

Air Arabia – 2Q17 Review

TP: AED 1.37 / share

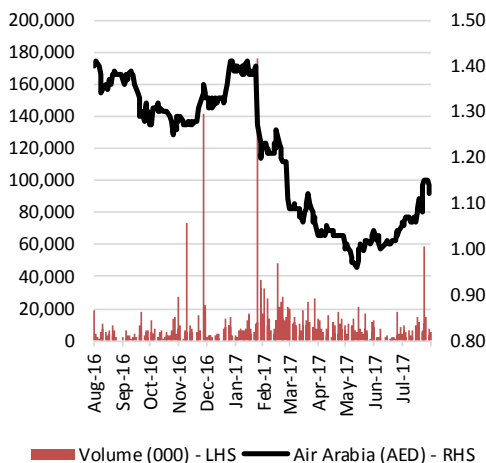
Recommendation	BUY
Bloomberg Ticker	AIRARABI.UH
Current Market Price (AED)	1.13
52wk High / Low (AED)	1.440/0.960
12m Average Vol. (000)	9,755.4
Mkt. Cap. (USD/AED bn)	1.4/5.2
Shares Outstanding (mn)	4,666.7
Free Float (%)	67%
3m Avg Daily Turnover (AED mn)	7.5
6m Avg Daily Turnover (AED mn)	10.8
PE 2017e (x)	10.2
PBv 2017e (x)	0.9
Dividend Yield '17e (%)	8.0%

Price Performance:

1 month (%)	6.60
3 month (%)	11.88
12 month (%)	(19.86)

Source: Bloomberg

Price Volume Chart



Source: Bloomberg

We maintain our recommendation at **BUY** on Air Arabia with a revised target price of **AED1.37/share**. Our target price represents an upside of 22% to the latest closing price of AED1.13/share. The stock is currently trading at PE'17e of 10.2x and PB'17e of 0.9x. The stock is down on YTD and 12m basis by 15% and 20%, respectively.

Solid 2Q17 performance; cost control played an active role

Air Arabia's financial results for the second quarter ending June 30, 2017 registered a net profit of AED 150.7mn, an increase of 19% YoY and 55% QoQ. Significant growth in the bottom line was result of drop in cost on a YoY basis despite increase in oil prices. As a result of drop in cost, gross margins of the company rose to 22% when compared with 17% in 1Q17 and 18% in 2Q16. The company's turnover for the second quarter of 2017 increased to AED 906mn, compared to AED 894mn in the corresponding period last year. Air Arabia served over 2.05mn passengers in the second quarter of 2017, while the average seat load factor for the quarter stood at 79%. Yield remained higher on a QoQ basis but were lower on YoY basis by a percent to AED 442.

(AED 000)	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	YoY	QoQ
Revenue	945,756	893,774	1,124,218	814,260	810,395	906,204	1.4%	11.8%
Cost of Sales	(748,705)	(731,369)	(811,741)	(855,487)	(673,042)	(706,707)	-3.4%	5.0%
Gross Profit	197,051	162,405	312,477	(41,227)	137,353	199,497	22.8%	45.2%
S.G. & A.	(66,862)	(59,476)	(85,986)	(53,246)	(66,302)	(61,787)	3.9%	-6.8%
Operating Profit	130,189	102,929	226,491	(94,473)	71,051	137,710	33.8%	93.8%
Net Profit	111,100	126,415	291,528	(38,620)	97,099	150,731	19.2%	55.2%
Gross Margin	20.8%	18.2%	27.8%	-5.1%	16.9%	22.0%		
Operating Margin	13.8%	11.5%	20.1%	-11.6%	8.8%	15.2%		
Net Margin	11.7%	14.1%	25.9%	-4.7%	12.0%	16.6%		
Passengers (mn)	2.10	2.00	2.27	2.09	2.05	2.05	2.5%	0.0%
Load Factor (%)	81%	78%	81%	78%	81%	79%		
Yield (AED)	450	447	495	390	395	442	-1.1%	11.8%

Source: Company Financials & U Capital Research

Air Arabia's net profit for the first six months of 2017 stood at AED 248mn, up 4.3% compared to the corresponding period of 2016 while the turnover for the first six months was down 6.7% on lower yields. Average yields during 1H17 stood at AED419 compared to AED449 in the same period last year.

Operating cash flow of the company declined during 1H17 when compared to 1H16 to AED588mn, mainly on account of negative ineffective portion of cash flow hedge amounting to AED47.7mn. For the year 2017, Air Arabia has hedged 36% of fuel requirements at a price of USD 51/bbl. We believe the oil price hedge taken at a price of USD51/bbl is quite appropriate and if the prices go higher, it would be at the benefit of the airline.

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Two new aircrafts and 12 new destinations added in 1H17

Air Arabia received two new Airbus A320 aircraft in the first half of 2017 ending June 30 and added 12 new routes from its five operating hubs in the UAE, Morocco, Egypt and Jordan. Air Arabia currently serves a global destination network of 130 routes across the world. Majority of its fleet is stationed in Sharjah and Morocco while Egypt, Jordan and Ras Al Khaimah have 1-2 planes stationed. Five hubs give the airline enough flexibility to rotate their stationed planes looking into the demand and scenario changes.

TP offers an upside of 22% to AED1.37/share

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 22% compared to the current market price of AED 1.13/share. The airline is currently trading at PE'17e and PBv'17e multiple of 10.2x and 0.9x, respectively.

		Growth Rate (%)				
		1.0%	2.0%	2.5%	4.0%	5.0%
WACC (%)	5.6%	1.59	2.03	2.36	4.62	12.97
	6.6%	1.28	1.56	1.75	2.76	4.52
	7.6%	1.06	1.25	1.37	1.94	2.70
	8.6%	0.91	1.04	1.13	1.49	1.90
	9.6%	0.79	0.89	0.95	1.20	1.46

Financial Statements

(AED mn)	2014	2015	2016	2017e	2018e	2019e
Income Statement						
Net Sales Revenue	3,729	3,826	3,778	3,680	3,995	4,184
Cost of Sales	(3,046)	(3,024)	(3,147)	(3,087)	(3,382)	(3,573)
Gross Profit	683	802	631	592	613	611
General & Administrative Expense	(200)	(238)	(266)	(251)	(273)	(285)
Operating Profit	483	564	365	341	340	326
Finance Income	66	79	116	121	127	134
Other Income	83	(39)	119	136	150	165
Net Profit	566	531	509	519	535	539
Minority Interest	13	19	18	18	19	19
Net Profit Excluding Minority Interest	553	511	490	501	516	520
Balance Sheet						
Cash and Bank Balance	1,324	1,599	1,819	1,440	1,058	1,092
Trade and Other Receivables	396	503	588	705	847	1,016
Inventories	17	17	16	18	20	22
Intangible Assets	1,095	1,098	1,098	1,098	1,098	1,098
Advance for New Aircraft	579	344	299	212	223	234
Goodwill	199	199	200	200	200	200
Investments Available-for-Sale	704	664	770	793	817	842
Net Fixed Assets	5,644	6,354	7,108	7,698	8,139	8,118
Total Assets	10,574	11,399	12,513	12,879	13,236	13,598
Finance Lease Liabilities	3,085	3,496	3,878	4,002	4,131	4,263
Trade and other payables	1,491	1,678	1,523	1,585	1,653	1,726
Deferred income	255	268	233	294	320	335
Others	(31)	93	936	970	1,005	1,041
Paid-up Capital	4,667	4,667	4,667	4,667	4,667	4,667
Reserves	583	685	783	883	986	1,090
Treasury Shares	-	-	-	-	-	-
Cumulative Change in Fair Values	49	33	33	33	33	33
Retained Earnings	450	443	415	395	389	385
Minority Interest	26	36	45	49	54	59
Total Shareholders Equity	5,774	5,863	5,942	6,027	6,128	6,234
Total Equity & Liability	10,574	11,399	12,513	12,879	13,236	13,598
Cash Flow Statement						
Cash Flow from Operating Activities	1,236	1,078	1,126	900	901	889
Cash Flow from Investing Activities	(499)	(178)	(351)	(989)	(1,001)	(582)
Cash Flow from Financing Activities	(656)	(732)	(555)	(290)	(282)	(273)
Change in Cash	81	168	220	(379)	(382)	34
Net Cash at End	1,324	1,599	1,819	1,440	1,058	1,092
Ratio Analysis						
Current Ratio (x)	0.8	1.0	1.2	1.0	0.8	0.9
Quick Ratio (x)	0.8	1.0	1.2	1.0	0.8	0.9
Gross Profit Margin	18.3%	21.0%	16.7%	16.1%	15.3%	14.6%
Operating Margin	13.0%	14.7%	9.7%	9.3%	8.5%	7.8%
Net Profit Margin	15.2%	13.9%	13.5%	14.1%	13.4%	12.9%
Return on Average Assets	5.7%	4.8%	4.3%	4.1%	4.1%	4.0%
Return on Average Equity	10.7%	10.6%	9.5%	9.0%	9.2%	9.1%
EPS (AED)	0.12	0.11	0.11	0.11	0.11	0.12
Book Value Per Share (AED)	1.08	1.06	1.22	1.24	1.26	1.28
Market Price (AED) *	1.50	1.36	1.33	1.13	1.13	1.13
Market Capitalization (AED mn)	7,000	6,347	6,207	5,273	5,273	5,273
Dividend Yield	4.8%	6.6%	6.8%	8.0%	8.0%	8.0%
P/E Ratio (x)	12.4	12.0	12.2	10.2	9.9	9.8
P/BV Ratio (x)	1.4	1.3	1.1	0.9	0.9	0.9

Source: Company Filings & U Capital Research

* Market price for 2017 and subsequent years as per closing prices on August 16, 2017

Recommendation

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