

India Airlines

Cabinet approves 49% FDI in aviation, we recommend selling aviation stocks into the current rally

Aviation stocks rallying on 49% FDI in Indian aviation, we advise investors to use this opportunity to sell. In a widely anticipated move, the Indian cabinet has approved 49% FDI (foreign direct investment) in the aviation sector. Details of the FDI policy are expected within a month (source Bloomberg). Indian airline stocks have rallied on back of this announcement- we recommend investors to sell into this rally.

• **Why don't we share the exuberance on the sector as suggested by recent stock rally?** Our negative stance is premised on the following factors:

- 1) **Operating landscape for Indian aviation remains challenged** on account of high oil prices and slowing passenger traffic growth. Domestic ATF prices are near all time highs of past 10 years and passenger traffic has started to de-grow over recent months, which will likely limit pricing power.
- 2) **Recapitalization of weak balance sheets could reverse benefits of recent consolidation.** The Indian aviation sector has seen consolidation over past 12-18 months, as KAIR has curtailed capacity, and other incumbents have slower pace of fleet expansion owing to stretched balance sheets, which has allowed for pricing power. In our view, any potential infusion of new capital into the industry will drive up competitive intensity and potentially reverse the benefits of recent consolidation.
- 3) **Not all airlines are eligible for FDI.** Amongst the listed players, Jet Airways does not meet eligibility norms given its current promoter's holding of 80% is routed through overseas entities and is already deemed as FDI. Thus we find Jet Airways at a relative disadvantage to its competitors, which are eligible for investments.
- 4) **Too early to assume that foreign airlines will invest** We believe it is too early to assume that foreign airlines will pay a significant premium to invest, given fundamental headwinds. As per press (Bloomberg), while few foreign operators (IAG and Lufthansa) have welcomed the FDI move, they are not considering investing in the near term. In our view, Spicejet is the most likely domestic player which could see a potential investment - it has a relatively stronger balance sheet compared to its listed peers and has potential to gain market share through fleet expansion. Press reports (Bloomberg) have stated that Spicejet has been in talks with a Middle East based carrier for a potential investment.

• **Maintain recommendation and Price Target:** We maintain our UW rating on JETIN with Mar-13 TP of Rs245, based on 8x FY14E EV/EBITDAR. We have N rating on SJET with Mar-13 TP of Rs28, based on 9x FY14E EV/EBITDAR.

Table 1: Indian airline valuation summary

Airline	Rating	Target Price (Rs)	Current Price (Rs)	EV/EBITDAR			EV/EBITDA		
				FY12	FY13E	FY14E	FY12	FY13E	FY14E
JET AIRWAYS	UW	245	368.7	21.8	13.1	9.3	nm	26.9	11.6
SPICEJET LTD	N	28	34.5	nm	16.6	10.3	nm	nm	nm

Source: J.P. Morgan estimates. Priced as of 09/14/12, * EV/EBITDAR has been adjusted for the capitalization of aircraft operating leases

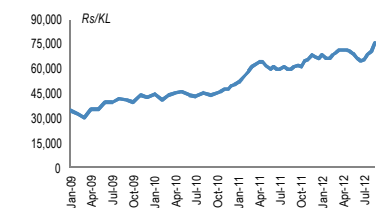
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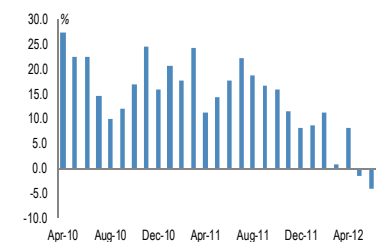
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Figure 1: Indian ATF prices trend



Source: IOCL website

Figure 2: Indian domestic passenger traffic growth trend (%)

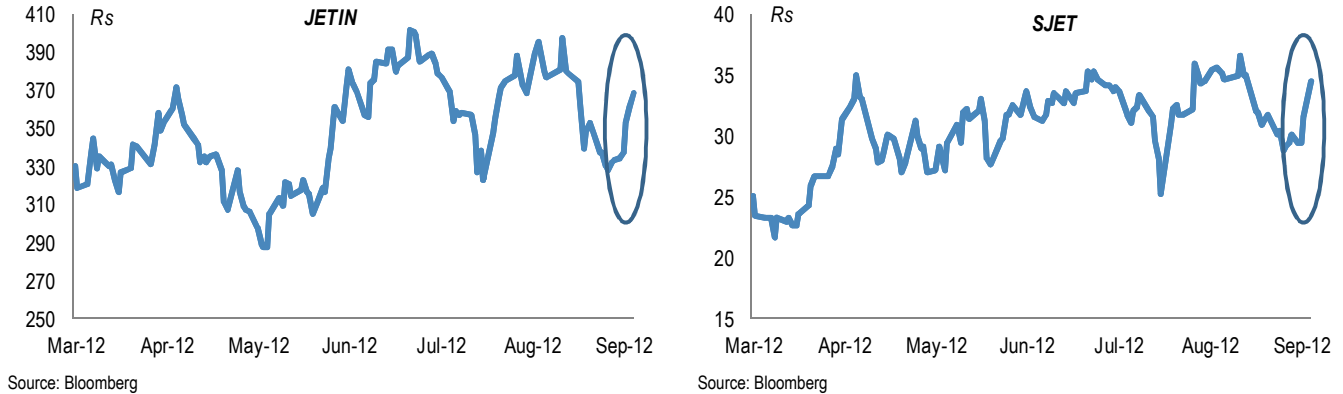


Source: DGCA

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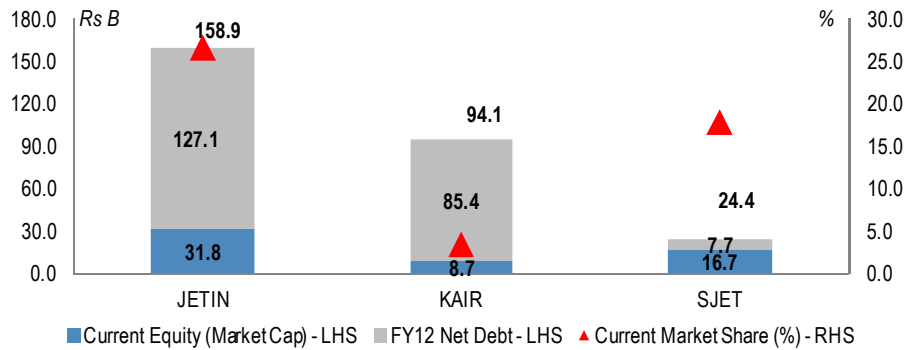
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Figure 3: Indian aviation stocks have rallied over past few days in anticipation of FDI in aviation. We recommend investor to sell into this rally. (JET Airways and Spice Jet stock price trend (Rs))



While JETIN is not eligible for FDI (given its promoter holdings are through overseas entities), we believe that SJET may be the most likely candidate to attract investments, given its relatively stronger balance sheet compared to listed peers and sizeable market share

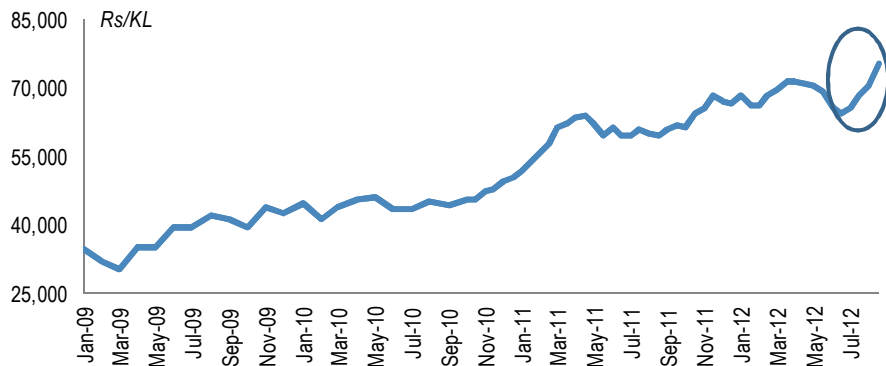
Figure 4: JETIN, KAIR and SJET Enterprise Value (Rupees Billion) vs. Market share (%)



Source: Company reports, DGCA, Bloomberg

Domestic jet fuel prices have risen sharply over past 2 months, after correcting over Mar-Jun 12. YTD 2012 domestic jet fuel price has increased 15% YoY

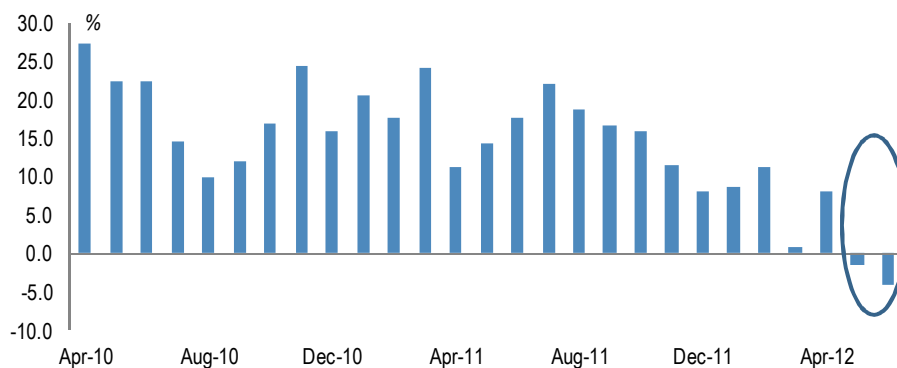
Figure 5: Indian ATF price trend (Rs/kilolitre)



Source: IOCL website

Slowing economic growth and demand destruction on account of sharp price hikes by airline operators has led to a considerable slowdown in passenger traffic

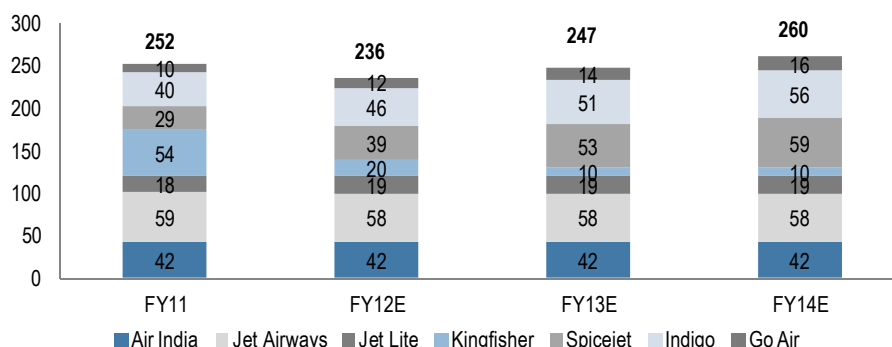
Figure 6: Indian domestic airline passenger growth (%)



Source: DGCA

With curtailment of Kingfisher's fleet largely behind, we expect airline supply to increase by 5%-6% over FY13E and FY14E, which will ease the tight supply situation witnessed over past 12-18 months. We believe that this will limit further pricing power. Also recapitalization of weak players could drive up competitive intensity and reverse the benefits of consolidation

Figure 7: Indian aviation domestic fleet trend (nos.)



Source: Company data, DGCA, J.P. Morgan estimates

JETIN and SJET target price, recommendations and risk:

JETIN: Our Mar-13 target price of Rs245 is based on 8x FY14E EV/EBITDAR, at a 10% premium to the Asian peer group multiple and in line with that of Chinese carriers, which we believe offer a similar growth and earnings profile. Key risks include a rise in passenger demand, significant decrease in ATF prices, favorable outcome of litigation with Sahara group and further rupee appreciation.

SJET: Our Mar-13 target price of Rs28 is based on 9x FY14E EV/EBITDAR, at a 13% premium to our target multiple for JETIN. We attribute a premium to SJET over Indian full-service players on account of SJET's efficient operations, higher growth over the next two years, strong balance sheet and low cost structure. Key downside risks include slowdown in passenger traffic, increase/changes to airport charges regulations, difficulties in including Q400s in India and further rupee weakening. Key upside risks include better than expected yield growth, significant improvement in passenger demand and decline in oil prices.

Companies Recommended in This Report (all prices in this report as of market close on 14 September 2012)
 Jet Airways (India) Ltd. (JET.BO/Rs368.65/Underweight), Spicejet Ltd (SPJT.BO/Rs34.50/Neutral)

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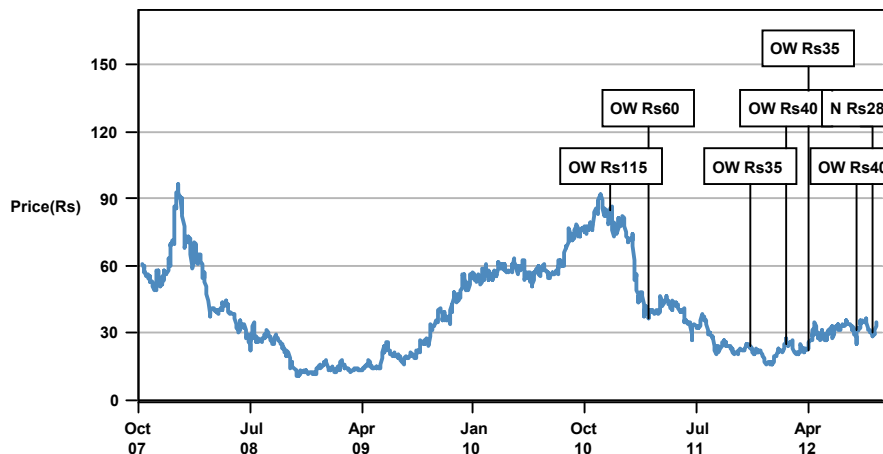
Jet Airways (India) Ltd. (JET.BO, JETIN IN) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
03-May-07	OW	718.35	1000.00
19-Jul-07	OW	761.40	--
02-Dec-10	OW	810.30	1090.00
08-Mar-11	OW	442.00	518.00
21-May-11	OW	453.20	575.00
13-Nov-11	OW	266.30	365.00
23-Jan-12	OW	231.40	300.00
30-Mar-12	UW	316.25	245.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Break in coverage Jul 19, 2007 - Dec 02, 2010.

Spicejet Ltd (SPJT.BO, SJET IN) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
02-Dec-10	OW	85.05	115.00
08-Mar-11	OW	36.85	60.00
13-Nov-11	OW	24.30	35.00
06-Feb-12	OW	24.60	40.00
30-Mar-12	OW	22.70	35.00
30-Jul-12	OW	30.85	40.00
05-Sep-12	N	30.15	28.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Dec 02, 2010.

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*Percentage of investment banking clients in each rating category.

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