SSKI

INDIA RESEARCH

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BSE Sensex: 13114

Jet Airways

Rs628

OUTPERFORMER

Event Update

Mkt Cap: Rs54.2bn; US$1.2bn

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After calling off merger talks in June 2006, Jet Airways and Air Sahara have inked their deal today. In 2006, we had a negative bias on Jet Airways bid to buy Sahara Airlines, given the valuations (Rs22bn). However, we see merit in the deal being struck this time round at NPV of Rs12.5bn on following counts:

- **The agreed EV of Rs14.5bn (NPV of Rs12.5bn given the staggered payment terms) is at significant discount to the earlier price. Sahara Airlines is valued at less than 1x revenues vis-à-vis Jet Airways valuations of 2x**
- **We always believed that Jet Airways was on a poor footing in the arbitration process and would have to do away with atleast Rs7bn. Rather, we believe that Jet Airways has effectively got an incremental market share of 8% at a value of Rs5.5bn.**
- **With capacity addition slowing down in the domestic market and yields improving, we see market dynamics also turning favourable then what they were in 2006.**
- **It also strengthens Jet Airways' international operations, as Sahara Airlines has permit to operate in Gulf market and operations are expected to commence in early 2008.**

After three years of bearish call on Jet Airways, we had turned positive in January 2007, as we believe that the worst is over in the domestic operations and profitability in the business will be driven by rapidly surging international operations. Acquisition of Sahara, we believe, strengthens the case for Jet Airways in the domestic market. Reiterate Outperformer.

❑ Contours of the deal

- Jet Airways has entered into purchase agreement of Sahara Airlines at an enterprise value of Rs14.5bn, 30% lower to the earlier deal price in 2006
- While Rs5bn has already been paid, Jet Airways will pay Rs4bn by April 20th and remaining Rs5.5bn to be paid in four interest free annual installments starting before April 2008 - Effective NPV of Rs12.5bn
- With the deal going through, Jet Airways adds 8% to its current market share of 25%. Besides, Jet adds 89 Aircrafts to its domestic operations and gets access to airport infrastructure.
- Sahara Airlines will operate as a separate entity - This entitles the company for two separate permits, which is more important in international operations
- Sahara Airlines has an approximate revenue base of Rs18bn, losses of Rs3bn and accumulated losses of Rs7bn. Jet Airways is entitled for tax shield on accumulated losses.

❑ Our Take - Positive on operations as also on valuations

Our take is that the Jet - Sahara deal is a definite positive over the medium to longer term. We are convinced that Jet can leverage its operational capabilities to ensure a smooth and efficient transition. Jet will control 33% of the market and increase its fleet size. With capacity addition slowing down in the industry, the increase in fleet size will be a net benefit for Jet. Jet Airways also stands to benefit in its international operations, as Sahara Airlines has permit to operate in Gulf market. What impresses us the most is the valuations of Rs14.5bn (NPV of Rs12.5bn) considering the following - a) valuations at less than 1x revenues (Jet Airways is trading at EV/ Sales of 2x), b) potential optional value of sale and lease back on few aircrafts ordered by Sahara, where pre-delivery payment is made and c) tax shield on Rs7bn of accumulated losses.

Worst is over in domestic operations

After a bearish call on Jet Airways since the time of IPO, we just turned positive on Jet Airways in January 2007, as we could sense the changing economics. What has prompted our bearish call on Jet earlier were the deteriorating economics of the business on the back of intensifying competitive landscape and excess capacity build up. We were proven right and this is evident from Jet's depleting profits as also Rs20-25bn of cash burn by the aviation industry in the previous year.

However, we do believe that the worst is over in the domestic operations. While the demand growth continues to remain robust, capacity addition is slowing down. This is bound to improve the average load factors as also yields for domestic operators. Gross yields which were hovering under Rs6.0 till 2006 are expected to improve to Rs6.6 (FY08E) and Rs6.8 (FY09E). Average load factors are also expected to improve from 69% to 74% in FY09.

We believe the fears of price wars, low load factors and oversupply seem to be a thing of the past. We also expect increased air travel in Tier II cities to add to the growth rates. While the economy has been growing at 8 to 10% over the past few years, the aviation industry has been growing at 20 - 25% and at these rates, the domestic air travel is expected to touch 60mn passengers by FY09.

International operations to trigger profitability

While the economics in the domestic operations improve, what we see as a major trigger point for Jet Airways is the international operation. Given the fact that India is the largest passenger origination market after US and China, we see immense potential for Jet Airways. What excites us more about the international operations is higher realization (no issue of Purchase Price Parity), higher load factors (over 70%) and better margin profile.

Jet Airways performance in the international operations has been comparable to the global peers as its yield as also load factors on Mumbai London and Mumbai Singapore are similar to that of British Airways and Singapore Airlines. With the addition of 13 wide-bodied aircrafts and the launch of US operations in July 2007, we see further gain of momentum in the international business. We expect international revenues to help double total revenues in the next 2 years.

Reiterate Outperformer

Improving domestic operations and rapid scale up of international operations, and now acquisition of Sahara Airlines at an attractive valuations, strengthens our positive bias on Jet Airways. We believe that when compared to international players, the Indian aviation industry is undervalued. Hong Kong with 41mn passengers, the industry is valued at USD22bn (market capitalization/ passenger ratio = 0.54) and China with 128mn passengers, the industry is valued at USD41.5bn (mkt cap/pax ratio = 0.32), whereas the industry in India is valued at only USD4.5bn with 60mn passengers (domestic & international), resulting in a market cap to passenger ratio of only 0.08. We believe that Jet Airways offers substantial value creation potential given the discounted valuations to global peers. As revenues from international operations scale up, we believe that valuations will also move closer to international peers - given the fact that there is no issue of PPP in the international market. Reiterate Outperformer.

Jet Airways - Undervalued

	Market Cap ($ bn)	Total Pax (mn)	Market Cap/Total Pax
US	90.20	740	0.12
China	41.50	128	0.32
UK	37.10	235	0.16
Hong Kong	21.90	41	0.54
India	4.50	60	0.08

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

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