Company

20 August 2009 | 13 pages

Jet Airways (JET.BO)

Equity ☑
Target price change ☑
Estimate change ☑

Sell: Flying Through The Storm, Rs174 Target Price

- **Status quo continues** — Overcapacity in an industry that has commodity characteristics has resulted in lower yields and lower profitability. Volatile macro factors (oil and F/X) contribute to the uncertain outlook of a highly financially leveraged sector.
- **Glimmer of a silver lining emerging... —** We view Jet's management is taking the correct measures of: a) leasing of surplus aircraft, non-renewal of expired leases, b) rationalisation of network, and c) cutting manpower and other overhead costs. These, coupled with lower oil costs (compared to one year ago), imply Jet's operating profitability will improve significantly over FY10E-FY11E.
- **...but strained balance sheet prevents us from becoming more positive —** We forecast Jet's operating cash losses will continue into FY10E and expect it will need to raise fresh funds to refinance debt repayment (c.Rs25-30bn over FY10E-FY11E each). Debt/equity ratios are rendered meaningless given the significantly impacted net worth, debt-equity is forecast at >10x at end-FY12E.
- **Operational earnings upgrade —** EBITDAR increased 130%-190% for FY10E-FY11E reflecting lower oil forecasts ($62/bbl vs. $75/bbl earlier), coupled with slightly better yields and lower cost pressures.
- **Maintain Sell** — Our target price of Rs174 (from Rs167), is based on 9x FY11E EV/EBITDAR. Our target multiple is pegged at a c.15% premium to global low cost carriers. We have reverted to an earnings based methodology (previously asset based methodology), given our view that earnings based methodology will better capture the turnaround in Jet’s profitability from 2HFY11E (assuming macro assumptions remain unchanged). We maintain our Sell (3H) rating.

Sell/High Risk	**3H**
Price (20 Aug 09)	Rs243.50
Target price	Rs174.00
from Rs167.00	
Expected share price return	-28.5%
Expected dividend yield	1.2%
Expected total return	**-27.3%**
Market Cap	Rs21,022M
	US$432M

Price Performance (RIC: JET.BO, BB: JETIN IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	-11,263	-130.46	na	-1.9	0.5	-34.7	2.5
2009A	-14,598	-169.10	-29.6	-1.4	0.6	-38.0	1.2
2010E	-10,368	-120.10	29.0	-2.0	0.9	-35.5	1.2
2011E	-563	-6.52	94.6	nm	0.9	-2.4	1.2
2012E	5,095	59.02	na	4.1	0.7	19.4	1.2

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	-1.9	-1.4	-2.0	nm	4.1
EV/EBITDA adjusted (x)	nm	-18.0	28.6	11.6	7.9
P/BV (x)	0.5	0.6	0.9	0.9	0.7
Dividend yield (%)	2.5	1.2	1.2	1.2	1.2
Per Share Data (Rs)					
EPS adjusted	-130.46	-169.10	-120.10	-6.52	59.02
EPS reported	-130.46	-275.19	-120.10	-6.52	59.02
BVPS	492.99	395.97	280.78	274.19	333.15
DPS	6.00	3.00	3.00	3.00	3.00
Profit & Loss (RsM)					
Net sales	102,456	130,779	116,634	134,628	142,615
Operating expenses	-112,095	-148,387	-119,434	-128,586	-131,018
EBIT	**-9,639**	**-17,608**	**-2,800**	**6,041**	**11,597**
Net interest expense	-5,225	-8,023	-10,439	-9,454	-8,718
Non-operating/exceptionals	6,757	3,710	3,300	3,100	3,465
Pre-tax profit	**-8,107**	**-21,921**	**-9,939**	**-313**	**6,344**
Tax	1,568	656	298	47	-952
Extraord./Min.Int./Pref.div.	-4,723	-2,492	-727	-298	-298
Reported net income	**-11,263**	**-23,757**	**-10,368**	**-563**	**5,095**
Adjusted earnings	-11,263	-14,598	-10,368	-563	5,095
Adjusted EBITDA	-1,621	-8,587	6,057	14,522	19,700
Growth Rates (%)					
Sales	45.2	27.6	-10.8	15.4	5.9
EBIT adjusted	nm	-82.7	84.1	315.7	92.0
EBITDA adjusted	-144.8	-429.7	170.5	139.8	35.7
EPS adjusted	-696.5	-29.6	29.0	94.6	nm
Cash Flow (RsM)					
Operating cash flow	**14,716**	**-5,119**	**-9,036**	**9,374**	**13,893**
Depreciation/amortization	8,018	9,021	8,857	8,480	8,103
Net working capital	14,946	-431	-8,252	1,160	397
Investing cash flow	**-107,389**	**-49,671**	**3,942**	**-200**	**-200**
Capital expenditure	-107,975	-24,387	-200	-200	-200
Acquisitions/disposals	586	-25,284	2,571	0	0
Financing cash flow	**87,165**	**34,363**	**-4,447**	**-9,374**	**-13,893**
Borrowings	61,490	44,287	-16,357	-9,071	-13,590
Dividends paid	-606	-303	-303	-303	-303
Change in cash	**-5,508**	**-20,426**	**-9,541**	**-200**	**-200**
Balance Sheet (RsM)					
Total assets	**215,570**	**244,399**	**208,068**	**200,933**	**193,421**
Cash & cash equivalent	9,584	14,662	1,000	1,000	1,000
Accounts receivable	13,990	8,075	8,628	9,959	10,550
Net fixed assets	172,877	188,243	177,815	169,335	161,231
Total liabilities	**173,010**	**210,215**	**183,828**	**177,262**	**164,660**
Accounts payable	20,354	17,736	13,521	14,794	15,235
Total Debt	122,053	166,340	149,983	140,912	127,322
Shareholders' funds	**42,560**	**34,184**	**24,240**	**23,671**	**28,761**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	-1.6	-6.6	5.2	10.8	13.8
ROE adjusted	-34.7	-38.0	-35.5	-2.4	19.4
ROIC adjusted	-6.7	-9.6	-1.4	3.6	6.6
Net debt to equity	264.3	443.7	614.6	591.1	439.2
Total debt to capital	74.1	83.0	86.1	85.6	81.6

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Investment Thesis – Maintain Sell

We maintain our Sell recommendation on Jet Airways. We believe that the bounce in the stock price from its absolute low in March 2009 adequately reflects the positives expected over both FY10E and FY11E.

Fundamentally, we think the industry remains in a situation of structural overcapacity. Additionally, with LCCs now accounting for ~40% of seat capacity, discounting and lower fares are now an endemic feature of the domestic industry. The industry's pricing mechanism has also been vitiated – as carriers have adopted a strategy of maximizing revenue/flight – rather than yields.

Jet Airways' significant debt burden – and the cost of servicing this debt – implies that even though operational profits (EBITDAR) are forecast to improve meaningfully over FY10E-11E, we think the company will only return to profits (post tax) in FY12E. Its strategy of: a) cutting loss making operations (both in domestic and international), b) leasing/returning surplus fleet, and c) control on overheads like manpower, and SGA, should enable it to minimize losses over FY11E. The company's international business and its Jetlite operation have reported robust profits at an EBITDAR level, but we think these are slightly inflated given that a fair amount of overheads are likely absorbed in Jet's domestic cost structure.

We have changed our valuation methodology basis. We revert to an earnings based methodology, from an asset based methodology, given that we think the earnings based methodology will better capture the turnaround in Jet’s profitability from 2HFY11E (assuming that macro assumptions on oil and FX don’t meaningfully change). Our target price has marginally increased from Rs167 to Rs174, based on 9x FY11E EV/EBITDAR. Our target multiple of 9x pegs Jet at a c.15% premium to other regional/global low cost carriers. This premium is justified in our view given: a) Jet is gradually transitioning to a low cost based business model, and b) Growth prospects in India are arguably higher than in many other emerging markets.

Domestic Operations – Yields Remain Pressured

The domestic aviation industry faces turbulent times as yields remain pressured due to: 1) Overcapacity in the industry, and 2) Sharp slowdown in business traveler traffic as corporations cut travel/expense budgets.

Overcapacity Continues

Passenger traffic has declined much faster than the reduction in capacity by the airlines, which has impacted yields of the industry. We believe the industry is still in an overcapacity situation and expect yields will continue to be under pressure until capacity declines another 10%-15%.

Figure 1. Capacity and Traffic Quarterly Trend

	4QFY08	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10
Aviation Industry Capacity Y/Y Growth (%)	+18.1	+13.4	-3.2	-8.5	-11.0	-8.0
Passenger Traffic Growth Y/Y (%)	+11.1	+4.2	-17.5	-16.5	-12.0	-5.0

Source: Company, Citi Investment Research and Analysis

LCCs Dictate Pricing

Low cost carriers (LCCs) have steadily gained market share from full service carriers (FSCs) over the past year due to: 1) Decline in business traveler traffic, 2) Shift of business traveler traffic to LCCs from FSCs, and 3) Lower fares of LCCs have attracted leisure traffic. This has resulted in average yields for the industry collapsing (lower oil prices have also resulted in carriers partially passing on these benefits).

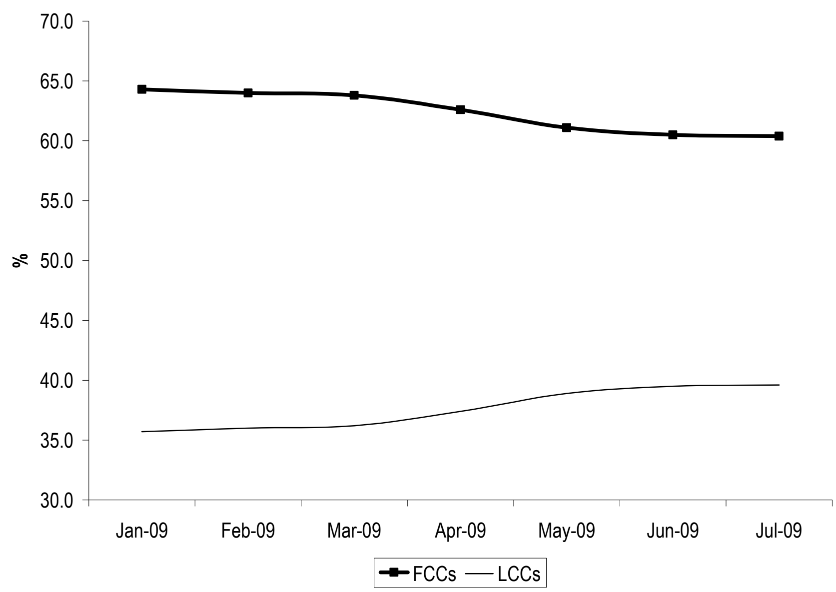
Figure 2. Fare Comparison on Key Routes

		August-2008					August-2009					
From	To	Spice Jet	Jet (check fares)	IA (check fares)	Deccan	Average	Spice Jet	Jet (check fares)	IA (check fares)	Deccan	Average	% increase (average Aug09 vs. Aug08)
Mumbai	Ahmedabad	6,449	8,450	8,000	7,248	7,537	6,949	5,960	5,958	4,638	5,876	(22.0)
Mumbai	Bangalore	9,650	13,100	11,550	10,600	11,225	10,150	6,818	7,868	7,468	8,076	(28.1)
Mumbai	Chennai	10,650	14,000	13150	11600	12,350	11,150	8,058	10,158	8,258	9,406	(23.8)
Mumbai	Goa	6,350	8,600	8,800	8,048	7,950	6,850	7,158	7,258	5,576	6,711	(15.6)
Mumbai	Hyderabad	6,350	9,400	7,850	7,448	7,762	6,850	6,933	6,433	5,133	6,337	(18.4)
Mumbai	Jaipur	na	13,100	11,550	10,600	11,750	-	7,748	7,558	9,558	6,216	(47.1)
Ahmedabad	Bangalore	11,149	14,350	14,240	11,600	12,835	11,649	7,818	14,708	8,718	10,723	(16.5)
Ahmedabad	Chennai	10,650	14,690	12,160	11,600	12,275	11,150	7,558	13,138	8,958	10,201	(16.9)
Ahmedabad	Delhi	9,650	12,250	11,450	na	11,117	10,150	4,258	9,058	5,148	7,154	(35.7)
Bangalore	Delhi	10,650	16,450	13,250	11,600	12,988	11,150	10,818	14,518	10,218	11,676	(10.1)
Bangalore	Hyderabad	6,350	9,500	7,550	7,648	7,762	6,850	6,093	7,593	6,993	6,882	(11.3)
Chennai	Bangalore	na	8,700	8,550	7,448	8,233	-	6,718	6,918	7,818	5,364	(34.9)
Chennai	Delhi	10,650	15,800	13,850	11,600	12,975	11,150	12,158	12,558	11,558	11,856	(8.6)
Chennai	Hyderabad	na	9,300	8,000	7,100	8,133	-	5,933	7,533	6,733	5,050	(37.9)
Chennai	Kolkata	10,650	12,950	13,250	11,600	12,113	11,150	15,258	13,058	10,558	12,506	3.2

Source: Company Websites, CIRA

Figure 3. Market Share Trend – FSC vs. LCCs

LCCs' 'de facto' seat share would be almost 50% if one were to include Jetlite and KF Red.



Source: DGCA

Figure 4. Jet Airways — Domestic Parameters Trend

	4QFY08	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10
Base Fare/Pax (Rs)	3,894	3,527	4,029	4,367	3,074	2,739
Fuel Surcharge/Pax (Rs)	1,727	2,133	2,662	2,623	2,469	2,394
Fuel Costs/Litre (Rs)	41.8	57.0	55.8	34.6	26.3	29.0

Source: Company

Jet has outlined a strategy to operate a low cost model called Jet Konnect to cater to the VFR traffic as business travel has declined. It plans to operate its existing Boeing and ATR fleets and operate shorter haul flights. Operations of this service were started in May 2009 with six ATRs and three Boeings, and while it has led to improvement in load factors, yields have declined. The company at present runs a third of its domestic fleet capacity on Jet Konnect and plans to increase it to two-thirds by October 2009. Jet indicated that it will be able to cut costs by 20%-25% through this model. If this strategy works we believe it could be a key positive for Jet Airways and could aid profitability. We assume a 20% YoY decline in Operating Costs/ASKM in FY10E vs. FY09, in-line with company guidance.

International Operations – Route Rationalisation Has Resulted in Profitability Improvement

Jet's international operations have shown a significant improvement due to:

- **Restructuring of flights and routes –** Jet has leased nine of its widebody aircrafts, which were utilized on loss making routes, and has been using Boeing 737s to run shorter haul routes mainly on ASEAN and Gulf Routes.

- **Load factors have improved sharply over the last few quarters –** As traffic has stabilised on mainline routes, and peripheral routes have been discontinued, load factors have improved. We expect Jet's international operations to remain stable as the strategy is to rationalise and grow selectively, rather than aggressively.

Figure 5. International Operations: Route Wise Load Factors (%)

	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10
UK Routes	60.9	63.4	70.0	76.7	70.9
US Routes	67.0	71.4	68.1	79.3	79.6
ASEAN Routes	67.7	62.9	71.7	78.3	83.0
GULF Routes	61.6	55.8	58.5	62.1	73.2
SAARC Routes	66.0	77.0	78.2	75.6	71.7

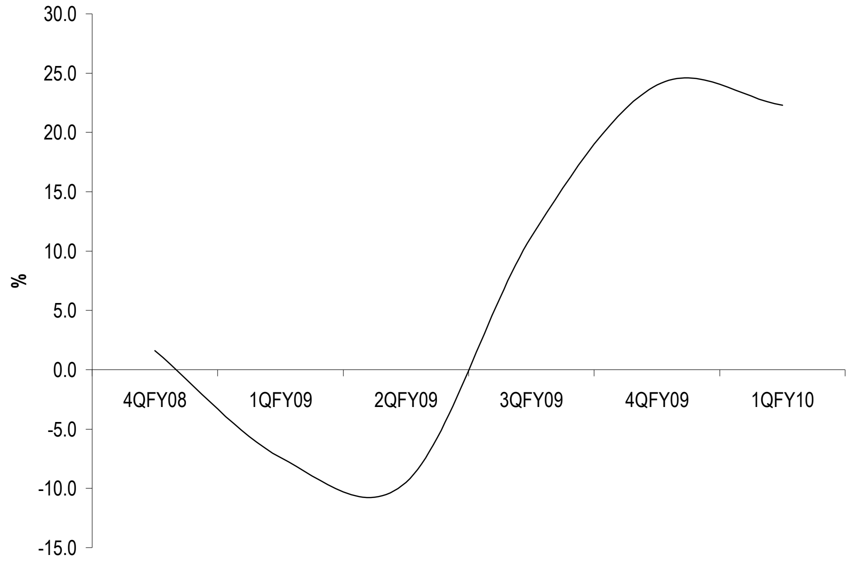
Source: Company, Citi Investment Research and Analysis

Figure 6. Jet Airways Quarterly Trend – International Operating Assumptions

	4QFY08	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10
ASKs	4,687	5,216	5,795	5,705	4,639	4,431
RPKs	3,234	3,374	3,827	3,866	3,493	3,391
Load Factors (%)	69.0	64.7	66.0	67.8	75.3	76.5
Gross Yields (%)	3.2	3.6	3.8	3.7	2.3	2.1
Average Revenue/Pax (Rs)	16,446	16,667	18,469	17,590	14,097	12,095
Total Cost/Pax (Rs)	10,114	20,539	22,799	17,771	13,479	12,942

Source: Company, Citi Investment Research and Analysis

Figure 7. Jet Airways International Operations: EBITDAR Margin – Quarterly Trend (%)



Source: Company

JetLite – Operational Improvements Beginning to Emerge

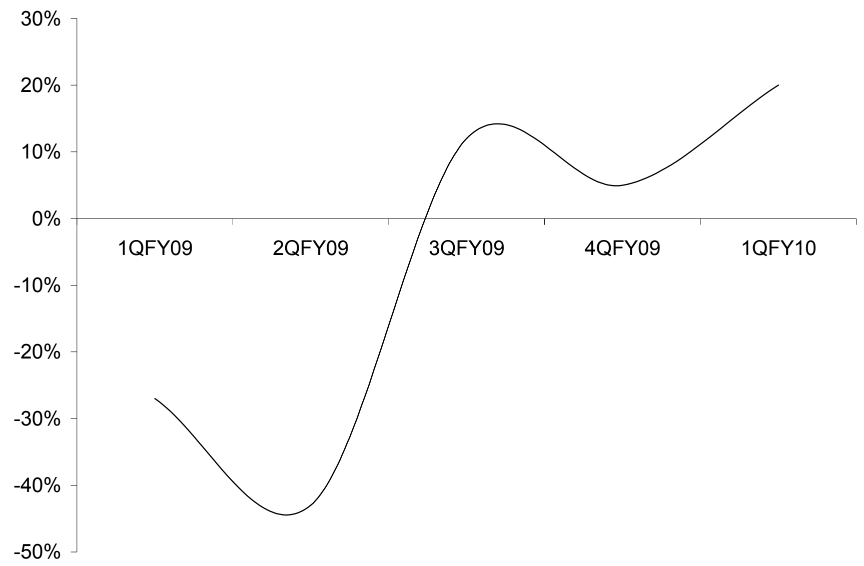
Jet Airways has been able to achieve considerable improvement in Jetlite's operations driven by: 1) Improving load factors, 2) Stable yields, and 3) Lower fuel costs. EBITDAR margins have improved from -27% in 1QFY09 to +20% in 1QFY10, commendable given the challenging environment. We believe Jet's strategy of marketing the Jetlite and Jet Konnect proposition could work as the airline plans to operate both models on different routes. We forecast stable EBITDAR margins of 14%-16% over FY10E-FY12E.

Figure 8. Operational Parameter Comparison – 1QFY10

	JetLite	Jet Airways	Spicejet
Total Operating Cost/ASK	2.6	4.1	2.3
Total Operating Cost/ASK (ex fuel)	1.5	2.9	1.5
Yields	3.5	6.0	3.2

Source: Companies, Citi Investment Research and Analysis

Figure 9. Jet Lite: EBITDAR Margin – Quarterly Trend (%)



Source: Company

Macro Assumptions:

Fuel ($/bbl): FY10E-12E – $62, $73, $74

Rs/$: FY10E-12E – 47, 44.5, 43

Figure 10. Jet Airways Sensitivity — Impact on EBITDAR of Changes in Key Macro Variables

	FY10E		FY11E	
	Rs 1 depreciation	$1 increase in oil/bbl	Rs 1 depreciation	$1 increase in oil/bbl
EBITDAR	-4.6%	-3.3%	-3.8%	-2.2%

Source: Citi Investment Research and Analysis Estimates

Figure 11. Jet Airways — Earnings Revision Table

	FY10E			FY11E		
	Old	New	% Chg	Old	New	% Chg
Revenues	114,825	116,634	1.6	124,338	134,628	8.3
EBITDAR	6,170	17,933	190.6	11,501	26,630	131.5
Margin (%)	5.4	15.4	-	9.2	19.8	-
Recurring PAT	(14,330)	(10,368)	27.7	(10,514)	(563)	94.6
EPS FD	(166.0)	(120.1)	27.7	(121.8)	(6.5)	94.6

Source: Citi Investment Research and Analysis Estimates

Figure 12. Jet Airways — Domestic Operating Assumptions

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Average fleet size	51	56	61	60	56	56
Average trip length (km)	862	875	864	850	850	850
Total block hours	190,911	194,916	181,232	168,645	171,267	176,510
ASKs (m)	12,155	12,073	10,297	10,693	11,062	11,492
RPKs (m)	8,538	8,564	6,884	6,844	8,407	8,848
PLF (%)	70.2%	70.9%	66.9%	64.0%	76.0%	77.0%
Gross Yield (Rs)	6.1	6.17	7.17	5.88	5.88	6.00
Cost / ASK (Rs)	4.3	4.6	5.7	4.1	4.3	4.3
Cost / ASK (ex - fuel) (Rs)	2.7	3.0	3.7	2.9	2.9	2.9
Total Revenues	57,004	57,631	54,552	43,960	54,683	58,957
EBITDAR margin (%)	16.0%	10.3%	2.7%	9.5%	20.8%	22.8%

Source: Company, Citi Investment Research and Analysis Estimates

Figure 13. Jet Airways — International Operating Assumptions

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Total block hours	36,238	72,598	131,775	139,791	146,471	146,471
ASKs (m)	5,543	12,374	21,355	18,035	18,612	18,612
RPKs (m)	3,770	8,350	14,559	13,512	14,203	14,420
PLF (%)	67.5%	67.5%	65.9%	74.9%	76.3%	77.5%
Gross Yield (Rs)	3.2	3.25	3.56	3.02	3.24	3.33
Cost / ASK (Rs)	2.7	2.5	2.8	2.7	2.8	2.9
Cost / ASK (ex - fuel) (Rs)	1.7	1.4	1.5	1.7	1.8	1.9
Total Revenues	13,574	30,480	60,218	55,634	61,009	63,740
EBITDAR margin (%)	7%	5%	4.3%	20.5%	20.6%	23.0%

Source: Company, Citi Investment Research and Analysis Estimates

Jet Airways

Company description

Jet Airways is one of India's leading domestic airlines with ~19% market share (~26% including Jet Lite). Long the leader in the domestic market, it has scaled up its international operations and now flies to several international destinations in the Asia Pacific region, US, Europe and Middle East. Jet has an aggressive fleet expansion plan, and plans to increase its fleet to 89 planes at end-FY10, from 81 planes at end-FY08.

Investment strategy

We rate Jet Airways Sell/High Risk (3H) with a target price of Rs174. Jet is one of India's leading airlines with a market share of ~26% and arguably the best brand and service orientation. In the past, the domestic aviation sector grew at a sedate 6% and was characterized by low levels of competition and high airfares, accompanied by high costs due to regulation. But the situation has changed over the past few years. Economic growth and liberalization have stimulated demand for air travel, and the sector has been averaging growth of over 25% over the past few years. Given the strong base effect and slowing economy we expect a decline in demand over the next 12-18 months. Deregulation has also resulted in a substantial increase in seat capacity, which we estimate will taper off over the next two years. The industry has come full circle, with consolidation commencing among key players. Given the supply overhang and challenging global environment, the benefits of consolidation are yet to be reflected – we believe that airline P&Ls will remain under pressure unless they aggressively scale back capacity induction. A rapidly consolidating industry should also discourage the entry of new players in the industry.

Valuation

Airlines are trading plays – given the cyclical nature of their business, high operational and financial leverage and an earnings profile that is excessively volatile and sensitive to macro variables like oil prices and currency movements. Given the excessive volatility in earnings of airlines, we prefer to utilize a more stable metric to value airlines. Our target price of Rs174 is based on 9x EV/EBITDAR on our FY11E estimates (shifted from replacement cost methodology to earnings based methodology as Jet's profitability improves and sharp fluctuations in profitability reduce). Our target multiple of 9x pegs Jet at a c.15% premium to other regional/global low cost carriers. This premium is justified in our view given: a) Jet is gradually transitioning to a low cost based business model, and b) Growth prospects in India are arguably higher than in many other emerging markets.

Risks

Our High Risk rating on Jet Airways is in-line with our quantitative risk rating system, which tracks 260-day share price volatility. We believe that Jet merits a High risk rating given: a) the competitive scenario in the domestic market; b) its international operations are still at a relatively embryonic phase and should take at least another 12-18 months to stabilize; and c) its highly leveraged balance sheet. Key upside risks to our recommendation and target price are: a) Faster than anticipated capacity rationalization in the domestic airline industry; b) A sustained decline in ATF prices; c) Faster than anticipated ramp up, and greater than forecast profitability of international operations; and d) Rapid restructuring and turnaround of Jet Lite.

Appendix A-1

Analyst Certification

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IMPORTANT DISCLOSURES

Jet Airways (JET.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy

	Date	Rating	Target Price	Closing Price
1	3-Jul-07	*3M	*716.00	801.85
2	5-Mar-08	3M	*765.00	721.95
3	25-Jun-08	3M	*440.00	543.95
4	10-Nov-08	*3H	*167.00	202.20

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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