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Indian Aviation

May passenger traffic: Another strong performance

- ▶ **Strong growth seen in May's domestic passenger traffic; this reinforces our bullish outlook on the sector**
- ▶ **Load factor is at the highest level in the last ten years**
- ▶ **Our investment thesis on OW(V)-rated Jet Airways remains intact**

Strong growth continues in May: The trend of high growth in domestic passenger traffic continued in May 2010 as well. Total passenger traffic in May at 4.7m, the highest ever, grew by 22% y-o-y and 14% m-o-m. Also, this time, the growth was not induced by cheap fares, which indicates a strong rebound in domestic travel and reinforces our bullish outlook on the sector. For Jet Airways (JET.BO), our preferred play in the sector, April domestic traffic at 0.8m (41% y-o-y and 13% m-o-m growth) was in line with our expectations.

Load factor is at the highest level in last 10 years: Passenger load factor in May reached the highest level in the last ten years for both Industry as well as Jet Airways. May's load factor improved by c8%, to c85% due to: (1) strong demand in May and (2) low single digit capacity addition by full service carriers. Budget carriers saw greater improvements in load factors. For Jet Airways, seat factors improved by 8%, to c83%, while for Jet Lite, this metric improved by 7%, to 85.3%. Jet Airways' international load factors improved by c3% to 80.3% over April. These improvements in load factors are in line with our expectations and augur well for profitability.

Jet maintains market share: Jet Airways as a group has been able to maintain its market share at c26% benefiting from budget carrier brands namely, Jet Konnect and Jet Lite.

Oil prices have started to soften again: Jet fuel prices have declined from USD95/bl to USD85/bl in the last couple of months vs. our assumption of USD90/bl for FY11 and thus poses an upside risk to our earnings assumptions. Oil constitutes one-third of operating costs. Our sensitivity suggests a 10% drop in oil prices can increase FY11 earnings of Jet Airways by 50%.

Investment thesis remains intact: Jet Airways is a key beneficiary of the revival in aviation traffic. Industry discipline should lead to improved yield and profitability. Strong Q1FY11 aviation traffic and earnings are likely positive triggers. We have an Overweight (V) rating on Jet stock, with a 12-month target price of INR590. We value the company on EV/EBITDAR and benchmark it to regional Asian peers. Our target price implies 7.5x FY12e EV/EBITDAR (the average of Chinese airline and regional international airline multiples). On FY11e, the stock is trading at 8.2x, which we expect to contract as EBITDAR growth slows to 6% in FY12e from 48% in FY11e. Key risks include sharper-than-expected increases in jet fuel prices, any scenario of a double-dip recession, and higher-than-expected capacity additions.

16 June 2010

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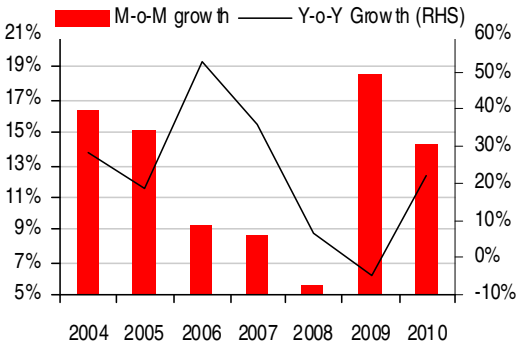
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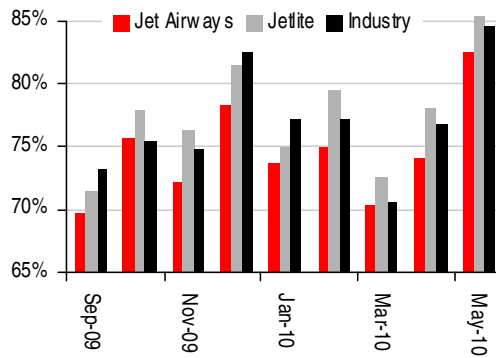
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1. Strong domestic passenger traffic growth continues in May



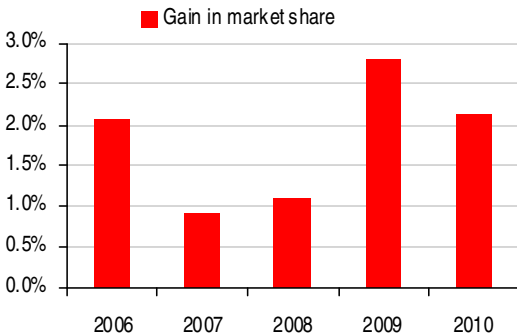
Source: DGCA

2. Load factor at the highest level in a decade



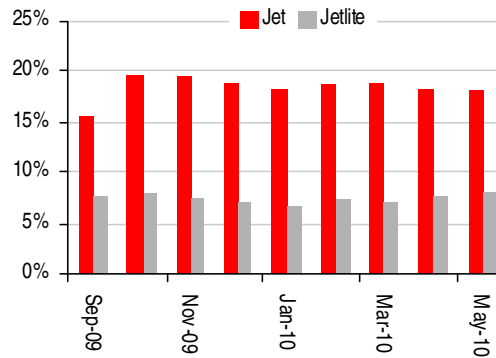
Source: DGCA

3. Budget carriers gains market share gain in Apr-Jun quarter vs. Jan – March quarter due to holiday season



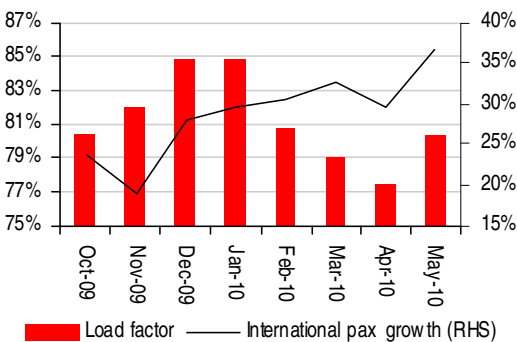
Note: 1. Spicejet, Indigo and Go Air considered budget carrier to analyse the market share trend of budget carriers, 2. For 2010, market share data compares Apr-May period over Jan- March period; Source: DGCA

4. JetKconnect strategy paying off as Jet as a group has maintained market share at 26%



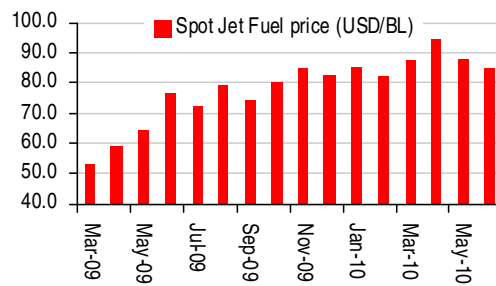
Note: Jet airways launched Jet Kconnect, a budget carrier, in FY10; Source: DGCA

5. Jet Airways international operations benefiting from a rebound in business travel



Note: Pax stands for passenger traffic; Source: Company data

6. Jet fuel prices has been trending lower and thus poses an upside risk to our earnings assumption for Jet Airways



Note: For Jet Airways, we have assumed jet fuel price at USD90/bl for FY11 and FY12; Source: Bloomberg

Domestic passenger traffic trends

	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10
Passenger traffic ('000)						
Nacil	820	734	663	693	762	847
Jet Airways	852	751	726	739	766	869
Jet Lite	321	277	282	279	318	384
Kingfisher	935	908	877	899	898	1,000
SpiceJet	579	500	465	463	527	632
Paramount	64	72	62	50	13	19
Go Air	232	220	211	206	246	281
Indigo	684	625	577	574	658	753
Total	4,487	4,087	3,863	3,903	4,188	4,785
YOY Growth						
Nacil	47%	32%	16%	28%	31%	23%
Jet Airways	54%	26%	22%	32%	39%	41%
Jet Lite	25%	15%	13%	20%	30%	30%
Kingfisher	4%	-1%	-3%	7%	4%	-1%
SpiceJet	55%	27%	13%	22%	36%	27%
Paramount	-20%	1%	2%	-28%	-83%	-77%
Go Air	209%	172%	151%	119%	70%	49%
Indigo	34%	37%	31%	35%	45%	39%
Total	35%	23%	16%	24%	26%	22%
Market Share						
Nacil	18%	18%	17%	18%	18%	18%
Jet Airways	19%	18%	19%	19%	18%	18%
Jet Lite	7%	7%	7%	7%	8%	8%
Kingfisher	21%	22%	23%	23%	21%	21%
SpiceJet	13%	12%	12%	12%	13%	13%
Paramount	1%	2%	2%	1%	0%	0%
Go Air	5%	5%	5%	5%	6%	6%
Indigo	15%	15%	15%	15%	16%	16%
Total	100%	100%	100%	100%	100%	100%
Load Factor						
Nacil	80%	74%	72%	67%	73%	78%
Jet Airways	78%	74%	75%	70%	74%	83%
Jet Lite	82%	75%	80%	73%	78%	85%
Kingfisher	80%	76%	76%	70%	76%	83%
SpiceJet	88%	82%	81%	74%	81%	90%
Paramount	89%	88%	85%	85%	85%	87%
Go Air	86%	77%	78%	70%	78%	86%
Indigo	90%	83%	83%	74%	82%	92%
Total	83%	77%	77%	71%	77%	85%

Note: NACIL stands for National Aviation Company of India Ltd
Source: DGCA

Investment case

Jet Airways is the largest airline company in India. We expect it to be a key beneficiary of the revival in passenger traffic. Industry discipline has lowered the risk of price wars, while cost-cutting measures are leading to margin improvement. Higher-than-expected passenger traffic growth and upside earnings surprise should act as positive triggers.

Valuation

We value Jet Airways on EV/EBITDAR and benchmark it to regional peers, given the company's limited trading history. We compare earnings growth prospects, profitability, and solvency risk of aviation companies across the region. Jet Airways has a strong domestic market, similar to Chinese companies, but we believe its growth potential is lower than these companies, while compared to international players such as Cathay Pacific or Singapore Airlines, Jet Airways has higher growth potential and larger domestic exposure. Hence, we believe Jet stock should trade at multiples higher than the international players but

lower than those of Chinese players. A mid-range multiple of 7.5x FY12e generates our 12-month target price of INR590. Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below our hurdle rate for Indian stocks of 10.5%, or 0.5-20.5% above the share price. As the potential return was above the Neutral band at the time we set our target time, we rate the stock Overweight (V).

Key risks

Key downside risks, in our view, include a sharper-than-expected rise in the jet fuel price; a loss of price discipline, although slow capacity additions reduce the likelihood of such a possibility; a scenario of a global double-dip recession

Valuation comparison with Asian peer airlines

	Reuter code	EV/EBITDAR CY10e	CY11e	EBITDAR Growth CY09-11	ROIC CY11e	ROE CY11e
Air China	0753.HK	9.0	8.9	53%	6%	12%
China Eastern Airlines Co	0670.HK	9.3	8.1	236%	5%	10%
China Southern Airlines Co	1055.HK	17.5	14.3	36%	4%	3%
Cathay Pacific	0293.HK	7.1	5.9	15%	12%	14%
Singapore Airlines	SIAL.SI	4.2	3.6	28%	12%	10%
Thai Airways International	THAI.BK	6.2	4.2	20%	6%	12%
Jet Airways	JET.BO			32%	5%	25%
Domestic Market plays		11.9	10.4	109%	5%	8%
International Market plays		5.8	4.6	21%	10%	12%

Note: Data pertains to 21 March 2010. For Jet Airways, CY10 is FY11 and CY11 is FY12
Source: Company data, HSBC, Bloomberg

Disclosure appendix

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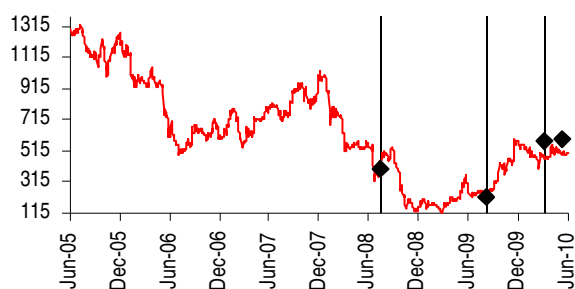
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Share price and rating changes for long-term investment opportunities

Jet Airways (JET.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight (V)	Neutral (V)	25 July 2008
Neutral (V)	Underweight (V)	19 August 2009
Underweight (V)	Overweight (V)	22 March 2010
Target Price	Value	Date
Price 1	400.00	25 July 2008
Price 2	218.00	19 August 2009
Price 3	580.00	22 March 2010
Price 4	590.00	21 May 2010

Source: HSBC

HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
JET AIRWAYS	JET.NS	495.95	15-Jun-2010	2, 7

Source: HSBC

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