

Jet Airways (India) Ltd

Upgrade to Overweight; price target raised to Rs1,000

Upgrade
Overweight

Previous Rating: Underweight

Rs721.50

03 May 2007

Price Target: Rs1,000.00

- We upgrade Jet Airways from Underweight to Overweight on expectation of imminent rationalization of the Indian aviation sector. Media reports that Kingfisher might buy Deccan Aviation is a critical step, in our view, in reducing the market to 5 major operators – a long term stable industry structure – and also would remove a major discounter from the market. We estimate that the Indian airline industry has lost over US\$700m over the last 3 years and we believe that shareholders have now had enough.
- We increase our loss forecast for FY2007 based on reports of disappointing earnings in the Mar-07 qtr. More importantly, based on our expectation for improved industry operating conditions, we raise our FY2008 forecasts from a loss of Rs2.5bn to a profit of Rs1.8bn and FY2009 from a loss of Rs1.5bn to a profit of Rs7.0bn.
- We raise our Dec-07 price target from Rs550 to Rs1,000 – offering 39% upside - based on a 17x PER for FY2009 earnings and 2x price-to-book ratio. We put Jet into our Analyst Focus List. We believe that the market will look beyond FY2008, which is a key transition year for the airline, towards FY2009. The key risk to our price target would be poor execution of the Air Sahara acquisition, a return to severe fare discounting or a spike in oil prices and collapse in global economic growth.



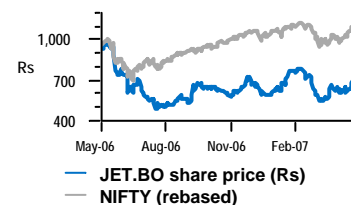
India
Airlines

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Price Performance



	YTD	-1M	-3M	-12M
Absolute	16.7%	13.6%	-6.0%	-25.4%
Relative	13.6%	6.6%	-5.1%	-38.8%

Source: RIMES, Reuters.

Table 1: Jet Airways: Bberg JETIN IN; Reuters JET.BO

Rs in millions

Year to March	2006	2007E	2008E	2009E
Sales (Rs MM)	56,937	71,401	134,045	205,966
Operating profit (Rs MM)	5,221	-2,430	2,933	13,259
EBITDA (Rs MM)	9,285	1,701	9,521	22,305
EBDRIT (Rs MM)	13,625	8,562	22,325	37,522
Net profit ((Rs MM)	4,520	-578	1,835	7,000
EPS (Rs)	52.36	-6.70	19.05	62.88
Net debt (cash) (Rs MM)	29,105	63,028	95,697	93,159
Equity (MM)	23,059	22,481	44,317	61,317
ROE (%)	20.9%	-2.5%	5.5%	13.3%
ROCE (%)	8.7%	1.1%	4.1%	7.6%
P/E (x)	13.8	-107.7	37.9	11.5
EV/EBITDA (x)	9.8	73.7	16.6	7.0
P/BV (x)	2.7	2.8	1.7	1.4
Dividend yield (%)	0.8%	0.0%	0.0%	0.0%

Source: Company reports and JPMorgan estimates.

Company Data

52-week range	979.25-475.10
Market cap (Rs M)	62,290
Market cap (Rs M)	1,516
Shares outst.(M)	86.3
Free float	20%
Avg daily vol (M)	0.105
Avg daily value (US\$M)	2.2
Sensex	14,078.21
Exchange rate	41.1
Year-end	March

Source: Bloomberg

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Industry consolidation and rationalization

We believe that the Indian aviation industry is finally set for consolidation, which should result in the surviving players moving to a sustainable base of profitability.

At the start of 2007, there were 12 airlines in the marketplace. We believe that by the end of 2007, the market will be reduced to 5 major players. While Paramount, Jagson and GoAir may survive in the marketplace, we do not believe that they will have the wherewithal to compete with the behemoths that will otherwise dominate the domestic market.

Already, we have seen the Government move to consolidate its four carriers into one entity. We also expect that Air Deccan is looking to find a buyer or to be merged into a larger airline group. Excluding the IUO that Deccan has from Investec, we estimate that Deccan has close to zero residual equity. If they cannot find private equity to inject funds immediately, we believe that their departure from the market is imminent.

While reports in the Times of India suggest that Kingfisher is looking at Deccan, we believe that this could well be true. Not only would Deccan be a willing seller, for the reasons outlined above, but we would also see Kingfisher as a keen buyer, in event of a firesale.

Table 2: India Aviation - Industry players pre-2007 and post 2007

Full-Service	Pre-2007		Full-Service	By end 2007	
	Low Cost Carriers	Government		Low Cost Carriers	Government
Jet Airways	Air Deccan	Air India	Jet Airways	SpiceJet	Indian
Kingfisher	SpiceJet	Air India Express	Kingfisher	IndiGo	
Air Sahara	IndiGo	Indian Airlines			
Paramount	Go Air	Alliance Air			
Jagson Airlines					

Source: Company reports.

No room left for private equity

It has been widely covered in the press that private equity investors have been having a close look at all of India's private airlines. While Spicejet was lucky enough to raise US\$85m earlier this year, we believe that Deccan, GoAir, etc, have been unsuccessful in raising fresh funds.

We believe that investors have been attracted by the industry's strong underlying growth and potential to consolidate. Herein lies the problem for private equity, in our view. If they provide funds for a player like Deccan to stay in the market, then there is no scope for the industry to consolidate. Alternatively, to improve the fortunes of an airline, like Deccan, it might require major management changes, which a private equity investor may not necessarily be able to provide.

In this sense, we believe that Kingfisher is the only logical buyer given their strong financials, existing management team, fleet compatibility, common Bangalore head office, etc. We believe that a Kingfisher, Deccan merger would take time to produce synergies, but we believe that the removal of a key price discounter in the market would allow both Jet/Sahara and Kingfisher/Deccan to immediately allow yields to rise beyond breakeven levels.

Earnings revisions

Our earnings revisions cover two main issues:

1. Inclusion of Air Sahara which became a subsidiary of Jet Airways on April 20, 2007
2. Expectation that the irrational industry behaviour will cease within the next quarter and that the industry will rapidly return to profitability

Table 3: Jet Airways - Profit & Loss Statement

Rs in millions

Yr to Mar 31	FY07E			FY08E			FY09E		
	New	Old	Pct Chg	New	Old		New	Old	
Total revenue	71,401	71,822	-0.6%	134,045	103,582	29.4%	205,966	147,316	39.8%
<i>Growth %</i>	25.4%	26.1%		87.7%	421.9%		53.7%	363.6%	
Operating Expenses	-62,839	-62,711	0.2%	-111,720	-92,521	20.8%	-168,445	-128,683	30.9%
<i>Growth %</i>	45%	45%		78%	48%		51%	39%	
EBITDAR	8,562	9,111	-6.0%	22,325	11,061	101.8%	37,522	18,632	101.4%
<i>Margin %</i>	12.0%	12.7%		16.7%	10.7%		18.2%	12.6%	
EBITDA	1,701	2,311	-26.4%	9,521	1,654	475.5%	22,305	7,652	191.5%
<i>Margin%</i>	2.4%	3.2%		7.1%	1.6%		10.8%	5.2%	
Total Operating Expenses	-73,832	-73,642	0.3%	-131,113	-108,051	21.3%	-192,707	-148,261	30.0%
<i>Growth %</i>	43%	42%		78%	47%		47%	37%	
EBIT	-2,430	-1,820	33.5%	2,933	-4,469		13,259	-946	
<i>Margin%</i>	-3.4%	-2.5%		2.2%	-4.3%		6.4%	-0.6%	
Net Interest	-832	-832		-1,374	-1,139		-1,592	-1,485	
Gain from aircraft sale	2,600	2,600		1,500	1,500		0	0	
Pre tax Profit	-663	-53		3,059	-4,108		11,667	-2,431	
Tax	85	-159		-1,224	1,643		-4,667	972	
Reported NPAT	-578	-212	172.3%	1,835	-2,465		7,000	-1,458	
<i>Margin%</i>	-0.8%	-0.3%		1.4%	-2.4%		3.4%	-1.0%	
EPS	-6.7	-2.5 ¢	172.3%	19.1	-24.3 ¢		62.9	-11.1 ¢	

Source: JPMorgan estimates

Table 4: Jet Airways - Balance Sheet

Rs in millions

Yr to Mar 31	FY06	FY07E	FY08E	FY09E
Cash	21,043	16,816	14,148	29,685
Total current assets	40,775	36,549	33,880	50,539
Total non-current assets	49,754	81,046	134,579	153,709
Total assets	90,529	117,595	168,459	204,248
Total current liabilities	21,256	22,409	20,719	20,468
Total non-current liabilities	46,215	72,705	103,424	122,463
Total liabilities	67,470	95,114	124,143	142,931
Net assets	23,059	22,481	44,316	61,317
Share capital	863	863	1,063	1,163
Retained earnings & reserves	22,196	21,618	43,254	60,154
Total shareholders' equity	23,059	22,481	44,317	61,317
Net debt/(cash)	29,105	63,028	95,697	93,159
Working capital	19,520	14,140	13,161	30,071
Off balance sheet debt (7x)	30,379	48,033	89,628	106,520
Gearing (net debt/equity)	126.2%	280.4%	215.9%	151.9%
Gearing (net debt/[net debt+equity])	55.8%	73.7%	68.3%	60.3%
BVPS	267	260	417	527

Source: JPMorgan estimates.

Table 5: Jet Airways - Cashflow Statement

Rs in millions

Year to Mar 31	FY06	FY07E	FY08E	FY09E
Pre-tax cash profit	7,223	(663)	3,059	11,667
Depreciation and Amortisation	4,259	4,131	6,588	9,045
Other	(8,407)			
Operating cash flow	3,074	3,468	9,647	20,713
Capex	(23,318)	(3,920)	(28,953)	(18,417)
Term deposits	3,992			
Aircraft PDPs and security deposits		(27,275)	(18,862)	(9,758)
Investments	(5,390)		(14,500)	
Investing cash flow	(24,716)	(31,195)	(62,316)	(28,175)
Free cashflow	(21,641)	(27,727)	(52,669)	(7,462)
Increase/(decrease) in borrowings	19,174	23,500	30,000	13,000
Share issue proceeds			20,000	10,000
Financing cash flow	18,879	23,500	50,000	23,000
Net change in cash	(2,763)	(4,227)	(2,669)	15,538
Net debt/(cash)	29,105	63,028	95,697	93,159

Source: Company reports and JPMorgan estimates.

Potential to reduce share issue

Based on our revised price target, we expect that Jet might be able to get away with only raising Rs30bn of new equity, below our previous expectation for Rs50bn of new equity to keep its gearing around 2.0x.

We now expect Jet to issue 30m new shares, rather than our previous estimate of 60m new shares.

Key risks

Our forecasts assume that Jet executes well in the merger of Air Sahara. With the pending consolidation of the domestic market, we are not convinced that converting Sahara to a Jet Lite business model is necessarily the best idea. Still, there is a lot of execution risk with this transaction, especially while an expanding Kingfisher will pounce on any mistake by Jet.

It remains quite possible that the Government may deregulate the market further, including allowing foreign airlines to own equity in Indian carriers. If this occurs, it is possible that a number of cash rich Middle Eastern carriers would look to assist in the launch of new airlines in India. Alternatively, these Middle Eastern investors may well want to buy into a strong player in a consolidating industry, which could provide further upside for Jet Airways in the longer run.

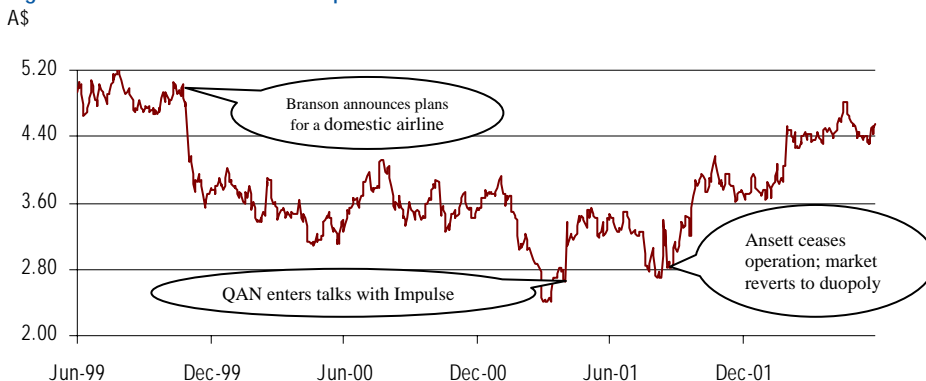
Jet's cargo business has always been a problem for the airline. The appointment of an experienced cargo specialist should help accelerate the turnaround of this business. Still, there is a lot of competition in this space, so we remain hopeful that their new hire will deliver the goods, so to speak.

Jet is expanding aggressively into the international arena, which is a new market for the airline. Again, poor execution here could be very costly for the company, especially given the number of well funded competitors.

The upside that we expect

We believe that the increased competition and subsequent consolidation in Australia in 1999 – 2001 may well reflect what is happening in India. Once Qantas announced that it was in talks to buy the smallest player in the market, the stock shot up and, after surviving 9/11, which induced further rationalization, the stock almost doubled in 12 to 15 months after reaching bottom.

Figure 1: Qantas—historical share price chart



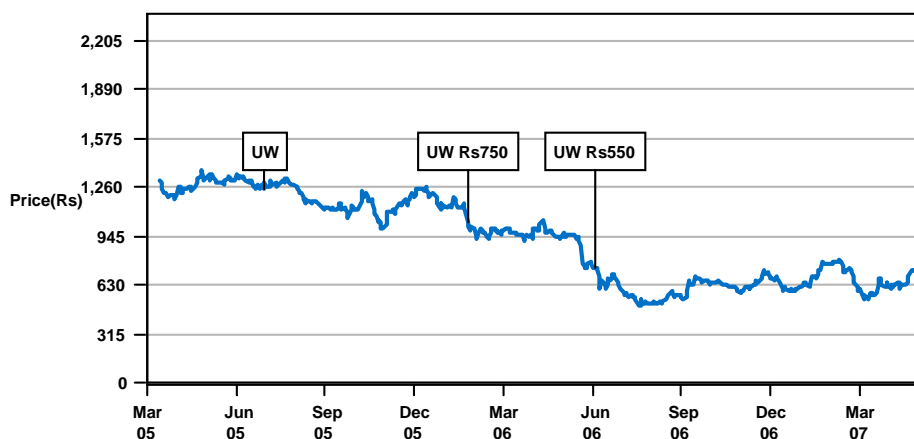
Source: Datastream, JPMorgan.

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Jet Airways (India) Ltd (JET.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
29-Jun-05	UW	1255.05	-
24-Jan-06	UW	1038.10	750.00
02-Jun-06	UW	734.90	550.00

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
 Initiated coverage Jun 29, 2005. This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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Jet Airways (India) Ltd: Summary of Financials

Profit and Loss statement					Cash flow statement				
INR in millions, year-end Mar	FY06A	FY07E	FY08E	FY09E	INR in millions, year-end Mar	FY06A	FY07E	FY08E	FY09E
Revenues	56,937	71,401	134,045	205,966	Pre-tax cash profit	7,223	-663	3,059	11,667
% change Y/Y	65.2	25.4	45.7	45.7	Depreciation & amortisation	4,259	4,131	6,588	9,045
Gross Margin (%)									
EBITDA	9,285	1,701	9,521	22,305	Cash flow from operations	3,074	3,468	9,647	20,713
% change Y/Y	7.5	-81.7	80.3	80.3	Capex & PDPs	-23,318	-31,195	-47,816	-28,175
EBITDA Margin (%)	16.3	15.1	18.7	18.7	Disposal/ (purchase)	3,992			
EBIT	5,221	-2,430	2,933	13,259	Investments	-5,390			
% change Y/Y	49.6	-146.5	51.4	51.4	Free cash flow	9,540	-27,727	-52,669	-7,462
EBIT Margin (%)	9.2	9.4	9.8	9.8	Equity raised/ (repaid)		23,500	30,000	13,000
Net Interest	-1,862	-832	-1,374	-1,592	Debt raised/ (repaid)	19,174	25,000	30,000	15,000
Earnings before tax	7,223	(663)	3,059	11,667	Other				
% change Y/Y	305.4	-109.2	24.0	24.0	Dividends paid	-295			
Tax	-2,702	85	-1,224	-4,667	Beginning cash	12,242	21,043	22,915	28,560
as % of EBT	-37.4	-40.0	-40.0	-40.0	Ending cash	21,043	16,816	14,148	29,685
Net Income (Reported)	4,520	-578	1,835	7,000	DPS	6.000	0.000	0.000	0.000
% change Y/Y	177.1	-112.8	24.0	24.0					
Shares Outstanding	86	86	106	116					
EPS (reported)	52.36	-6.70	19.05	62.88					
% change Y/Y	131.4	-112.8	11.3	11.3					
Balance sheet					Ratio Analysis				
INR in millions, year-end Mar	FY06A	FY07E	FY08E	FY09E	%, year-end Mar	FY06A	FY07E	FY08E	FY09E
Cash and cash equivalents	21,043	16,816	14,148	29,685	EBITDA margin	16.3	15.1	18.7	18.7
Security deposits	11,349	11,349	11,349	11,130	Operating margin	9.2	9.4	9.8	9.8
Other	8,384	8,384	8,384	9,725	Net profit margin	7.9	(0.8)	1.4	3.4
					SG&A/sales	27.9	15.7	15.1	18.7
Current assets	40,775	36,549	33,880	50,539	Sales per share growth	25.8	25.4	52.4	45.7
LT investments	1,872	736	15,236	15,236	Sales growth	65.2	25.4	45.7	45.7
Net fixed assets	47,882	78,115	119,343	138,473	Net profit growth	177.1	-112.8	24.0	24.0
Total assets	64,035	81,046	134,579	153,709	EPS growth	131.4	-112.8	11.3	11.3
Total current liabilities	21,256	22,409	20,719	20,468	Interest coverage (x)	2.8	-2.2	-3.9	-0.6
Long term debt	43,008	72,705	103,424	122,463	Net debt to total capital	32.1	49.8	52.4	47.9
Other liabilities	3,207	0	719	6,758	Net debt to equity	126.2	280.4	215.9	151.9
Total liabilities	67,470	95,114	124,862	149,689	Sales/assets	62.9	88.1	99.6	134.0
					Assets/equity	392.6	360.5	303.7	250.7
Shareholders' equity	23,059	22,481	44,317	61,317	ROE	20.9	-2.5	5.5	13.3
BVPS	267	260	417	527	ROCE	8.7	1.1	4.1	7.6

Source: Company reports, JPMorgan estimates.