

Company Flash

12 April 2007 | 6 pages

Jet Airways (JET.BO)

Sell: Acquires Air Sahara for Rs14.5bn

- Update** – Jet has acquired Air Sahara for a total purchase consideration of Rs14.5bn (including Rs5bn paid earlier). Rs4bn will be paid shortly, with Rs5.5bn to be paid in 4 annual instalments, commencing on or before March 2008. Present value of the deal is Rs12bn. Prima facie, the deal appears more reasonable (in valuation terms) than that speculated on by the press 2 days ago; immediate cash outflows will also be lower.
- Positives** – 1) The Jet–Sahara combine has market share of c.35%. On key routes like Mumbai–Delhi, its market share will be ~45-50%. 2) The staggered payment mechanism will not strain Jet's near-term cash flows. 3) Jet will have access to Sahara's infrastructure, which should aid its future expansion plans. 4) We believe Jet might also be able to use Sahara's losses as a tax shield.
- Concerns** – 1) Effective and timely integration remains key, given different sets of corporate cultures of both airlines. 2) Jet's balance sheet will continue to remain stretched; given its near-term expansion (total outlay of ~USD2bn).
- Domestic market – consolidation ≠ yield improvement** – Yes, consolidation has commenced within the domestic industry – but we believe that at least some of the larger carriers will have to become distressed, and their capacity will have to leave the industry, before structural pressure on the yields of players abates. We remain negative on the industry.
- Maintain Sell (3H)** – Key upside risks: 1) Meaningful and sustained improvement in Jet's domestic yields; 2) Lower than forecast losses in the US operations.

Sell/High Risk	3H
Price (12 Apr 07)	Rs617.00
Target price	Rs390.00
Expected share price return	-36.8%
Expected dividend yield	0.3%
Expected total return	-36.5%
Market Cap	Rs53,268M US\$1,248M

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	3,714	43.02	245.4	14.3	2.6	31.5	0.5
2006A	2,612	30.25	-29.7	20.4	2.3	11.9	1.0
2007E	1,101	12.76	-57.8	48.4	2.3	4.7	0.3
2008E	2,057	23.83	86.8	25.9	2.2	8.7	0.5
2009E	2,844	32.94	38.2	18.7	2.0	11.2	0.6

Source: Powered by dataCentral

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

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Jet Airways

Company description

Jet is the market leader in the Indian aviation sector (c30% market share Apr – Dec FY07) with a strong franchise built on high operational efficiency and effective positioning focused on the business traveler. Jet currently flies 44 domestic and 6 international operations and has one of the youngest fleets globally; the average age is less than five years.

Investment thesis

We rate Jet Airways as Sell/High Risk (3H) with a target price of Rs390. Jet is India's largest airline with a market share of more than 30% and possibly the best brand and service orientation. Economic growth and liberalization have stimulated demand for air travel, and the sector has been averaging growth of around 20% for the past two years. Given the positive trend in key demand drivers, we expect growth rates to accelerate for the medium term. The government's policy of opening up international routes, albeit gradually and selectively, has opened up another substantial growth opportunity for local airlines such as Jet. Deregulation, however, is also resulting in a substantial increase in capacity, which we estimate to grow at a CAGR of more than 22% for the next four years. Three new airlines commenced operations in 2005; most are modeling themselves as LCCs and expecting to compete on price. Easier access to funding has enabled start-ups to embark on substantial acquisition plans. The mismatch in capacity creation and demand is resulting in a collapse in fare structures. We believe this situation of irrational pricing will persist in the near term. Longer term, we believe it will accelerate the consolidation process in the industry - but the timing and extent of consolidation remain uncertain. For the next 2-3 years, the domestic aviation sector could witness conditions last evidenced in the mid-1990s when some of the start-up airlines had to close down.

Valuation

Our target price of Rs390 is based on a 7.5x FY07E EV/EBITDAR multiple. Our multiple is based on a 15% discount to the average 8.8x CY06E EV/EBITDAR multiple of our regional airline universe (ex Air Asia). We believe the discount to the Asian airlines is justified given: a) the very competitive domestic landscape; b) delays in stabilization of Jet's international operations; and c) soaring fuel costs (which Indian carriers cannot hedge).

Our current estimates do not factor in potential negative impact of the Air Sahara acquisition (we believe that the Rs20bn will eventually be returned to Jet Airways). Moreover, they also do not reflect the impact of the fund raising that management has announced (a US\$500m FCCB issuance and a \$300m GDR) to fund its medium-term capital expenditure program.

Risks

Our High Risk rating on Jet Airways is in contrast to the risk ratings on peers in our regional coverage universe which are typically assigned a Low to Medium Risk rating. We believe that Jet merits a High Risk rating, given: a) the intense competitive scenario in the domestic market; b) international operations are still at a relatively embryonic phase and should take 2-3 years to stabilize; c) potential fall-out from the aborted Air Sahara acquisition; and d) soaring fuel prices. Key upside risks to our rating and target price are: a) faster-than-

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expected consolidation in the domestic airline industry; b) a sustained decline in ATF prices; and c) faster-than-expected ramp up and stabilization of international operations. If any of these factors has a greater impact than we expect, the stock could have difficulty achieving our target price.

Appendix A-1

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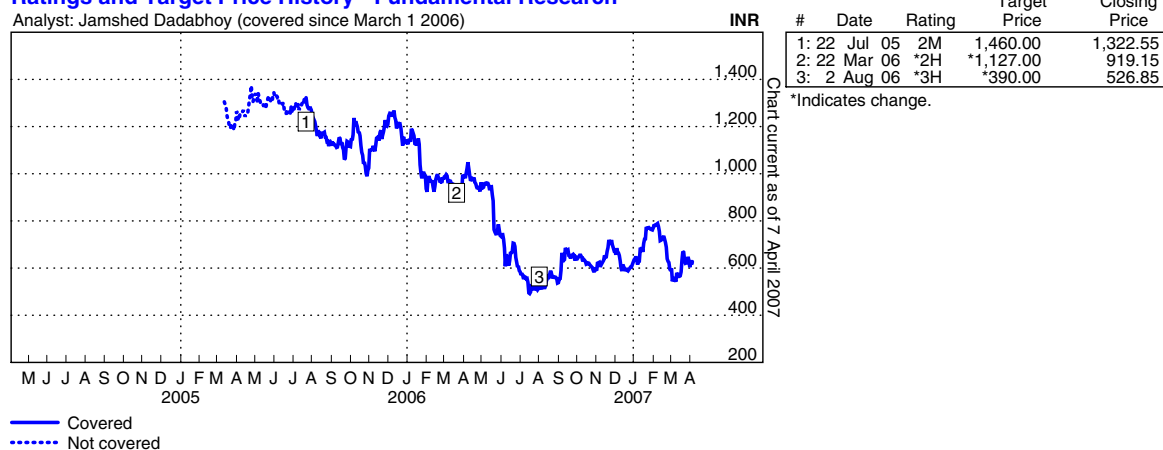
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Jet Airways (JET.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Jamshed Dadabhoy (covered since March 1 2006)



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