

JET AIRWAYS

INR 609

Helpless with Sahara

REDUCE



According to news reports, Jet has agreed upon purchasing Air Sahara at an EV of INR 18.5 bn. This is at a minor discount to the earlier agreed upon price of INR 22 bn, before the deal fell through.

We believe that this development is negative for Jet in the following context:

- Jet has been consciously keeping its domestic capacity flat, going by deployed ASKMs, although its intentions at the beginning of the year were to grow domestic capacity by 10-15% Y-o-Y. This is because of the continuing price competition in the industry and the resultant losses. Key players like Kingfisher, Spice Jet and Indigo continue to add capacity aggressively. In this scenario, adding Sahara is likely to worsen Jet's profitability in the near term.
- Given that Jet had not backed out of the deal at an EV of INR 22 bn, it remains to be seen how it is ready to redo the deal at a 20% discount only, given that Jet's stock price has almost halved since the EV of INR 22 bn was decided upon earlier.

Hence it is likely that the deal is being done now due to legal compulsions, which arose during the arbitration process.

* Impact on Jet's financials and stock-price:

This deal will likely erode margins and hence profits on the domestic front. There would be some likely relief from improving load factors on the international front. Exact extent of the repercussions would be a function of Sahara's existing financials as well as of what Jet does with Sahara. However, our initial calculations suggest that in an optimistic scenario, in the immediate future, this can bring down FY08E (post merger) EPS by 50%. In the longer term, the impact would be a function of Jet's strategy on deploying the acquired capacity (see over-leaf for possibilities). The balance sheet stretch for funding this deal would be an added negative and would entail higher equity dilution.

This outcome is likely to create a negative overhang on the stock (earlier expectations on the outcome was around a INR 1-5 bn compensation payout by Jet). The current scenario is worse. We maintain our '**REDUCE**' recommendation. At CMP of ~INR 609, Jet is trading at 25.2x and 23.3x our FY08E and FY09E EPS estimates.

Financials

Year to March	FY06	FY07E	FY08E	FY09E
Sales (INR mn)	56,937	70,515	121,194	130,598
Growth (%)	31.3	23.8	71.9	7.8
EBITDA (INR mn)	9,285	1,902	10,907	13,872
Growth (%)	(23.3)	(79.5)	473.4	27.2
Net profit (INR mn)	4,520	(452)	2,085	2,258
Growth (%)	15.3	(110.0)	(561.6)	8.3
Shares outstanding (mn)	86.3	86.3	86.3	86.3
EPS (fully diluted)	21	(30)	24	26
EPS growth (%)	(53.7)	(240.7)	(181.7)	8.3
P/E (x)	29.0	(20.6)	25.2	23.3
EV/EBITDA (x)	8.8	50.5	11.4	8.8
ROE (%)	20.9	(2.0)	8.8	8.7

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Reuters : JET.BO
Bloomberg : JETIN IN

Market Data

52-week range (INR) : 1,059 / 475
Share in issue (mn) : 86.3
M cap (INR bn/USD mn) : 52.6 / 1,226.8
Avg. Daily Vol. BSE/NSE ('000) : 496.4

Share Holding Pattern (%)

Promoters : 80.0
MFs, Fls & Banks : 6.2
Fls : 8.6
Others : 5.2



* **Industry impact:**

Short term impact on other players is mild positive as Sahara had been undercutting prices heavily to gain market share and some rationality should be restored following consolidation.

Long term impact would be a function of what Jet decides to do with Sahara. We foresee three likely scenarios and different impacts there-of:

- ◆ Jet converting Sahara into a LCC. This would mean more price competition and hence negative impact for the industry.
- ◆ Jet running Sahara as it is with some operational improvements. Mild positive impact on industry, as more consolidation (the combine would have ~32% of current industry capacity) would mean lesser price wars.
- ◆ Jet gradually redeploys Sahara's planes on international routes leading to capacity reduction on the domestic front. This would be somewhat positive for the industry, as some capacity will get taken out from the domestic industry.

Company description

Jet Airways is India's premium full service carrier with a market leading status on the domestic front. It has been facing increasing competition from low cost carriers over the last year, resulting in market share and profitability erosion. Jet is currently focused on expanding its international operations, especially with the induction of the new fleet of wide-bodies and commencement of India-US connection in the later half of the current calendar year.

Investment theme

Jet continues to face strong price competition from LCCs on the domestic front, which will likely depress domestic profitability. It is adding capacity at a very high pace on the international front over FY08, which will likely increase losses still it stabilizes. It is also likely to face strong competition from existing long-distance carriers. The capex will stretch the balance sheet too, resulting in depressed earnings and/ or dilution. After factoring in the positives in our forecasts, current valuations look stretched. Downside remains from hikes in crude price and worsening of the current domestic competitive scenario.

Key risks

Risks to our current hypothesis are three-fold:

- ◆ Faster than assumed scale-up of its international operations, which might happen if Jet is able to gain strong traction in the US market with its wide-bodied aircrafts..
- ◆ Crude prices coming off even further from the current levels.
- ◆ Shake-out in the domestic industry leading to Jet getting back pricing power for its offering.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Operating revenues	43,380	56,937	70,515	121,194	130,598
Fuel cost	10,517	16,789	24,954	37,910	40,645
Employee expenses	3,747	5,672	9,202	13,908	14,591
Maintenance expenses	2,874	4,409	6,350	13,224	13,593
Landing & navigation fees	2,388	3,704	6,506	9,704	10,453
Commissions	5,591	7,740	9,145	15,606	15,944
Other operating costs	3,476	4,999	6,279	8,491	9,314
Total expenditure	28,593	43,312	62,436	98,841	104,541
EBITDAR	14,788	13,625	8,078	22,353	26,057
Lease rentals	2,681	4,340	6,176	11,446	12,185
EBITDA	12,107	9,285	1,902	10,907	13,872
Depreciation/Amortization	4,570	4,064	3,932	6,808	9,053
EBIT	7,537	5,221	(2,030)	4,099	4,819
Interest expenditure	2,537	2,416	2,499	3,830	4,416
Non-operating income	822	1,711	1,978	2,709	2,823
Profit before tax	5,821	4,516	(2,551)	2,978	3,226
Provision for taxation	1,901	2,702	-	893	968
Profit after tax	3,920	1,813	(2,551)	2,085	2,258
Extraordinary items	-	2,706	2,100	-	-
Reported profit	3,920	4,520	(452)	2,085	2,258
Preference dividend	35	-	-	-	-
PAT for common share holders	3,885	4,520	(452)	2,085	2,258
EPS (INR) fully diluted	45.4	21.0	(29.5)	24.1	26.2
Adj EPS (INR) fully diluted	45.0	52.4	(5.2)	24.1	26.2
CEPS (INR) fully diluted	97.9	99.4	40.3	103.0	131.0
Dividend per share	3	6	-	-	-
Dividend payout ratio (%)	6.6	28.6	-	-	-

Common size metrics- as % of operating revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Fuel cost	24.2	29.5	35.4	31.3	31.1
Employee expenses	8.6	10.0	13.1	11.5	11.2
Maintenance expenses	6.6	7.7	9.0	10.9	10.4
Commissions	12.9	13.6	13.0	12.9	12.2
Interest expenditure	5.8	4.2	3.5	3.2	3.4
EBITDAR margin	34.1	23.9	11.5	18.4	20.0
EBITDA margin	27.9	16.3	2.7	9.0	10.6
EBIT margin	17.4	9.2	-2.9	3.4	3.7
Net profit margin	9.0	3.2	-3.6	1.7	1.7

Growth metrics

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	25.8	31.3	23.8	71.9	7.8
EBITDA	40.1	(23.3)	(79.5)	473.4	27.2
EBIT	116.0	(30.7)	(138.9)	NA	17.6
Net profit	140.3	15.3	(110.0)	NA	8.3
EPS	100.7	(53.7)	(240.7)	NA	8.3
CEPS	4.6	1.5	(59.4)	155.5	27.2

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	863	863	863	863	863
Reserves	19,238	22,196	21,744	23,829	26,086
Shareholders funds	20,102	23,059	22,607	24,692	26,949
Borrowings					
Subordinated debt	3,341	-	-	-	1
Secured loans	600	2,060	10,060	40,060	40,060
Unsecured loans	25,707	46,896	52,042	68,078	48,078
Deferred tax liability	1,949	3,207	2,492	3,326	4,229
Sources of funds	51,699	75,221	87,201	136,156	119,317
Gross assets	52,021	43,721	68,801	126,001	133,041
Less depreciation	25,935	22,496	26,428	33,236	42,289
Capital WIP	320	26,657	26,657	16,657	16,657
Net fixed assets	26,407	47,882	69,029	109,421	107,408
Investments	15,957	1,872	1,872	1,872	1,872
Current assets	20,444	40,775	39,574	61,392	47,730
Debtors	2,523	4,332	5,679	8,074	8,681
Cash & bank balance	12,242	21,043	19,167	37,297	21,687
Inventory	3,325	4,053	5,313	8,752	9,484
Advances	2,353	11,349	9,414	7,270	7,879
Current liabilities	11,109	15,308	23,273	36,529	37,693
Working capital	9,335	25,468	16,300	24,863	10,037
Uses of funds	51,699	75,221	87,201	136,156	119,317
BV per share (INR)	233	267	262	286	312

Cash flow statement					
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	8,490	5,877	1,381	8,893	11,311
Cash for working capital	3,824	(6,075)	6,578	10,401	119
Net operating cash flow	12,314	(197)	7,959	19,293	11,430
Net purchase of fixed assets	(992)	(25,539)	(25,080)	(47,200)	(7,040)
Net purchase of investments	(13,623)	14,085	-	-	-
Net cash flow from investing	(14,615)	(11,454)	(25,080)	(47,200)	(7,040)
Proceeds from LTB/STB	(2,451)	19,308	13,146	46,036	(19,999)
Proceeds from shareholders	13,586	(0)	(0)	(0)	(0)
Dividend payments/Others	(295)	-	-	-	-
Net cash flow from financing	10,839	19,308	13,146	46,036	(19,999)
Free cash flow	11,322	(25,736)	(17,121)	(27,907)	4,390

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE	33.0	20.9	(2.0)	8.8	8.7
ROCE	14.7	10.9	2.5	5.3	5.2
Debtor (days)	20	22	26	21	23
Inventory (days)	29	24	24	21	25
Fixed assets t/o (x)	1.5	1.0	0.9	0.9	1.2
Debt/Equity (x)	1.6	2.3	2.9	4.5	3.4
Interest coverage (x)	3.0	2.2	(0.8)	1.1	1.1

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (diluted) (INR)	45.4	21.0	(29.5)	24.1	26.2
<i>Y-o-Y growth (%)</i>	<i>100.7</i>	<i>(53.7)</i>	<i>(240.7)</i>	<i>(181.7)</i>	<i>8.3</i>
CEPS (INR)	97.9	99.4	40.3	103.0	131.0
<i>Y-o-Y growth (%)</i>	<i>4.6</i>	<i>1.5</i>	<i>(59.4)</i>	<i>155.5</i>	<i>27.2</i>
PE (x)	13.4	29.0	(20.6)	25.2	23.3
Price/Cash EPS (x)	6.2	6.1	15.1	5.9	4.6
EV/Sales (x)	1.3	1.4	1.4	1.0	0.9
EV/EBITDA (x)	4.6	8.8	50.5	11.4	8.8
EV/EBITDAR (x)		8.4	17.6	9.4	8.2

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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