

Industrials
Airlines
Equity – India

Neutral (V)

Target price (INR)	350.00
Share price (INR)	320.65
Forecast dividend yield (%)	0.0
Potential return (%)	9.2

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	-6.2	6.4	-28.7
Relative ^A (%)	-0.5	17.5	-20.9

Index^A BOMBAY SE IDX

RIC JET.BO
Bloomberg JETIN IN

Market cap (USDm) 498
Market cap (INRm) 27,683

Enterprise value (INRm) 235,007
Free float (%) 20

Note: (V) = volatile (please see disclosure appendix)

25 May 2012

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Issuer of report: The Hongkong and Shanghai Banking Corporation Limited

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This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Jet Airways (JETIN)

N(V): But for the INR, 4QFY12 trends encouraging

- ▶ **4QFY12 performance was better than expected on lower-than-anticipated costs**
- ▶ **Domestic yield improvements to drive future performance; international business likely to benefit from weakening full service rivals; fuel price decline to allay cost pressures**
- ▶ **Remain N(V) with a target price of INR350; yield and fuel trends are encouraging, just waiting for the INR slide to reverse**

4QFY12 performance better than expected. Jet Airways reported a consolidated loss of INR3.5bn for the January-March quarter versus a loss of INR1.9bn in the same period last year. There was a INR300m non-recurring gain from the reversal of foreign exchange losses booked earlier. Stripping this gain out, we estimate that the recurring loss of INR3.8bn was below our forecast loss. The main driver of the increased loss was the 9% y-o-y increase in unit yields more than offsetting the 13% increase in unit costs. The performance was better than expected, largely on account of lower-than-forecast costs.

Trends encouraging. In its outlook statement, Jet Airways said, “Capacity reduction in the industry has helped the domestic airlines to increase fares and improve yields. The full impact of the same would be felt in the current quarter. We have not seen any adverse effect on the passenger traffic flow. Rupee depreciation and Crude Oil prices continues to be a cause of concern.” Our previous concerns over the underperforming international business were allayed by this quarter’s performance. Jet’s domestic business and JetLite should see better performance ahead as the benefits from improved industry dynamics flow in.

Remain Neutral (V), target price of INR350. As earnings show signs of a recovery, valuations tend to be driven by earnings. We continue to value Jet Airways on EV/EBITDAR. As Jet Airways’ own trading range is very volatile, we apply a multiple of 8x (the average of the implied one-year forward EV/EBITDAR at our target for the three Chinese airlines under our coverage). This implies a target price of INR350, and we maintain our Neutral (V) rating on the stock. Key upside risks are better-than-expected traffic and yield performance, a reversal of the INR slide, and a continued fall in fuel price. Key downside risks are a stall in traffic from upward yield revisions and a further weakening of the INR.

Key financial data

	Revenues INRm	EBITDAR INRm	EBIT INRm	HSBC NP INRm	HSBC EPS INR	PE x	P/BV x	EV/EBITDAR x
FY11a	144,884	27,613	6,975	-2,870	-33	-9.6	1.7	8.5
FY12a	167,032	11,653	-9,810	-17,723	-205	-1.6	NA	20.2
FY13e	194,723	26,121	3,435	-3,342	-39	-8.3	NA	9.0
FY14e	205,650	31,418	7,596	1,079	12	25.7	NA	7.2

Source: Company, HSBC estimates

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	144,884	167,032	194,723	205,650
EBITDA	16,161	-397	12,726	17,152
Depreciation & amortisation	-9,186	-9,413	-9,290	-9,556
Operating profit/EBIT	6,975	-9,810	3,435	7,596
Net interest	-11,772	-10,058	-9,242	-8,779
PBT	-484	-14,399	-3,342	1,438
HSBC PBT	6,690	-7,747	5,948	10,995
Taxation	-374	198	0	-360
Net profit	-858	-14,201	-3,342	1,079
HSBC net profit	-2,870	-17,723	-3,342	1,079
Cash flow summary (INRm)				
Cash flow from operations	3,070	352	3,579	8,320
Capex	-1,006	-3,720	-2,100	-2,100
Cash flow from investment	-7,930	-4,910	-7,332	-7,410
Dividends	0	0	0	0
Change in net debt	-11,870	-273	844	-8,182
FCF equity	3,102	-7,319	1,479	6,220

Balance sheet summary (INRm)

	03/2011a	03/2012e	03/2013e	03/2014e
Intangible fixed assets	18,724	18,724	18,724	18,724
Tangible fixed assets	136,372	130,679	123,489	116,033
Current assets	45,023	46,281	48,529	53,455
Cash & others	7,573	6,002	4,712	8,243
Total assets	203,947	200,485	196,775	195,555
Operating liabilities	50,655	60,443	64,075	65,776
Gross debt	215,170	213,326	212,881	208,229
Net debt	207,597	207,324	208,168	199,987
Shareholders funds	15,964	-1,022	-4,364	-3,285
Invested capital	223,562	206,304	203,806	196,703

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	22.0	15.3	16.6	5.6
EBITDA	52.1	-102.5	-	34.8
Operating profit	648.0	-240.6	-	121.1
Ratios (%)				
Revenue/IC (x)	0.6	0.8	0.9	1.0
ROIC	9.6	-1.9	4.8	5.4
ROE	-17.3	-237.2	124.1	-28.2
ROA	9.8	-2.1	3.0	3.9
EBITDA margin	11.2	-0.2	6.5	8.3
Operating profit margin	4.8	-5.9	1.8	3.7
EBITDA/net interest (x)	1.4	-	1.4	2.0
Net debt/equity	1300.4	0.0	0.0	0.0
Net debt/EBITDA (x)	12.8	-522.2	16.4	11.7
CF from operations/net debt	1.5	0.2	1.7	4.2
Per share data (INR)				
EPS reported (fully diluted)	-9.93	-164.47	-38.71	12.49
HSBC EPS (fully diluted)	-33.24	-205.26	-38.71	12.49
DPS	0.00	0.00	0.00	0.00
NAV	184.88	-11.83	-50.54	-38.05

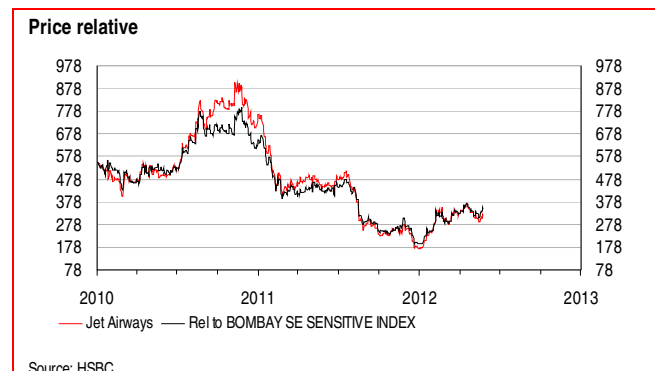
Key forecast drivers

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Capacity growth (%)				
Overall (ATK)	12%	11%	8%	8%
Passenger (ASK)	16%	12%	9%	9%
Cargo (FATK)	8%	10%	6%	6%
Traffic growth (%)				
Overall (RTK)	16%	11%	8%	8%
Passenger (RPK)	18%	12%	9%	8%
Cargo (FTK)	11%	7%	7%	6%
Load factor (%)				
Overall (RTK/ATK)	65%	65%	65%	65%
Passenger (RPK/ASK)	79%	79%	79%	78%
Cargo (FTK/FATK)	41%	40%	40%	40%
Break-even load factor	66%	72%	67%	66%
Change in yields and unit costs				
Overall (INR/RTK)	7%	6%	8%	-2%
Passenger (INR/RPK)	4%	5%	8%	-3%
Cargo (INR/FTK)	21%	8%	0%	0%
Unit costs (INR/ATK)	4%	15%	0%	-4%
Spot jet fuel price (USD/bbl)	99	128	125	115

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	1.6	1.4	1.2	1.1
EV/EBITDAR	8.5	20.2	9.0	7.2
EV/IC	1.0	1.1	1.2	1.1
PE*	-9.6	-1.6	-8.3	25.7
P/NAV	1.7	NA	NA	NA
REP**	1.0	0.0	2.2	1.7
Dividend yield (%)	0.0	0.0	0.0	0.0

Note: * = Based on HSBC EPS (fully diluted) **EV/IC divided by ROIC/WACC



Note: price at close of 24 May 2012

4QFY12 performance better than expected

Jet Airways reported a consolidated loss of INR3.5bn for the January-March quarter versus a loss of INR 1.9bn in the same period last year. There was a INR300m non-recurring gain from the reversal of foreign exchange losses booked earlier. Stripping this gain out, we estimate that the recurring loss of INR3.8bn was below our forecast loss. The main driver of increased loss was the 9% y-o-y increase in unit yields more than offsetting the 13% increase in unit costs.

1. 4QFY12 financial results versus prior year and HSBC forecasts

INRM	Group					Jet Airways - standalone				
	4Q12a	4Q11a	Change %	HSBC 4Q12e	Diff %	4Q12a	4Q11a	Change %	HSBC 4Q12e	Diff %
Passenger	39,888	30,679	30%	39,988	0%	34,766	26,773	30%	34,963	-1%
Cargo	3,800	3,082	23%	3,696	3%	3,658	2,983	23%	3,581	2%
Other	2,100	2,286	-8%	2,751	-24%	1,992	2,679	-26%	2,531	-21%
Total revenue	45,788	36,047	27%	46,434	-1%	40,416	32,435	25%	41,075	-2%
Staff costs	4,582	4,187	9%	4,894	-6%	4,107	3,790	8%	4,471	-8%
Fuel	21,302	15,234	40%	22,379	-5%	18,225	12,797	42%	19,289	-6%
Operating leases	3,268	2,704	21%	3,501	-7%	2,441	2,089	17%	2,702	-10%
Depreciation	2,496	2,215	13%	2,342	7%	2,488	2,198	13%	2,331	7%
Commissions	3,791	3,612	5%	3,971	-5%	3,378	3,398	-1%	3,623	-7%
Other	11,990	9,332	28%	12,735	-6%	11,008	8,674	27%	11,570	-5%
Operating costs	47,429	37,284	27%	49,823	-5%	41,647	32,946	26%	43,986	-5%
EBITDAR	4,123	3,682	12%	2,455	68%	3,698	3,776	-2%	2,122	74%
Margin	9%	10%	-1%	5%	4%	9%	12%	-2%	5%	4%
EBIT	-1,641	-1,237	33%	-3,388	-52%	-1,231	-511	141%	-2,911	-58%
Margin	-4%	-3%	0%	-7%	4%	-3%	-2%	-1%	-7%	4%
Net interest expense	-2,660	-3,596	-26%	-2,487	7%	-2,579	-2,930	-12%	-2,426	6%
Other income	600	899	-33%	581	3%	511	461	11%	548	-7%
Non-recurring items	300	1,431	-79%	0	NA	462	1,108	-58%	0	NA
Profit before tax	-3,401	-2,504	36%	-5,294	-36%	-2,838	-1,872	52%	-4,789	-41%
Taxation	144	-623	-123%	0	NA	144	-628	-123%	0	NA
Net profit	-3,545	-1,882	88%	-5,294	-33%	-2,982	-1,245	140%	-4,789	-38%
HSBC net profit	-3,845	-3,109	24%	-5,294	-27%	-3,443	-2,353	46%	-4,789	-28%

Source: Company data, HSBC estimates

The performance was better than expected, largely on account of lower-than-forecasted costs.

2. 4QFY12 operating results versus prior year and HSBC forecasts

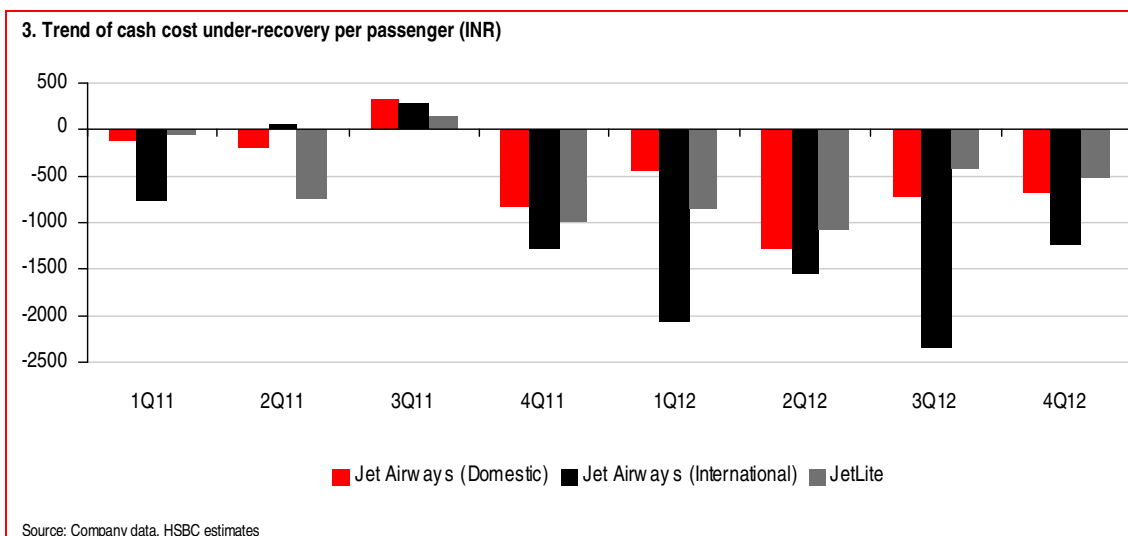
	Group					Jet Airways - standalone				
	4Q12a	4Q11a	Change %	HSBC 4Q12e	Diff %	4Q12a	4Q11a	Change %	HSBC 4Q12e	Diff %
Capacity										
Overall (ATKm)	1,512	1,348	12%	1,512	0%	1,380	1,213	14%	1,380	0%
Passenger (ASKm)	11,574	10,298	12%	11,574	0%	10,129	8,809	15%	10,129	0%
Cargo (FATKm)	553	492	12%	553	0%	538	477	13%	538	0%
Traffic										
Overall (RTKm)	1,025	865	19%	1,025	0%	928	768	21%	928	0%
Passenger(RPKm)	9,536	8,013	19%	9,536	0%	8,403	6,865	22%	8,403	0%
Cargo (FTKm)	226	198	14%	226	0%	222	194	14%	222	0%
Utilisation										
Overall load factors	68%	64%	4%	68%	0%	67%	63%	4%	67%	0%
Passenger load factor (%)	82%	78%	5%	82%	0%	83%	78%	5%	83%	0%
Cargo load factor	41%	40%	1%	41%	0%	41%	41%	1%	41%	0%
Break-even load factor	74%	71%	3%	77%	-4%	73%	70%	3%	77%	-4%
Yields and costs (INR)										
Revenue/RTK	42.6	39.0	9%	42.6	0%	41.4	38.7	7%	41.5	0%
Passenger yields(INR/RPK)	4.2	3.8	9%	4.2	0%	4.1	3.9	6%	4.2	-1%
Cargo yield (INR/FTK)	16.8	15.5	8%	16.3	3%	16.5	15.4	7%	16.1	2%
Unit costs per ATK	31.4	27.7	13%	33.0	-5%	30.2	27.2	11%	31.9	-5%
Unit costs per ATK (fuel)	14.1	11.3	25%	14.8	-5%	13.2	10.6	25%	14.0	-6%
Unit costs per ATK (ex fuel)	17.3	16.4	6%	18.2	-5%	17.0	16.6	2%	17.9	-5%

Source: Company data, HSBC estimates

Encouraging trends suggesting a better outlook

In its outlook statement, Jet Airways said, “Capacity reduction in the industry has helped the domestic airlines to increase fares and improve yields. The full impact of the same would be felt in the current quarter. We have not seen any adverse effect on the passenger traffic flow. Rupee depreciation and Crude Oil prices continues to be a cause of concern. This coupled with sluggish economy could impact traffic growth to some extent in the short to medium term as the discretionary spending on travel could get affected.”

As we had discussed in detail in our sector upgrade note earlier this month, [Back on the radar screen](#), 10 May 2012, there are clear signs of improving industry dynamics in India. These signs are more evident in the domestic market, where capacity pressures have been easing, leading to improved load factor performance and yields have been rising. Irrational competitive pressures have slowed and signs of discipline are visible. However, the pick-up in Jet’s international performance also suggests that it may be benefitting from weakening full service rivals.



Jet Airways’ operating statistics have been very encouraging in the past quarter. We expect this to continue to be supported by the problems being faced the other full service rivals. Along with strong operating performance, the yield increases that were made at the end of the first calendar quarter of 2012 will fully be reflected over the April-June quarter and together this should help lift performance.

Valuation

Neutral (V) rating; target price of INR350

As earnings show signs of a recovery, valuations tend to be driven by earnings. We continue to value Jet Airways on EV/EBITDAR. As Jet Airways’ own trading range is very volatile, we apply a multiple of 8x (the average of the implied one-year forward EV/EBITDAR at our target for the three Chinese airlines under our coverage). This implies a target price of INR350.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppts above and below the hurdle rate for India stocks of 11%. Our target price of INR350 implies a potential return of 9.2%, within the Neutral band; therefore, we are reiterating our Neutral (V) rating. Potential return equals

the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Risks and catalysts

Risks to our rating and estimates

Upside

- ▶ **Fuel price and currency.** The main upside risks to our earning estimates and rating are a fall in fuel prices and an appreciation of the INR versus the USD. As airlines are low margin businesses, the magnitude of the earnings impact of a small change in the largest cost item (fuel) tends to be substantial. Also, a more favourable currency movement will help to alleviate cost pressures as we estimate nearly 50% of Jet Airways' cost base is USD denominated. Besides, it also has large USD debt.
- ▶ **Sale and lease back.** Jet Airways intends to sell and lease back 12-13 of its Boeing 737- 800 aircraft and use the proceeds to repay some loans. Jet Airways did a sale and lease back transaction on engines in 3QFY12 and plans to close a deal on the aircraft as early as 1QFY13. We do not attempt to forecast the proceeds or the profits from such deals. Therefore, our forecasts have upside potential if these deals do indeed materialise.

Downside

- ▶ **Rising airport charges.** Airport charges are beginning to become cumbersome for both airlines and passengers. Given substantial investment in infrastructure, airport operators have been demanding steep increases in airport charges. Some airports are now demanding levying/raising the charges/increasing the scope of a user development fee (UDF), in addition to the already charged airport development fee (ADF), besides lobbying for significant increases in landing and take-off charges. The latter are imposed directly on airlines. The impact of any such increase will likely be negative on demand. No matter who pays for these charges, it does increase costs for both airlines as well as passengers and could potentially dampen demand. More importantly, this would raise the fares for customers without benefitting airlines at all. Further, these hikes in airport charges could make it extremely difficult for airlines to raise fares in line with increases in fuel costs.
- ▶ **Fuel price rise and further INR slide.** A rise in fuel prices and a depreciating INR tend to spell double trouble for airline.

Potential share price catalysts

Positive

- ▶ **Earnings momentum.** Over the past two years, the price of Jet Airways shares has had a 0.5 correlation with the company's earnings momentum (defined as the q-o-q change in one year forward consensus earnings estimates). Earnings momentum has turned positive for Jet Airways since March 2012. If fuel prices continue to correct, this may continue.

Disclosure appendix

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The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Rajani Khetan and Mark Webb

Important disclosures

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HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

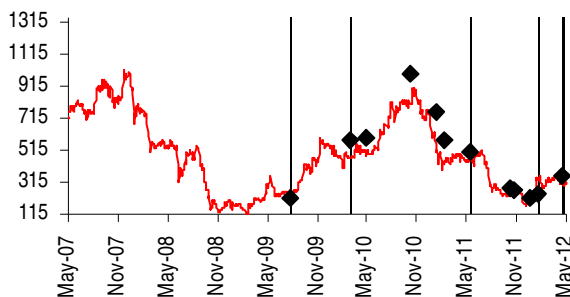
Rating distribution for long-term investment opportunities

As of 25 May 2012, the distribution of all ratings published is as follows:

Overweight (Buy)	49%	(26% of these provided with Investment Banking Services)
Neutral (Hold)	37%	(25% of these provided with Investment Banking Services)
Underweight (Sell)	14%	(16% of these provided with Investment Banking Services)

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
Neutral (V)	Underweight (V)	19 August 2009
Underweight (V)	Overweight (V)	22 March 2010
Overweight (V)	Neutral (V)	07 June 2011
Neutral (V)	Underweight (V)	14 February 2012
Underweight (V)	Neutral (V)	09 May 2012
Target Price	Value	Date
Price 1	218.00	19 August 2009
Price 2	580.00	22 March 2010
Price 3	590.00	21 May 2010
Price 4	1000.00	03 November 2010
Price 5	750.00	04 February 2011
Price 6	580.00	02 March 2011
Price 7	500.00	07 June 2011
Price 8	275.00	01 November 2011
Price 9	270.00	14 November 2011
Price 10	220.00	17 January 2012
Price 11	240.00	14 February 2012
Price 12	350.00	09 May 2012

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
JET AIRWAYS	JET.NS	320.65	24-May-2012	6,7

Source: HSBC

- 1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
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- 5 As of 31 March 2012, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
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- 7 As of 31 March 2012, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-securities services.
- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
- 11 At the time of publication of this report, HSBC is a non-US Market Maker in securities issued by this company and/or in securities in respect of this company

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Additional disclosures

- 1 This report is dated as at 25 May 2012.
- 2 All market data included in this report are dated as at close 24 May 2012, unless otherwise indicated in the report.
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