3.82						
FCFPS (\$)	-0.90	-3.33	-1.16	-0.72	-0.33						
BVPS (\$)	14.19	14.24	14.70	15.65	16.75						
Wtd avg ord shares (m)	3,934	3,934	3,934	3,934	3,934						
Wtd avg diluted shares (m)	3,934	3,934	3,934	3,934	3,934						
Growth rates	2011	2012	2013E	2014E	2015E						
Sales revenue (%)	9.9	1.0	0.4	5.3	4.6						
EBIT (Adj) (%)	-50.7	-55.9	43.1	52.5	13.6						
Core NPAT (%)	-50.6	-66.1	51.1	60.4	20.5						
Core EPS (%)	-50.6	-66.1	51.1	60.4	20.5						
Balance Sheet (HK\$m)	2011	2012	2013E	2014E	2015E						
Cash & cash equiv.	19,597	24,182	19,552	16,466	13,799						
Accounts receivables	10,605	10,833	12,299	12,949	13,550						
Inventory	1,155	1,194	1,167	1,363	1,419						
Net fixed & other tangibles	87,882	100,052	99,454	103,767	109,947						
Goodwill & intangibles	0	0	0	0	0						
Financial & other assets	17,894	18,522	19,176	20,121	21,552						
Total assets	137,133	154,783	151,648	154,666	160,267						
Accounts payable	17,464	17,470	16,648	15,080	15,870						
Short-term debt	8,562	8,157	8,809	7,972	7,296						
Long-term debt	37,385	54,594	51,041	50,314	50,991						
Provisions & other liab	17,778	18,424	17,198	19,609	20,109						
Total liabilities	81,189	98,645	93,696	92,975	94,265						
Shareholders' equity	55,809	56,021	57,826	61,565	65,876						
Minority interests	135	117	126	126	126						
Total equity	55,944	56,138	57,952	61,691	66,002						
Net debt	26,350	38,569	40,298	41,820	44,488						
Net debt to equity (%)	47.1	68.7	69.5	67.8	67.4						

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For definitions of the items in this table, please click [here](#).

Passenger LF Improves, Cargo LF Declines

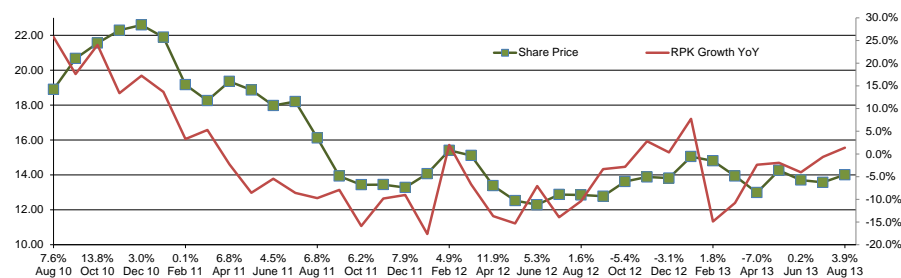
Figure 1. CX Operating Statistics Chart



Source: Company Report; Citi Research

Following the better passenger traffic growth trends, in the figure below we provide a look at the relationship between Cathay Pacific's share price and YoY RPK growth (which has exhibited a fairly decent (0.59) correlation since 2007). While we believe utilization and fleet growth/discipline have been one of the company's core differentiators YTD, the shares have less of a positive relationship with passenger load factor historically.

Figure 2. Cathay Pacific Share Price versus PRK Growth YoY % (Aug 2007-Present)



Source: Bloomberg; Company reports; Citi Research

Figure 3. CX Monthly Operating Statistics

	13-Jan	13-Feb	13-Mar	13-Apr	13-May	13-Jun	13-Jul	13-Aug	% Change YoY	YTD	% Change YTD	YTD % of Total
Traffic - RPK (mil)												
- China	633	691	702	676	622	664	775	788	7.3%	5,552	4.5%	8.0%
- Europe	1,485	1,291	1,564	1,462	1,504	1,646	1,886	1,827	11.3%	12,667	2.0%	18.2%
- South West Pacific & South Africa	1,346	1,215	1,142	1,106	995	1,087	1,182	1,178	5.5%	9,252	-1.2%	13.3%
- North America	2,162	1,862	2,195	2,205	2,390	2,360	2,378	2,460	-3.6%	18,011	-10.3%	25.9%
- North East Asia	978	1,050	1,145	1,083	976	1,102	1,207	1,267	7.9%	8,806	7.3%	12.7%
- Southeast Asia	1,155	1,160	1,247	1,186	1,195	1,215	1,280	1,346	0.8%	9,783	3.5%	14.1%
- India, ME, Pakistan and Sri Lanka	648	594	719	673	697	713	666	712	7.2%	5,423	-4.3%	7.8%
RPK total (mil)	8,407	7,862	8,715	8,392	8,379	8,787	9,375	9,577	3.9%	69,495	-1.4%	100.0%
Passengers carried ('000)	2,327	2,340	2,550	2,456	2,339	2,485	2,679	2,750	5.3%	19,926	2.6%	
Cargo and mail tonne km (mil)	724	574	761	682	679	705	715	712	1.4%	5,551	-3.4%	
Freight carried (mil kg)	133	104	137	124	122	122	123	123	0.3%	986	-1.5%	
Number of flights	5,982	5,450	5,941	5,864	5,939	5,846	6,175	6,197	5.1%	47,394	5.2%	
Capacity - ASK (mil)												
- China	957	890	958	955	960	938	995	999	5.7%	7,653	6.0%	9.1%
- Europe	1,745	1,537	1,748	1,713	1,799	1,775	2,008	1,992	7.2%	14,316	-1.8%	17.0%
- South West Pacific & South Africa	1,636	1,463	1,452	1,413	1,423	1,396	1,441	1,436	0.4%	11,660	-5.8%	13.8%
- North America	2,441	2,183	2,438	2,531	2,622	2,543	2,636	2,653	-7.1%	20,047	-12.4%	23.8%
- North East Asia	1,448	1,400	1,410	1,364	1,356	1,338	1,511	1,486	-0.3%	11,312	0.7%	13.4%
- Southeast Asia	1,572	1,416	1,508	1,488	1,536	1,480	1,562	1,600	-2.1%	12,163	3.1%	14.4%
- India, ME, Pakistan and Sri Lanka	912	837	938	876	907	884	873	880	0.1%	7,108	-3.4%	8.4%
ASK total (mil)	10,711	9,725	10,452	10,341	10,603	10,354	11,026	11,047	-0.4%	84,259	-3.7%	100.0%
Passenger load factor	78.5%	80.8%	83.4%	81.2%	79.0%	84.9%	85.0%	86.7%	363bp	82.5%	187bp	
Available cargo/mail tonne km (mil)	1,148	939	1,145	1,121	1,110	1,143	1,186	1,211	6.9%	9,004	0.3%	
Cargo and mail load factor (%)	63.0%	61.1%	66.4%	60.8%	61.1%	61.7%	60.3%	58.7%	-320bp	61.7%	-238bp	
ATK (mil)	2,167	1,864	2,139	2,105	2,118	2,127	2,234	2,262	3.4%	17,016	-1.6%	

Source: Company Report; Citi Research

While Cathay Air Cargo tonnage only improved modestly YoY, the positive inflection in August was the first YoY growth observed in the last six months. Beginning in September the YoY Air Cargo comps are slightly more difficult, however, new product launches by the likes of Apple, Sony and Microsoft, amongst others, could provide some much needed peak season volume. That said, the volume last year associated with new tech product launches (see our note regarding the [2012 iPhone 5 launch](#)) failed to have the impact on HK airfreight volumes to the extent we were expecting initially. That said, the added demand for regional airfreight capacity did push up yields across the board.

For detail on this year's iPhone 5 launch, [see our new note by Citi Tech Analyst Wei Chen](#) – according to analyst expectations, the iPhone 5S/5C build plan in 2H13 stays largely the same as our previous estimates but highlights the possibility of builds being front-end loaded as both China and Japan (NTT DoCoMo) will be included in the first wave of regional launch for the first time. Also we are less optimistic on higher than expected sell-thru given limited surprise as highlighted by Citi analyst Glen Yeung's note (Will Apple's New Products Provide a Second Wind?). In 3Q/4Q, we estimate builds of iPhone 5S to be around 5mn/30mn, iPhone 5C to be 10mn/25mn, and iPhone 4S to be 6mn/5mn.

Cathay Air Cargo Facility Ramping; Environment Remains Challenging

On February 21st, CX commenced operations at its new HK\$5.9bn (US\$750m) Cargo Handling Terminal, adding 2.6m tonnes in new air cargo handling capacity at Hong Kong International Airport, representing a 50% increase to existing handling capacity. That said, as the world's largest air cargo center, we believe the ongoing investment made by Cathay to modernize its cargo handling facilities, will secure its

position within the market as the preeminent carrier longer term (aided further by its air cargo JV in the Mainland with Air China).

With 1.6m tonnes of Air Cargo during 2012, CX captured ~56% of the total throughput at HACTL and ~39% of the total at HKIA (which declined over 300bp YoY as Cathay lost share, likely as smaller freight forwarders cut prices to win volumes in a challenging environment).

Figure 5. CX' New Cargo Facility at HKIA



Source: Cathay Pacific; Citi Research

Figure 4. Cathay Pacific, HACTL and Total HKIA Air Cargo Tonnage Reconciliation

	CX	HKIA	CX % of HKIA	HACTL	CX % of HACTL
2011	1,650,971	3,937,000	41.9%	2,718,974	60.7%
2012	1,562,369	4,026,000	38.8%	2,776,828	56.3%
YoY	-5.4%	2.3%	(313bp)	2.1%	(446bp)
7M13	863,472	2,303,000	37.5%	1,534,069	56.3%
YoY	-1.8%	1.9%	(131bp)	-1.6%	0bp

Source: Cathay Pacific, CEIC; HACTL, HKIA; Citi Research estimates

As Cathay is still ramping up full export operations (at least through July, the most recent data point for all three of the data series show above), CX continues to comprise 56% of HACTL volume YTD, but has lost some share of the total HK market (at 37.5% YTD, down another 130bp YoY), possibly reflecting relatively better express parcel volumes (vs heavy airfreight) and/or cost cutting by smaller freight forwarders. **Full 4Q data will provide a far cleaner picture of the ongoing market share split in our view, but the August data point alone maybe an early indicator as CX' share of the total HACTL volume rose to 65% (from 56% YTD and in 2012 on average).**

In the figure below, we also provide a look at HK Export growth by value (and by type of transportation). Total Exports by value in July improved 11% YoY, above expectations, driven in part by 20% growth in Exports by Air, although both likely reflect an easy year ago comp (as those figures declined 3% and 7% YoY a year ago, respectively).

Figure 6. Hong Kong Exports by Value (through July 2013)

	HK: Exports		by Air		by Land		by Ocean		by River	
	HKD m	YoY	HKD m	YoY	HKD m	YoY	HKD m	YoY	HKD m	YoY
Jan-12	259300.0	-9%	85514.3	-7%	94286.1	-11%	68120.6	-4%	10000.2	-29%
Feb-12	259749.9	14%	90243.3	21%	105859.9	17%	50760.4	1%	11090.7	-1%
Mar-12	262425.5	-7%	92665.9	-5%	100509.7	-7%	56621.0	-7%	11040.7	-20%
Apr-12	266252.8	6%	91112.7	7%	98825.0	7%	63862.4	4%	10677.5	-6%
May-12	294505.5	5%	100527.7	7%	114573.0	13%	66012.3	-5%	11301.7	-8%
Jun-12	278227.6	-5%	99456.7	0%	102157.0	-3%	65201.3	-10%	9548.7	-25%
Jul-12	276207.8	-3%	90591.1	-7%	104162.7	4%	69239.2	-7%	10425.5	-15%
Aug-12	311657.3	1%	100928.5	1%	125253.7	11%	71885.7	-12%	11504.4	-15%
Sep-12	313160.6	15%	103546.8	11%	126739.1	31%	70314.2	2%	10778.9	0%
Oct-12	297027.4	-3%	99021.8	-4%	119720.5	6%	66111.5	-10%	10244.6	-25%
Nov-12	307767.1	10%	100349.9	7%	129934.7	26%	64755.7	-4%	10914.2	-13%
Dec-12	310963.6	14%	101689.3	12%	122806.2	21%	72745.9	11%	11252.7	-5%
Jan-13	304818.3	18%	100091.8	17%	122824.5	30%	68321.0	0%	11791.9	18%
Feb-13	215741.6	-17%	76990.1	-15%	83086.0	-22%	45913.4	-10%	8185.4	-26%
Mar-13	291710.9	11%	105773.3	14%	119080.4	18%	53907.6	-5%	10921.4	-1%
Apr-13	290266.5	9%	100286.5	10%	120031.5	21%	56919.6	-11%	10459.6	-2%
May-13	291541.7	-1%	100151.3	0%	118886.1	4%	59306.0	-10%	11041.1	-2%
Jun-13	277636.8	0%	97460.2	-2%	106167.8	4%	62458.5	-4%	9563.3	0%
Jul-13	305413.4	11%	108771.2	20%	116535.1	12%	67273.6	-3%	10573.4	1%
YoY										
2012		3%		3%		9%		-4%		-14%
7M13		4%		6%		9%		-6%		-2%

Source: CEIC; Citi Research

Figure 7. Brent and Singapore Jet Fuel Price

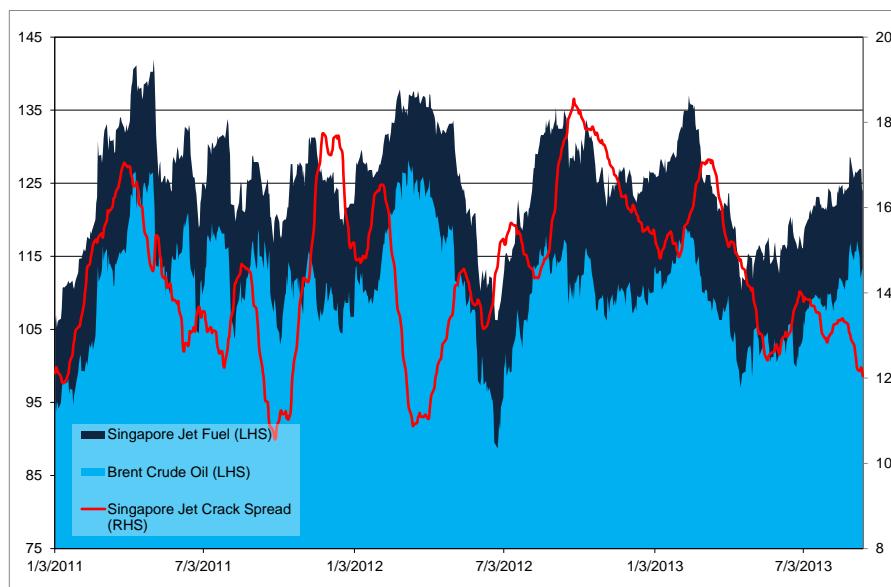
	Jet Fuel (USD/bbl)	Brent (USD/bbl)	Spread
2000	34.5	28.4	6.1
2001	28.5	24.4	4.1
2002	28.2	25.0	3.2
2003	32.7	28.8	3.9
2004	47.3	38.2	9.0
2005	68.4	54.5	13.9
2006	80.8	65.2	15.7
2007	87.2	72.5	14.6
2008	121.5	96.9	24.6
2009	70.4	61.6	8.8
2010	90.3	79.6	10.7
2011	125.7	111.4	14.3
2012	126.7	111.7	15.0
2013YTD	122.4	108.4	14.1

Source: Bloomberg; Citi Research

Jet Fuel Price Trends

At present, we are projecting an average 2013 Brent and Singapore Jet Fuel price of US\$105/bbl and US\$120/bbl, respectively. YTD, Brent and Singapore Jet Fuel are tracking at US\$108/bbl and US\$122/bbl, but US\$114 and US\$126/bbl in the month of September.

Figure 8. Brent and Singapore Jet Fuel Price Chart (2011-Present)



Source: Bloomberg; Citi Research

While the average price of fuel has increased from 2Q levels into Syria-related concerns, during 2H13 we expect Cathay will benefit from the better efficiency of its new 777s (see below, replacing its older 747-400s).

Operating Assumptions, Estimates and Fleet Outlook

In the figure below, we provide a look at our operating assumptions for FY13/14 as well as how our earnings estimates stack up against consensus. See the full Income statement below.

Figure 9. Cathay Pacific – Citi Forecasts vs Cons

	2011A	2012A	2013E	2014E
RPK Growth	5.1%	2.3%	1.5%	4.0%
ASK Growth	9.2%	2.6%	1.0%	4.5%
FTK Growth	-5.2%	-7.3%	-3.5%	4.2%
AFTK Growth	6.9%	-3.1%	-0.7%	3.9%
Pax. Yield per RPK	0.668	0.675	0.686	0.698
Cargo Yield per FTK	2.693	2.746	2.636	2.636
Operating Margin	5.8%	2.6%	3.6%	5.3%
EBITDAR margin	15.4%	12.9%	14.5%	15.9%
Adjusted Net Profit	5,751	1,949	2,945	4,722
Adjusted EPS	1.46	0.50	0.75	1.20
EPS Growth YoY	-51%	-66%	51%	60%
Consensus Net Profit			2,468	4,450
Citi vs Cons (as of 9/16/13)			19%	6%
Consensus EPS			0.64	1.11
			17%	8%

Source: Company Reports; Bloomberg; Citi Research estimates

In total, CX now has 83 aircraft on order through 2020. While we believe CX can manage the HK\$26bn in anticipated CapEx over the next three years, the 60% debt to equity ratio at mid year is just below the level at year-end 2009.

Figure 10. Cathay Pacific Fleet Profile as of June 30th, 2013

	Leased			Total	Year-end Est			Firm Orders			Lease Expiry					Purchas e	
Aircraft type	Owned	Finance	Operating	1H13A	2013	2014	2H13E	2014E	2015E+	Total	2013	2014	2015	2016	2017	2018+	Rights
Aircraft operated by Cathay Pacific:																	
A330-300	14	15	8	37	39	44	2	5	3	10			2	1	3	2	
A340-300	6	5	0	11	11	11				0							
A350-900				0	0	0			22	22							
A350-1000				0	0	0			26	26							
747-400	13		1	14	13	7	(1)	(6)		(7)			1				
747-200F/777-200F				0	0	0				0							
747-400F	3	3		6	6	5		(1)		(1)							
747-400BCF	1		1	2	2	2				0						1	
747-400ERF		6		6	6	6				0							
747-8F	0	9		9	13	13	4			4							
777-200	5	0		5	5	5				0							5
777-300	7	5		12	12	12				0							
777-300ER	5	11	16	32	38	46	6	8	4	18					2	14	0
Total	54	54	26	134	145	151	11	6	55	72	0	0	3	1	5	17	5
Growth %				-1%	5%	4%											
Aircraft operated by Dragonair:																	
A320-200	5		10	15	15	15				0			2	2		6	
A321-200	2		4	6	6	8		2		2			2	2			
A330-300	4	1	13	18	16	16	(1)			(1)	4	3	1	2	2		
Total	11	1	27	39	37	39	(1)	2	0	1	4	3	5	6	2	6	
Aircraft operated by AHK:																	
A300-600F/747-400 BCF	2	6	3	11	11	11				0				1	2		
Grand Total	67	61	56	184	193	201	10	8	55	73	4	3	8	8	9	23	5

Source: Company reports; Citi Research

Figure 11. Cathay Pacific - Financial Statements

Year to 31 December	2009A	2010A	2011A	1H12	2H12	2012A	1H13	2H13E	2013E	2014E	2015E
Revenues:											
Passenger Services	45,920	59,354	67,778	34,713	35,420	70,133	34,978	37,297	72,275	76,502	80,241
Cargo Services	17,255	25,901	25,980	11,897	12,658	24,555	11,278	11,472	22,750	23,698	24,737
Catering, Other Services & Recoveries	3,803	4,269	4,648	2,251	2,437	4,688	2,328	2,407	4,735	4,830	4,926
Total Revenues	66,978	89,524	98,406	48,861	50,515	99,376	48,584	51,176	99,760	105,030	109,904
Growth YoY %	-23%	34%	10%	4%	-2%	1%	-1%	1%	0%	5%	5%
Expenses:											
Staff	12,618	13,850	14,772	8,046	8,117	16,073	8,432	8,581	17,013	17,973	19,071
Route (Inflight Svc, Pax Exp, Landing, Parking, etc)	13,373	14,609	16,899	8,693	8,927	17,620	8,654	8,932	17,586	18,327	18,686
Fuel, Net of Hedging Gains	17,349	28,276	38,877	20,407	20,063	40,470	18,674	19,547	38,221	38,509	40,099
Aircraft Maintenance	6,567	7,072	8,468	4,643	3,554	8,197	3,861	3,940	7,801	8,717	8,902
Aircraft Depreciation & Opt Leases	7,978	8,288	8,197	4,415	4,464	8,879	4,565	4,528	9,093	9,328	9,950
Other Depreciation, Amortization & Opt Leases	1,103	1,107	1,205	669	763	1,432	889	889	1,778	1,833	1,895
Commissions	571	736	791	388	389	777	386	410	796	842	883
Others	2,940	3,915	3,447	1,627	1,763	3,390	2,088	1,753	3,841	3,960	4,121
Operating Expenses	62,499	77,853	92,656	48,888	48,040	96,838	47,549	48,578	96,127	99,489	103,608
Growth YoY %	-34%	25%	19%	11%	-1%	5%	-3%	1%	-1%	3%	4%
Growth Ex Fuel YoY %	-4%	10%	8%	12%	-1%	5%	1%	4%	3%	5%	4%
Operating Margin	6.7%	13.0%	5.8%	-0.1%	4.9%	2.6%	2.1%	5.1%	3.6%	5.3%	5.7%
Change in Operating Margin (YoY)	1542bp	635bp	-719bp	-604bp	-82bp	-329bp	219bp	18bp	109bp	163bp	45bp
Operating Profit/(Loss)	4,479	11,671	5,750	(27)	2,475	2,538	1,035	2,598	3,633	5,540	6,296
EBITDAR	13,560	21,066	15,152	5,057	7,702	12,849	6,489	8,014	14,503	16,702	18,141
Growth YoY %	N/A	55%	-28%	-32%	0%	-15%	28%	4%	13%	15%	9%
EBITDA	12,457	19,959	13,947	4,388	6,939	11,417	5,600	7,125	12,725	14,869	16,246
Growth YoY %	N/A	60%	-30%	-36%	-2%	-18%	28%	3%	11%	17%	9%
Net Finance Charges	(847)	(978)	(744)	(381)	(503)	(884)	(542)	(551)	(1,093)	(1,328)	(1,496)
Exceptional Items	1,254	2,415	(250)	(567)	(466)	(1,033)	(350)	(200)	(550)	0	0
Share of Profits/(Losses) of Associated Companies	261	2,587	1,717	212	808	924	195	909	1,104	1,445	1,931
Profit/(Loss) Before Taxation	5,147	15,695	6,473	(763)	2,314	1,545	338	2,756	3,094	5,658	6,730
Taxation	(283)	(1,462)	(803)	(57)	(248)	(417)	(173)	(246)	(419)	(695)	(792)
Profit/(Loss) After Taxation	4,864	14,233	5,670	(820)	2,066	1,128	165	2,510	2,675	4,962	5,938
Minority Interests	(170)	(185)	(169)	(109)	(103)	(212)	(141)	(139)	(280)	(240)	(250)
Profit/(Loss) Attributable to Shareholders	4,694	14,048	5,501	(929)	1,963	916	24	2,371	2,395	4,722	5,688
Realized and Unrealized Fuel Hedging Losses/(Gains)	-2,758	41									
Profit/(Loss) Excl Exceptional Items	682	11,674	5,751	(362)	2,311	1,949	374	2,571	2,945	4,722	5,688
Growth YoY %	N/A	N/A	-51%	-113%	-21%	-66%	-203%	11%	51%	60%	20%
Diluted EPS	1.19	3.57	1.40	-0.24	0.50	0.23	0.01	0.60	0.61	1.20	1.45
Diluted EPS Excl Exceptionals	0.17	2.97	1.46	-0.09	0.59	0.50	0.10	0.65	0.75	1.20	1.45
Growth YoY %	N/A	N/A	-51%	-113%	-66%	N/A	N/A	11%	51%	60%	20%
Shares Outstanding (millions)	3,934	3,934	3,934	3,934	3,934	3,934	3,934	3,934	3,934	3,934	3,934
Dividend	393	4,367	2,046			315	236	354	590	984	1,377
DPS	0.10	1.11	0.52	0.00	0.08	0.08	0.06	0.09	0.15	0.25	0.35
Payout Ratio	57.6%	37.4%	35.6%			16.2%	63.1%	13.8%	20.0%	20.8%	24.2%

Source: Company, Citi Research estimates

Cathay Pacific

Company description

Cathay Pacific Airways operates scheduled passenger and cargo flights and provides related services (such as in-flight catering and ground handling) to airlines flying to/from Hong Kong International Airport. Including Dragonair and Air Hong Kong, Cathay Pacific operates a passenger and freighter fleet of 184 aircraft and is a member of the One World global alliance. Cathay also owns a 60% stake in Air Hong Kong (a joint venture with DHL) and a ~20% stake in Air China. The company has 81 aircraft on order for delivery between August 2013-2020 (but is also retiring a number of its 744s through early 2014).

Investment strategy

CX' higher relative exposure to the cyclical premium passenger and air cargo business is likely to limit share price appreciation near term. However, easy comps in 2H13E and moderating fuel prices provide some relief. While excess capacity has been cut along certain long-haul lanes, Hong Kong Airlines has exited the HK-London route and management has announced a rash of cost-saving measures, we are on the sidelines until the demand/labor environment improves. As a result, we rate CX shares Neutral.

Valuation

Our HK\$15.70 TP reflects ~1.2x our FY13E tangible P/B of HK\$12.75/share (which is a half standard deviation discount to its mean tangible P/B of 1.4x). We are using a discounted multiple to reflect the deteriorating fundamentals within the company's premium passenger and cargo operations.

Risks

Major downside risks that could cause the stock to trade below our target price include rising fuel prices (specifically a oil shock associated with a military incursion in Iran), declining yields (net of fuel) due to weakening passenger demand, continued poor airfreight utilization rates, and weaker contribution from its associates (Air China, 19.5% held by Cathay) and/or Air China Cargo JV. Upside risks include, better premium business demand, an increase in air cargo tonnage and improvement in the European macro outlook.

Appendix A-1

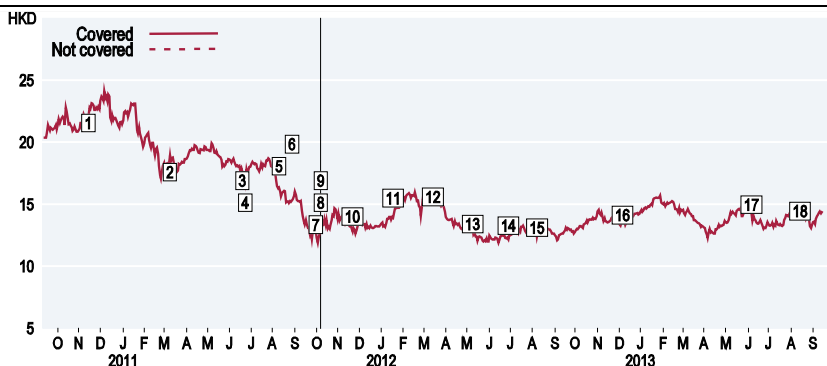
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Cathay Pacific (0293.HK) Ratings and Target Price History Fundamental Research

Analyst: Michael Beer
Covered since March 9 2011



Date	Rating	Target Price	Closing Price
1 15-Nov-10	2L	*23.75	22.05
2 9-Mar-11	2L	*19.50	18.94
3 19-Jun-11	2L	*19.00	17.92
4 23-Jun-11	2L	*18.50	16.90
5 10-Aug-11	2L	*17.00	16.34
6 28-Aug-11	2L	*16.50	15.18

* Indicates change

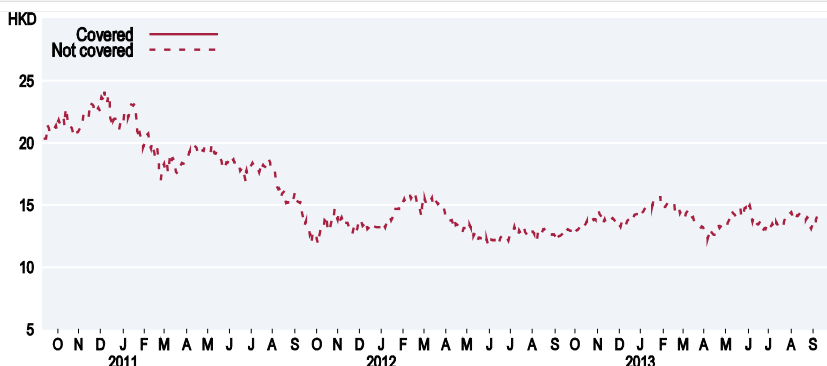
Date	Rating	Target Price	Closing Price
7 30-Sep-11	2L	*13.00	12.80
8 7-Oct-11	Stock rating system changed		
9 7-Oct-11	*2	13.00	13.20
10 22-Nov-11	*3	*10.50	12.80
11 18-Jan-12	3	*11.00	13.92
12 14-Mar-12	*1	*17.50	15.14

Date	Rating	Target Price	Closing Price
13 9-May-12	1	*15.25	13.36
14 28-Jun-12	1	*16.00	12.14
15 8-Aug-12	1	*14.25	12.36
16 6-Dec-12	*2	14.25	13.70
17 6-Jun-13	2	*15.75	14.16
18 14-Aug-13	2	*16.70	14.26

Rating/target price changes above reflect Eastern Standard Time

Cathay Pacific (0293.HK) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Michael Beer
Covered since March 9 2011



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Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2013

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell

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% of companies in each rating category that are investment banking clients	53%	50%	45%	58%	51%	49%

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