Event update

Aviation

Return to profitability!

8 June 2010
BSE Sensex: 16781

Aviation

'The global economy is recovering from the depths of the financial crisis much more quickly than could have been anticipated' - IATA Chief Executive Officer Giovanni Bisignani

IATA released a revised financial forecast for 2010 yesterday. Ahead of earlier estimates, the global commercial aviation industry is expected to return to profitability after two consecutive years of losses. With the assumption that crude will average at $79/b in 2010, IATA expects the industry to report a net profit of $2.5bn in 2010 as against earlier expectations of a net loss of $2.8bn (March 2010 forecast) and a net loss of $5.5bn (Jan 2010 forecast). The profit would be the industry's first since 2007 and only the third in the last decade. Asia-Pacific carriers are expected to see the strongest revival and report a net profit of $2.2bn this year. The exception to this improved outlook is Europe, which is the only region still forecast to lose money in 2010. The 'recovery' is expected to be demand led - IATA has significantly upgraded its forecasts for air travel and air cargo growth, to 7.1% (against March 2010 forecast of 5.6%) and 18.5% (against March 2010 forecast of 12%). Load factors have reached record levels as capacity returns to the market at a slower pace than the revival in demand. Going ahead, overall passenger traffic is expected to grow >2X capacity, supporting an overall 4.5% increase in yields. Evident in the return to profits, Indian aviation too is set for a take off with increasing traffic, improving yields and a limited supply of 6-8% of the existing fleet in FY11E.

Jet Airways – Turnaround: Post hitting the peak traffic levels in FY10, the Indian aviation sector is expected to see continued traction in passenger growth (for Apr-10, Indian aviation reported a 26.3% growth at 4.1m). With calibrated increase in capacity and traffic expected to grow 2X supply, yields and loads for the Indian aviation industry are expected to improve going ahead. With the cost curve of the industry at its bare bones, we expect the industry to return to profitability after 3 years of consistent losses. We expect Jet to move from a Rs4bn loss in FY10 to a profit of Rs6.8bn in FY11. With Jet returning to profitability, funding does not remain a critical overhang. With the industry in a sweet spot (global and Indian aviation traffic crossing peak levels) and lowered funding concerns, we expect the stock to see momentum over the next few quarters. Maintain outperformer with a price target of 700.

Global commercial airlines – Returning to profitability (ex - Europe)

	EBIT (%)			Net profits (US $ bn)			
	2008	2009	2010F	2008	2009	2010E (June 2010E)	2010E (Jan 2010E)
Global	(1.6)	(0.3)	2.3	(16.1)	(9.9)	2.5	(5.5)
North America	(1.8)	1.2	3.4	(9.6)	(2.7)	1.9	(2.0)
Europe	0.1	(2.2)	(1.1)	-	(4.3)	(2.8)	(2.5)
Asia Pac	(4.7)	-	4.7	(4.7)	(2.7)	2.2	(0.7)
Middle East	1.0	(1.5)	1.6	(0.3)	(0.6)	0.1	(0.3)
Latin America	2.3	2.7	4.5	(1.4)	0.5	0.9	0.1
Africa	(0.9)	(0.9)	0.9	(0.1)	(0.1)	0.1	(0.1)

Source: IATA; numbers are excluding exceptional items

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Revival in passenger and freight volumes, ahead of capacity growth

System-wide global commercial airlines	Traffic (TKP) %			Capacity (ATK) %		
	2008	2009	2010F	2008	2009	2010F
Global	(0.1)	(4.3)	10.2	0.7	(4.9)	5.4
North America	(2.4)	(7.3)	8.2	(2.8)	(6.5)	4.0
Europe	0.9	(8.7)	2.9	2.9	(5.7)	-
Asia Pac	(0.2)	(3.2)	16.2	0.6	(7.5)	8.3
Middle East	3.6	8.5	19.5	4.7	11.1	15.9
Latin America	3.3	-	13.9	3.2	1.3	9.6
Africa	5.1	(5.4)	13.5	7.2	(1.5)	9.5

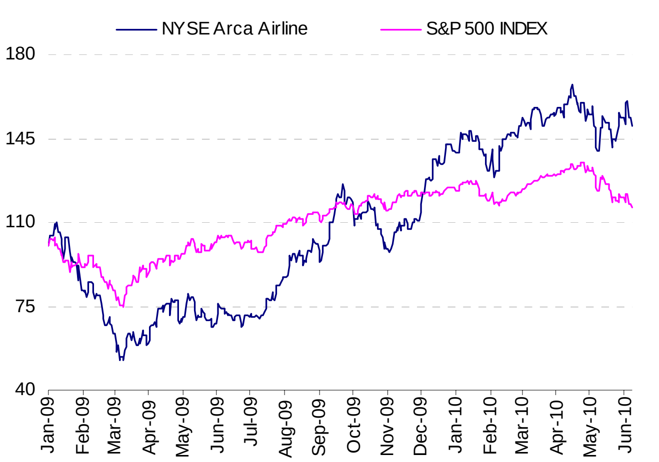
Source: IATA

Global Aviation P&L

	2001	2002	2003	2004	2005	2006	2007	2008	2009E	2010F
Revenues $bn	**307**	**306**	**322**	**379**	**413**	**465**	**510**	**564**	**483**	**545**
yoy%	*(6.4)*	*(0.3)*	*5.2*	*17.7*	*9.0*	*12.6*	*9.7*	*10.6*	*(14.4)*	*12.8*
Passenger	239	238	249	294	323	365	398	439	369	414
Cargo	39	38	40	47	48	53	59	64	49	61
Pax mn	**1640**	**1639**	**1691**	**1888**	**2022**	**2124**	**2281**	**2271**	**2224**	**2382**
Pax growth tkp %	*(2.7)*	*1.0*	*2.3*	*14.9*	*7.0*	*5.4*	*5.7*	*0.4*	*(2.1)*	*7.1*
World economic growth %	*2.2*	*2.7*	*2.8*	*4.2*	*3.4*	*4.0*	*3.8*	*1.7*	*(2.2)*	*3.1*
Pax yield %	**(4.0)**	**(1.7)**	**2.4**	**2.6**	**2.7**	**7.4**	**3.0**	**9.9**	**(12.0)**	**4.5**
Expenses $bn	319	310	323	376	409	450	490	573	484	533
yoy%	*0.5*	*(2.8)*	*4.2*	*16.4*	*8.8*	*10.0*	*8.9*	*16.9*	*(15.5)*	*10.1*
Fuel	43	40	44	65	91	107	134	189	113	140
% of expenses	*13*	*13*	*14*	*17*	*22*	*24*	*27*	*33*	*23*	*26*
Crude oil price, brent, $/b	24.7	25.1	28.8	38.3	54.5	65.1	73	99	62	79
Non fuel	276	270	279	311	318	343	354	368	345	350
cents per atk (non-fuel unit cost)	39.7	38.8	38.9	39.5	38.7	40.1	39.4	42.4	43.1	43.3
Breakeven load factor %	61.3	61.9	61.1	61.9	62	61.3	60.3	63.8	63.4	64.5
Weight load factor achieved %	59	60	60.8	62.5	62.6	63.3	63.3	62.8	63.2	66.1
Operating profit $bn	(11.8)	(4.8)	(1.4)	3.3	4.3	15.0	19.9	(8.9)	(1.2)	12.7
% margins	*(3.8)*	*(1.6)*	*(0.4)*	*0.9*	*1.0*	*3.2*	*3.9*	*(1.6)*	*(0.3)*	*2.3*
Net profit $bn	**(13.0)**	**(11.3)**	**(7.5)**	**(5.6)**	**(4.1)**	**3.6**	**12.9**	**(16.0)**	**(9.9)**	**2.5**
%margin	*(4.2)*	*(3.7)*	*(2.3)*	*(1.5)*	*(1.0)*	*0.8*	*2.5*	*(2.8)*	*(2.1)*	*0.5*

Source : IATA

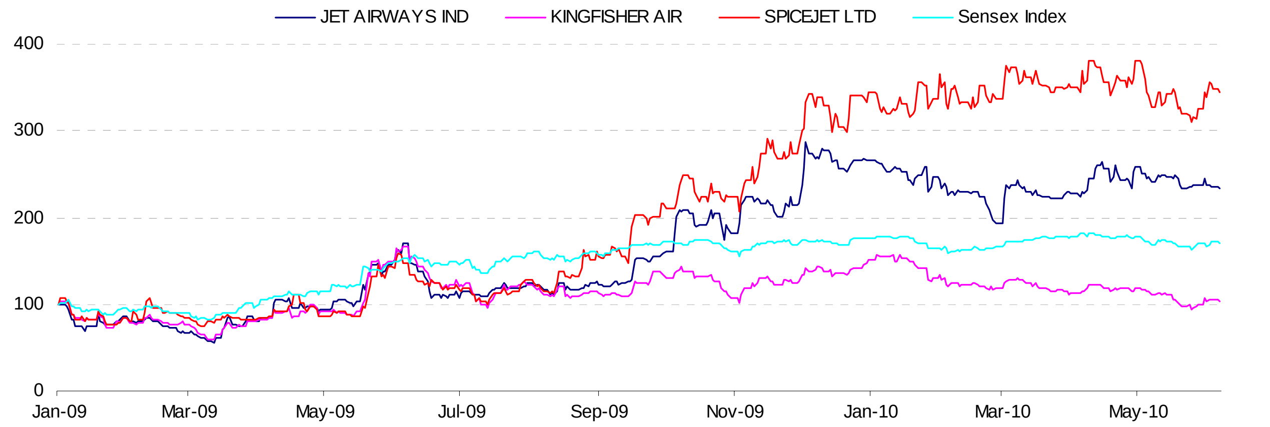
US Aviation: Riding the cycle of hope



Company Name	Mkt Cap (USDmn)
Alaska Air Group Inc	1,688
AMR Corp	2,562
Continental Airlines Inc	2,971
Delta Air Lines Inc	10,338
Gol Linhas Aereas Inteligentes SA	3,127
JetBlue Airways Corp	1,779
Lan Airlines SA	6,159
Ryanair Holdings PLC	7,563
Skywest Inc	725
Southwest Airlines Co	8,680
Tam SA	1,934
UAL Corp	3,406
US Airways Group Inc	1,347

Source: Bloomberg

Indian Aviation: Relative price performance



Source: Bloomberg

Global Valuations

Name	EV (US$)	Mkt Cap (US$ m)	Sales ($m) 2010Y	Sales ($m) 2011Y	Net Income 2010Y	Net Income 2011Y	PE(x) 2010Y	PE(x) 2011Y	PB (x) 2010Y	PB (x) 2011Y	EV/EBITDA (x) 2010Y	EV/EBITDA (x) 2011Y
Continental	6,009	2,971	14,330	15,217	487	614	6.6	5.4	2.8	1.7	4.5	4.0
Delta Air	22,341	10,338	31,535	33,360	1,360	1,617	7.6	6.0	6.6	3.9	5.2	4.4
Cathay Pacific	12,651	8,096	10,070	11,161	505	672	16.3	12.2	1.4	1.3	8.4	7.1
British Airways*	5,011	3,285	12,334	13,120	46	364	189.8	10.2	1.2	1.1	3.5	2.7
Air France KLM*	11,869	3,554	26,800	28,315	(449)	294	NA	14.1	0.5	0.5	6.9	4.3
Deutsche Luftanza	9,022	5,901	30,316	31,925	12	463	10,770.0	13.1	0.8	0.8	3.8	2.9
Qantas Airways^	6,423	4,639	11,429	12,573	221	448	20.8	10.4	1.0	0.9	4.6	3.4
China Airlines	5,945	2,049	3,542	3,848	(2)	34	56.2	33.3	1.7	1.7	12.9	11.7
Eva Airways	4,020	1,598	2,628	2,857	97	120	17.0	13.4	2.1	1.9	11.2	10.0
Thai Airways	4,956	1,250	5,589	6,068	240	271	5.5	4.8	0.7	0.6	4.5	4.2
Singapore Airlines*	10,093	12,092	10,025	11,064	864	1,169	13.9	10.4	1.2	1.1	4.7	3.9
Kingfisher Air*	1,436	256	-	-	-	-	-	-	-	-	-	-
Jet Airways*	4,127	921	2,934	3,347	84	147	24.7	9.2	2.2	1.7	9.3	7.6
Southwest Air	9,382	8,680	11,815	12,700	498	674	17.1	12.0	1.5	1.4	5.6	4.5
Jet Blue	3,832	1,776	3,742	4,092	87	158	18.9	11.1	0.9	0.9	6.6	5.4
Ryan Air*	6,635	6,268	4,164	4,792	423	585	14.7	10.8	1.8	1.5	7.5	6.0
Airasia	2,856	1,071	1,086	1,248	161	180	6.4	5.6	1.1	1.0	6.5	5.5
Spice Jet*	378	320	-	-	-	-	-	-	-	-	-	-

*Source: Bloomberg; * follows FY (2009Y stands for FY10)*

Jet Airways

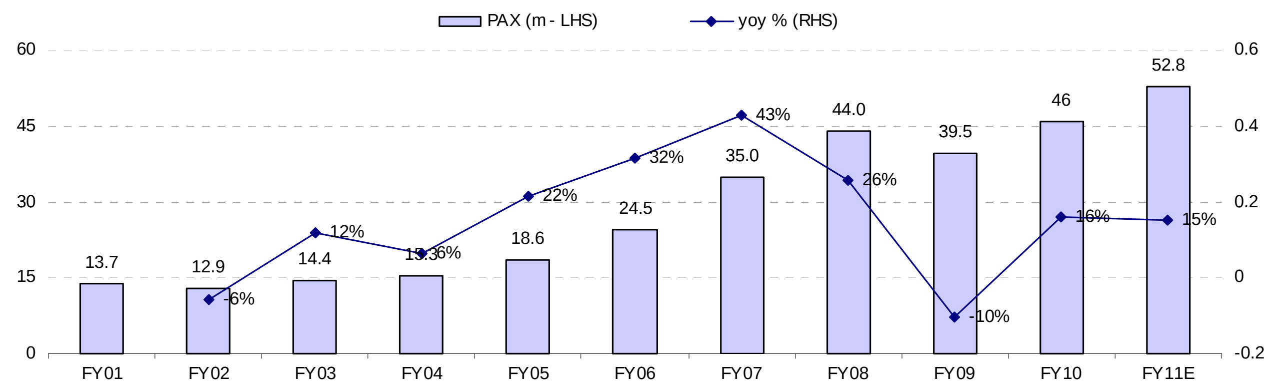
Rs486

Mkt Cap: Rs43bn; US$ 893bn

Post hitting the peak traffic levels in FY10, the Indian aviation sector is expected to see continued traction in passenger growth (for Apr-10, Indian aviation reported a 26.3% growth at 4.1m). With calibrated increase in capacity and traffic expected to grow 2X supply, yields and loads for the Indian aviation industry are expected to improve going ahead. With the cost curve of the industry at its bare bones, we expect the industry to return to profitability after 3 years of consistent losses. We expect Jet to move from a Rs4bn loss in FY10 to a profit of Rs6.8bn in FY11. With Jet returning to profitability, funding does not remain a critical overhang. With the industry in a sweet spot (global and Indian aviation traffic crossing peak levels) and lowered funding concerns, we expect the stock to see momentum over the next few quarters. Maintain outperformer with a price target of 700.

- **Traffic - Domestic Industry traffic on high growth path -12-15% increase in FY11:** Post a 10% decline in FY09, domestic passenger traffic – passenger traffic has reported a 16% growth at 46m – the highest passenger traffic till date. During the month of Apr-10, demand continued to be strong with a 26.3% yoy. The management believes that in line with the domestic economic recovery and a revival in corporate travel (70% of the domestic aviation market), domestic passenger traffic is expected to grow 12-15% in FY11.
- **Supply -Industry supply seeing a 'measured' induction – 6-8% increase in FY11:** Jet plans to add a net 3 aircrafts over the next 4-5 months. This includes a phase out of 7 CRJs and an induction of 4 737s and 6 ATRs. All other deliveries have been deferred for 18-24 months. Overall, the industry is likely to see a limited supply addition of 6-8% of the existing fleet capacity over the next 12-15 months.
- **Yields - Improving quality of yields:** Even though the fourth quarter is typically weaker than Q3, Revenue/ RPKM for the domestic market reported a 2% increase qoq and 12% decline yoy at 5.47. Domestic gross yields for Jet are currently over US$100/pax, which is above the global average. Revenue/RPKM for the international side reported a flattish growth qoq and 3% decline yoy at 2.83. International gross yields were at over $270/pax. Revenue/RPKM for Jetlite reported a 5.3% increase qoq and a 14.3% increase yoy at 4.0. With traffic increasing by ~2x supply, there is further room for loads and yields to increase.
- **Costs - At the bare bones:** ATF prices are pegged ~45% lower than the high touched in FY09, which has helped Jet significantly reduce the bleed. Coupled with other cost rationalization measures, Jet domestic has reported a significant 21.5% reduction in Cost/ASKM for the quarter. As a part of the cost reduction programme, employee headcount is down from 13,400 in Jan-09 to 11,500 in Mar-09. Currently, pilots and cabin crew account for ~40% of the employee expenses. Going forward, the company plans to recruit a higher number of Indian pilots versus expats, leading to further rationalization of costs (Expats which form 40% of the pilot base and have salaries higher by ~80%).
- **Redeliveries in Jetlite:** The average age of the Jetlite fleet is 8-9 years against the average age of the Jet fleet at 4-5 years. By Sept 2010, 7 CRJs and 2 classic B777s in the Jetlite fleet are expected to get redelivered and replaced by a B737 fleet. Management believes that coupled with the ability to charge higher yields, benefits through lower maintenance costs and better fuel utilization are expected to flow through. The current lease on these aircrafts is paid as per the contracts negotiated in 2007 – a significant premium to current rates; lease rentals on renewal of fleet is not expected to see a substantial increase.
- **International routes, all routes nearing breakeven:** With its strong domestic network capabilities feeding traffic on to the international routes, Jet has a relatively de-risked business model (international operations to contribute 51% of revenues in FY10). With seat factors stabilizing at >80% (US- 84%, UK – 90%, ASEAN– 78%, Gulf 73%, SAARC – 75%), all routes except US and UK are currently profitable. While there has been improvement in yields in the front end business class seats (~16% of the capacity), the economy class remains price sensitive.
- **Funding no more a critical event; higher visibility on restructuring balance sheet:** Jet reported a consolidated debt of US $3.03bn (which largely includes aircraft debt and working capital loans worth ~Rs3bn). With looming debt and outstanding liabilities at over $330m, Jet's ability to raise funds has been a key moniterbale. However, with increasing profitability, funding is no more a critical event. Sale and lease back of some of its assets (39 owned aircraft, leading to a net potential cash inflow of $390m) has been considered a potential source of funding. The management has indicated that the sale and lease back of ~10 assets is in the pipeline. Due to the ongoing arbitration with Sahara (hearing postponed to 1st week of July), Jet needs approval from the court to be able sell its assets. However the management believes that approval should not be a cause for concern. On the QIP side (shareholder approval for $400m; expected to raise $200m in the first tranch), the management expects to receive a clarification from the FIPB in favor of Jet over the next few weeks. With respect to the last potential source of restructuring the balance sheet is the sale of its BKC land (a 2.5 acre property). Jet expects to announce a transaction with a major developer over the next few weeks.

Domestic Passenger Traffic – Inflection point



Source: PIB, IDFC Securities Research

Jet Airways

(Rs m)	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
Net Sales	**56,937**	**70,578**	**102,456**	**130,778**	**118,786**	**132,998**	**142,591**
% yoy growth		*24*	*45*	*28*	*(9)*	*12*	*7*
Total Cost	43,312	60,499	95,870	128,935	96,546	98,490	104,902
EBITDAR	**13,625**	**10,079**	**6,586**	**1,842**	**22,240**	**34,507**	**37,689**
Aircraft rentals	4,340	6,458	8,216	10,430	11,591	10,504	10,595
EBITDA	9,285	3,621	(1,630)	(8,587)	10,649	24,003	27,094
Depreciation	4,064	4,141	8,018	9,021	9,703	9,754	9,793
EBIT	5,221	(520)	(9,648)	(17,608)	946	14,249	17,301
Interest	2,416	2,402	5,225	8,023	10,474	9,847	9,779
Other Income	4,417	3,435	6,757	3,710	3,716	3,231	3,341
PBT	**7,223**	**514**	**(8,115)**	**(21,921)**	**(5,812)**	**7,633**	**10,864**
Tax	2,702	234	(1,577)	(656)	103	763	1,086
Net Profit	**4,520**	**279**	**(6,539)**	**(21,265)**	**(5,915)**	**6,870**	**9,778**
YoY growth (%)		*(94)*	*(2,441)*	*225*	*(72)*	*(216)*	*42*
Tax rate (%)	*37*	*46*	*19*	*3*	*(2)*	*10*	*10*
Net Profit post exceptional items	4,520	279	(6,539)	(9,615)	(4,089)	6,870	9,778

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