

# Air Arabia – Outlook

**TP: AED 1.42/share**

## Recommendation

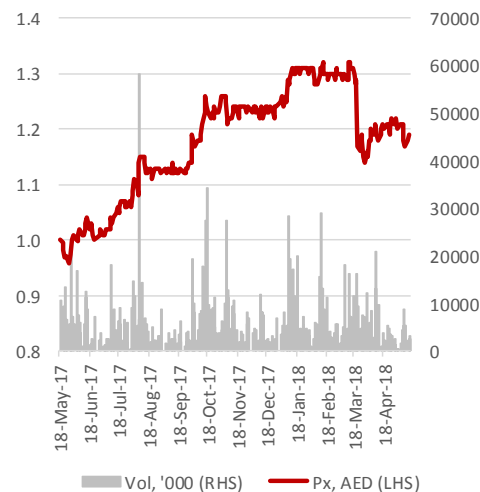
	<b>ACCUMULATE</b>
Bloomberg Ticker	AIRARABI.UH
CMP (16/5/2018) (AED)	1.19
52wk High / Low (AED)	1.33/0.96
12m Average Vol. ('000)	6,464.5
Mkt. Cap. (USD/AED bn)	1.5/5.6
Shares Outstanding (mn)	4,666.7
Free Float (%)	100%
3m Avg Daily Turnover (AED mn)	7.1
6m Avg Daily Turnover (AED mn)	7.5
PE 2018e (x)	8.2
PBv 2018e (x)	0.9
Dividend Yield '18e (%)	7.6%

## Price Performance:

1 month (%)	-
3 month (%)	(8.46)
12 month (%)	17.82

Source: Bloomberg

## Price-Volume Performance



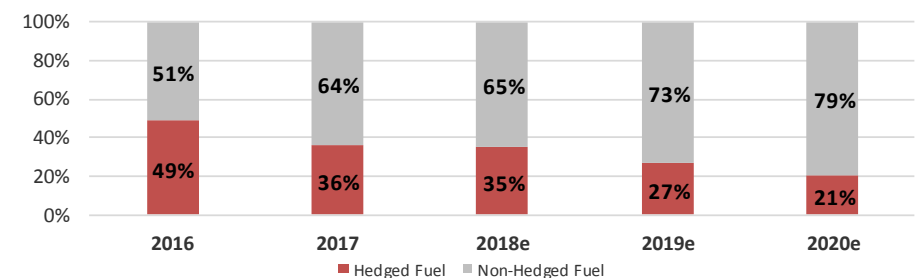
We raise our Target Price on Air Arabia to AED 1.42/share from AED 1.37/share and recommend **Accumulate**. Our target price represents an upside of 19% to the latest closing price of AED1.19/share. The stock is currently trading at PE'18e of 8.2x and PB'18e of 0.9x. The stock is down on 3m and YTD basis by 8.5% and 4.8%, respectively.

We anticipate airline profitability to grow by 4% in 2018 on a YoY basis and at a CAGR of 5% during 2017-2021. Growth in bottom line would largely result because of addition of new airline fleet in 2018 & 2019 and benefits which will flow because of launch of two new bases, four new aircrafts and 21 new routes during 2017.

## Cost control played an active role during 2017 and 1Q18

Despite addition of new bases and new routes and initial expenses associated with them, airline was able to lower its cost during 2017 and 1Q18 on account of better cost control and right hedging positions. The airline hedged 35% of its fuel requirement for 2017 at a price of USD54/bbl. While the average oil price fared around USD 55/bbl. in 2017. For 2018, Air Arabia has 27% of its fuel requirements at USD 67/bbl. while average oil price so far in 2018 have averaged over USD 69/bbl. and are estimated by various international oil agencies to rise further in anticipation of geopolitical risks and production issues in some oil producing countries. Hence we believe with oil prices expected to rise, Air Arabia would benefit from its hedging proposition.

## Air Arabia Fuel Hedge



Source: Company Reports & Presentation

Overall, Air Arabia profit during 1Q18 went up by 4.7% YoY and 455% QoQ to AED 101.6mn. The airline yield during the quarter went up by 11.0% YoY and 4.8% QoQ. More than 2mn passengers flew with Air Arabia between Jan - Mar 2018, in line with the record number of passengers carried in the first quarter of last year. The airline's average seat load factor during the first three months of 2018 stood at an impressive 80%. The airline added three new routes from its hubs in the UAE and Egypt in the first three months of 2018, with flights commencing from Sharjah to Moscow Sheremetyevo in Russia and to Jeddah and Kuwait from Sohag in Egypt. This was followed by the announcement of new flights from Sharjah to Qabala in Azerbaijan; Izmir and Bodrum in Turkey starting June 2018 and to Grozny in Russia starting April 2018.

### Oil Price Sensitivity to Air Arabia's net income

Airlines income are pretty sensitive to oil prices. With planned hedging policy of Air Arabia, we believe the blended oil price for the Company would be somewhere around USD 62/bbl. for 2018 which would result in a net income of AED 654mn, higher by 4% YoY.

(AED 000)		Brent Price (USD / barrel)				
		54	58	62	66	70
Base Fare Per Passenger	343	693,796	617,557	541,318	465,079	388,840
	353	751,887	675,648	599,410	523,171	446,932
	363	809,979	733,740	<b>657,501</b>	581,262	505,023
	373	868,070	791,831	715,593	639,354	563,115
	383	926,162	849,923	773,684	697,445	621,206

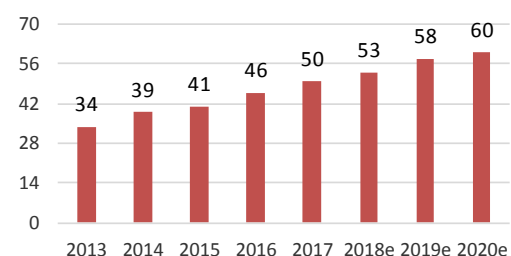
Source: U Capital Research

### Four new aircrafts and 21 new destinations added in 2017

Air Arabia received four new aircrafts in 2017, three of which were deployed in Morocco and one in Egypt. Last year, two new bases were launched from Morocco i.e. Fez Base in June and Agadir Base in October. The airline launched 21 new routes, majority of which were from its Morocco base and the rest from its main hub in Sharjah.

For 2018, the airline has planned 3 new aircrafts, two of which will operate from Sharjah and one from Egypt. While five new routes will be added to Turkey, Russia and ex-soviet country. While for 2019, the airline plans to add five A321, longer range and higher capacity aircrafts.

### Air Arabia Fleet Size



Source: Company Reports & Presentation

### Dividends expected to rise; TP offers an upside of 19% to AED 1.42/share

We remain optimistic on Air Arabia's dividend payout going forward. Considering airlines' profits grow at a CAGR of 5% during 2017-21. Strong free cash flow along with healthy balance sheet with AED 2.0bn in cash and AED 750mn in investments puts Air Arabia in a comfortable position to distribute dividends generously for FY17. The expected dividend translates to a strong dividend yield of 7.6% at current levels.

		Growth Rate (%)				
		1.0%	2.0%	2.5%	4.0%	5.0%
WACC (%)	6.8%	1.59	1.88	2.08	3.08	4.71
	7.8%	1.36	1.56	1.68	2.27	3.01
	8.8%	1.19	1.33	<b>1.42</b>	1.80	2.22
	9.8%	1.05	1.16	1.23	1.49	1.76
	10.8%	0.95	1.03	1.08	1.27	1.46

Source: U Capital Research

		Cost of Equity (%)				
		7.0%	8.0%	9.9%	10.0%	11.0%
Cost of Debt (%)	4.0%	2.45	2.05	1.57	1.55	1.39
	5.0%	2.26	1.92	1.49	1.48	1.33
	6.0%	2.10	1.81	<b>1.42</b>	1.41	1.27
	7.0%	1.96	1.70	1.35	1.35	1.22
	8.0%	1.84	1.61	1.30	1.29	1.17

Our target price is based on blended methodology of Discounted cash flow method (80% weight) and a Peer-group P/E valuation (20% weight). Our TP offers an upside of 19% compared to the current market price of AED 1.19/share. The airline is currently trading at PE'18e and PBV'18e multiple of 8.2x and 0.9x, respectively.

## Air Arabia – Quarterly Financials

(AED 000)	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	YoY	QoQ
<b>Revenue</b>	<b>945,756</b>	<b>893,774</b>	<b>1,124,218</b>	<b>814,260</b>	<b>810,395</b>	<b>906,204</b>	<b>1,163,836</b>	<b>858,431</b>	<b>877,288</b>	<b>8.3%</b>	<b>2.2%</b>
<b>Cost of Sales</b>	<b>(748,705)</b>	<b>(731,369)</b>	<b>(811,741)</b>	<b>(855,487)</b>	<b>(673,042)</b>	<b>(706,707)</b>	<b>(785,229)</b>	<b>(798,276)</b>	<b>(724,143)</b>	<b>7.6%</b>	<b>-9.3%</b>
<b>Gross Profit</b>	<b>197,051</b>	<b>162,405</b>	<b>312,477</b>	<b>(41,227)</b>	<b>137,353</b>	<b>199,497</b>	<b>378,607</b>	<b>60,155</b>	<b>153,145</b>	<b>11.5%</b>	<b>154.6%</b>
S.G. & A.	(66,862)	(59,476)	(85,986)	(53,246)	(66,302)	(61,787)	(84,738)	(81,315)	(57,702)	-13.0%	-29.0%
<b>Operating Profit</b>	<b>130,189</b>	<b>102,929</b>	<b>226,491</b>	<b>(94,473)</b>	<b>71,051</b>	<b>137,710</b>	<b>293,869</b>	<b>(21,160)</b>	<b>95,443</b>	<b>34.3%</b>	<b>n/m</b>
<b>Net Profit</b>	<b>111,100</b>	<b>126,415</b>	<b>291,528</b>	<b>(38,620)</b>	<b>97,099</b>	<b>150,731</b>	<b>364,501</b>	<b>18,300</b>	<b>101,646</b>	<b>4.7%</b>	<b>455.4%</b>
<b>Gross Margin</b>	<b>20.8%</b>	<b>18.2%</b>	<b>27.8%</b>	<b>-5.1%</b>	<b>16.9%</b>	<b>22.0%</b>	<b>32.5%</b>	<b>7.0%</b>	<b>17.5%</b>		
<b>Operating Margin</b>	<b>13.8%</b>	<b>11.5%</b>	<b>20.1%</b>	<b>-11.6%</b>	<b>8.8%</b>	<b>15.2%</b>	<b>25.3%</b>	<b>-2.5%</b>	<b>10.9%</b>		
<b>Net Margin</b>	<b>11.7%</b>	<b>14.1%</b>	<b>25.9%</b>	<b>-4.7%</b>	<b>12.0%</b>	<b>16.6%</b>	<b>31.3%</b>	<b>2.1%</b>	<b>11.6%</b>		
Passengers (mn)	2.10	2.00	2.27	2.09	2.05	2.05	2.33	2.05	2.00	-2.4%	-2.4%
Load Factor (%)	81%	78%	81%	78%	81%	79%	81%	78%	80%		
Yield (AED)	450	447	495	390	395	442	500	419	439	11.0%	4.8%

## Financial Statements

(AED mn)	2015	2016	2017	2018e	2019e	2020e	2021e
<b>Income Statement</b>							
Net Sales Revenue	3,826	3,778	3,739	4,022	4,410	4,773	4,949
Cost of Sales	(3,024)	(3,147)	(2,963)	(3,262)	(3,623)	(3,936)	(4,049)
<b>Gross Profit</b>	<b>802</b>	<b>631</b>	<b>776</b>	<b>760</b>	<b>787</b>	<b>836</b>	<b>900</b>
General & Administrative Expense	(238)	(266)	(294)	(316)	(347)	(375)	(389)
<b>Operating Profit</b>	<b>564</b>	<b>365</b>	<b>481</b>	<b>444</b>	<b>440</b>	<b>461</b>	<b>511</b>
Net Finance & Other Income	(33)	144	181	237	254	272	291
<b>Net Profit</b>	<b>531</b>	<b>509</b>	<b>662</b>	<b>681</b>	<b>694</b>	<b>733</b>	<b>802</b>
Minority Interest	19	18	32	24	24	26	28
<b>Net Profit Excluding Minority Interest</b>	<b>511</b>	<b>490</b>	<b>631</b>	<b>658</b>	<b>669</b>	<b>707</b>	<b>774</b>
<b>Balance Sheet</b>							
Cash and Bank Balance	1,599	1,819	2,048	2,374	2,373	2,788	3,259
Trade and Other Receivables	503	588	599	718	862	1,112	1,423
Inventories	17	16	17	19	21	36	63
Intangible Assets	1,296	1,298	1,299	1,299	1,299	1,299	1,299
Advance for New Aircraft	344	299	173	223	234	245	258
Investments Available-for-Sale	664	770	780	819	860	903	948
Other Assets	622	614	680	742	810	884	965
Net Fixed Assets	6,354	7,108	7,368	7,460	7,824	7,660	7,439
<b>Total Assets</b>	<b>11,399</b>	<b>12,513</b>	<b>12,964</b>	<b>13,654</b>	<b>14,282</b>	<b>14,927</b>	<b>15,654</b>
Finance Lease Liabilities	3,496	3,878	3,882	4,145	4,426	4,727	5,048
Trade and other payables	1,678	1,523	1,583	1,650	1,722	1,801	1,888
Deferred income	268	233	238	322	353	382	396
Others	93	936	992	1,025	1,059	1,094	1,130
Paid-up Capital	4,667	4,667	4,667	4,667	4,667	4,667	4,667
Reserves	685	783	909	1,041	1,174	1,316	1,471
Treasury Shares	-	-	-	-	-	-	-
Cumulative Change in Fair Values	33	33	33	33	33	33	33
Retained Earnings	443	415	593	699	768	820	926
Minority Interest	36	45	66	73	80	88	97
<b>Total Shareholders Equity</b>	<b>5,863</b>	<b>5,942</b>	<b>6,268</b>	<b>6,512</b>	<b>6,722</b>	<b>6,924</b>	<b>7,193</b>
<b>Total Equity &amp; Liability</b>	<b>11,399</b>	<b>12,513</b>	<b>12,964</b>	<b>13,654</b>	<b>14,282</b>	<b>14,927</b>	<b>15,654</b>
<b>Ratio Analysis</b>							
Current Ratio (x)	1.0	1.2	1.2	1.4	1.4	1.6	1.8
Quick Ratio (x)	1.0	1.2	1.2	1.4	1.4	1.6	1.8
Gross Profit Margin	21.0%	16.7%	20.7%	18.9%	17.8%	17.5%	18.2%
Operating Margin	14.7%	9.7%	12.9%	11.0%	10.0%	9.7%	10.3%
Net Profit Margin	13.9%	13.5%	17.7%	16.9%	15.7%	15.4%	16.2%
Return on Average Assets	4.8%	4.3%	5.2%	5.1%	5.0%	5.0%	5.2%
Return on Average Equity	10.6%	9.5%	11.2%	11.0%	10.8%	11.0%	11.7%
EPS (AED)	0.11	0.11	0.14	0.15	0.15	0.16	0.17
Book Value Per Share (AED)	1.06	1.22	1.31	1.36	1.40	1.44	1.50
Market Price (AED) *	1.36	1.33	1.24	1.19	1.19	1.19	1.19
Market Capitalization (AED mn)	6,347	6,207	5,787	5,553	5,553	5,553	5,553
Dividend Yield	6.6%	6.8%	5.6%	7.6%	8.4%	9.2%	9.2%
P/E Ratio (x)	12.0	12.2	8.7	8.2	8.0	7.6	6.9
P/BV Ratio (x)	1.3	1.1	0.9	0.9	0.8	0.8	0.8

Source: Company Filings & U Capital Research

\* Market price for 2018 and subsequent years as per closing prices on 16 May, 2018

## Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%