GCC Aviation Sector

30-November-2014

In this Report...

We are initiating coverage on the aviation sector in the GCC region, covering Jazeera Airways with an Outperform rating and a price target of KWD 0.501 (+15.1% upside) and Air Arabia with an Outperform rating and a price target of AED 1.64 (+10.3% upside).

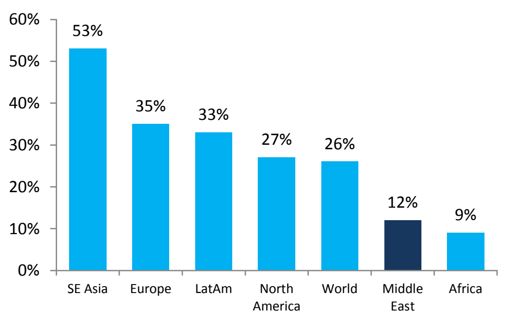
GCC Aviation Sector is expected to see substantial growth over the next decade on the back of higher demand from global leisure travelers into the region*, the increasing significance of gulf countries as a regional transportation hub due to its geographical advantage and due to the inherent demand from a rising population from other nationalities residing in the region. The five-year CAGR for passenger-kilometers on scheduled services stood at a strong 15.9% for the GCC member countries at the end of 2013 as compared to a global five-year CAGR of 6.0% for the same period as measured by ICAO. Total passenger kilometers increased by 12.6% during 2013 to 447 Bn passenger kilometers as compared to a 5.5% growth on a global scale.*

According to IATA, almost 1% of the global GDP is expected to be spent on air travel, translating to close to USD 746 Bn in 2014. *The increase is fuelled by both demand-side factor like increase in the utility of air travel as well as supply side factors that result in higher supply at a significantly lower price each year. The average air travel one-way fare is expected to decline by 3.5% to USD 231 per passenger during 2014. This comes after an even higher decline of 6.4% seen during 2013.*

With strong government support through developing and building new and larger airports and with high propensity to travel, *the Middle East region presents ample opportunity for the aviation sector. The geographical advantage as the physical center of the earth, medium and long-haul routes from Middle East to Asia-Pacific or Middle East to Europe represent the core growth markets for traffic in the region. As a consequence, the share of passenger aircraft as a percentage of global passenger count operated by Middle East carriers has doubled in 10 years.*

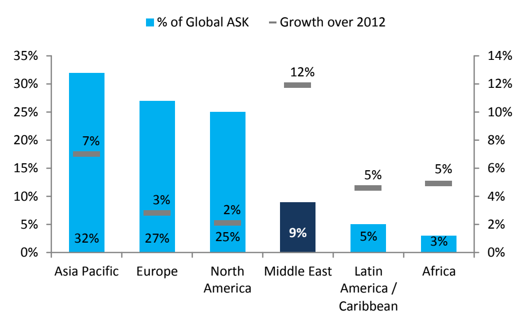
The low cost carrier (LCC) phenomenon is fast catching up in the Middle East aviation market. *According to Boeing, 12% of annual seats of Middle East-domiciled airline companies were offered by LCCs in 2013 as compared to a global average of 26%. LCC market share in the Middle East got a major boost after the financial crisis, which pushed the market share significantly in the following years.*

2013 LCC Market Share by Airline Domicile



Source : Boeing Current Market Outlook - 2014-2033

Regional Aviation Capacity



Source : Airbus Global Market Forecast - 2014-2033

JAZEERA AIRWAYS		
Outperform		
CMP (KWD)	PT (KWD)	Upside
0.435	0.501	15.1%
P/E 2015e	P/BV 2015e	Div. Yield
11.8	2.0	3.4%

AIR ARABIA		
Outperform		
CMP (AED)	PT (AED)	Upside
1.49	1.64	10.3%
P/E 2015e	P/BV 2015e	Div. Yield
9.4	1.1	6.7%

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Global Aviation Industry

Aviation industry is highly correlated to the developments on the economic front and in return the sector plays a key role in the economic development. It helps in achieving sustainable long term growth by providing a rapid worldwide transportation network enabling global markets integration along with various social benefits. Economic factors like the GDP per capita and demographic factors like population growth and migration have a strong influence on the health and growth of the aviation industry. Hence, tracking these indicators is the first step to ascertain the industry's future trends.

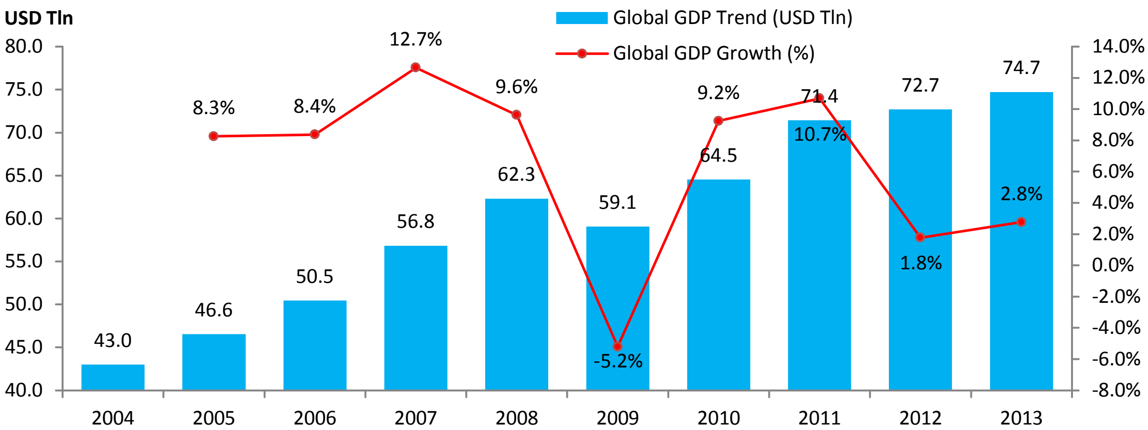
On the supply side, factors that lead to higher supply include availability of low cost financing, technological developments and stable fuel prices (as seen during 2011-2013). A favorable trend in the aforementioned factors coupled with excessive competition lowers the overall pricing and increase the overall propensity to travel. On the other hand, volatile fuel prices (during 2008-2011), stagnant technology and tight financial markets act as negative catalysts to airline growth as it leads to higher costs.

With the enhancement of technology, aircraft manufacturers are producing more efficient aircrafts that has resulted in significant reduction fuel costs, an airlines' largest single expense. The average fuel cost as a percentage of total revenue has been consistently declining over the years and currently stands at close to 30-40%. Environmental costs and regulatory fees are some of the other expenses that put pressure on an airlines' base fares and affects the overall demand supply equation.

Global economic growth at sustainable levels

Global GDP growth averaged at a CAGR of 6.9% over the past 10 years while the GDP per capita increased at a slightly slower pace of 5.7% over the same period. Globally, all the economies were affected during the 2008 financial crisis which resulted in economic slowdown during 2009, particularly in the developed markets in US and Europe and to a limited extent in MENA and a number of Asian markets. The corporate sector was under immense pressure to rethink their way of doing business and to lower costs to a bare minimum level. This cost cutting environment came as a blessing for airline companies offering budget fares as they started competing for a larger set of clients. Established airline companies offering premium travel experience had to take a hard look at their costs and in some cases transform their business model to offer low cost services through a subsidiary or a parallel business. Currently, the airline business has a much larger set of players that compete at various price points.

Global GDP Trend (USD Tln)



Source: IMF World Economic Outlook (WEO) - October 2014

Air travel to account for 1% of global GDP

According to IATA, almost 1% of the global GDP is expected to be spent on air travel, translating to close to USD 746 Bn in 2014. The increase is fuelled by both demand-side factor like increase in the utility of air travel as well as supply side factors that result in higher supply at a significantly lower price each year. The average air travel one-way fare is expected to decline by 3.5% to USD 231 per passenger during 2014. This comes after an even higher decline of 6.4% seen during 2013. According to the IATA, the cost of air travel has more than halved over the past twenty years.

Worldwide Air Travel Spend

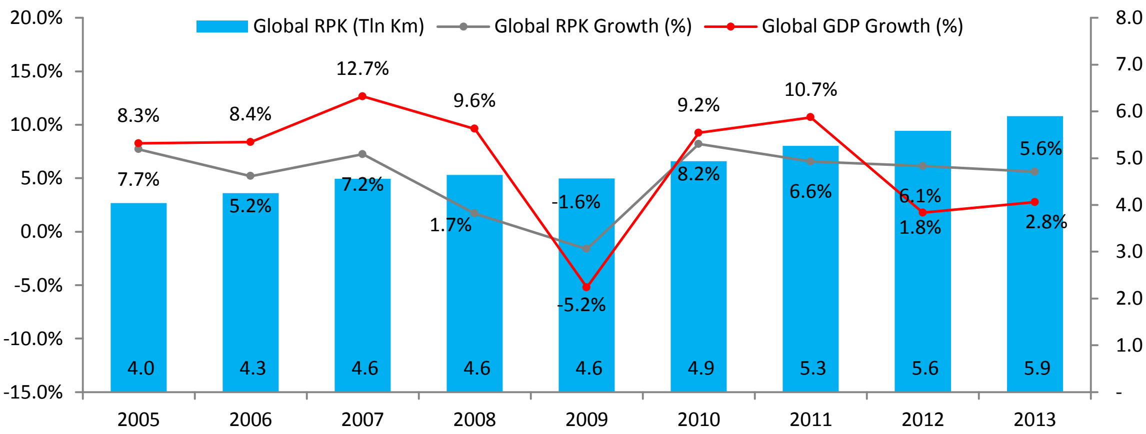
	2012	2013	2014
Spend on Air transport (USD Bn)	679	710	746
One Way Fare (USD/Passenger)	256	239	231
Passenger Departures (Mn)	2,977	3,141	3,320

Source: IATA—2014 Mid-year Report

Quantifying RPK vs. global GDP growth

Global airline revenue passenger kilometers (RPK) increased from 3.75 Tln Km in 2004 to 5.9 Tln Km in 2013, resulting in a CAGR of 6.0% over the past ten years. The two indicators (GDP and RPK) had a relatively strong correlation measured at 65.6% based on the past 10-year performance. Data from IATA also suggests a strong RPK growth of 5.9% during 2014 as connection between cities throughout the world increases.

Global Revenue Passenger Kilometer (RPK) Trend



Source: IMF WEO Oct 2014, Boeing Co. - Current Market Outlook 2014

Population and Demography

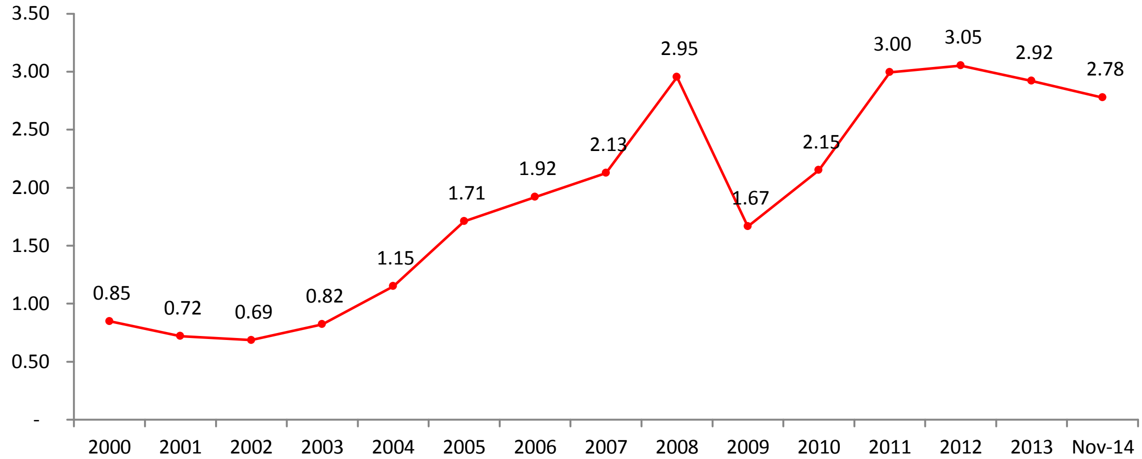
In terms of demography, the size and distribution of population in the airline carrier's domestic market has a significant impact on the growth of the overall sector. Globally, the population growth was recorded at a CAGR of 1.2% over the past 10 years. However, as compared to the global population growth, the airline industry depends more specifically on the composition and income levels of the population of the domestic market and the target market.

Moreover, for an airline carrier, the domestic market has to be large enough to support future growth and expansion. For instance, an airline company based in a small economy would not be able to generate enough returns on its investments if it caters only to the domestic population. In order to expand and to grow its revenue base and to support the load factor, the company has to establish its base in other economies as well as establish freedom rights (the level of permission from the target market government) across key markets.

Fuel Cost

Jet fuel prices have grown at a phenomenal rate over the past several years, growing at a CAGR of 10% since 2000. Average yearly prices peaked at USD 3.05/gallon during 2012. Fluctuating fuel costs have always kept airline companies on their toes forcing them to dynamically adjust their pricing strategies and more importantly their fuel hedging strategies. This is particularly true with larger airlines with large fuel price exposure. However, the quantum of fuel hedging is adjusted depending upon the fuel price trend. Airlines typically increase their hedging exposure in an increasing oil price scenario and scale down drastically when the prices decline. As seen recently, due to the fall in oil prices, airlines have reduced the percentage of fuel they have hedged for the third quarter and full year, while increasing coverage for next year.

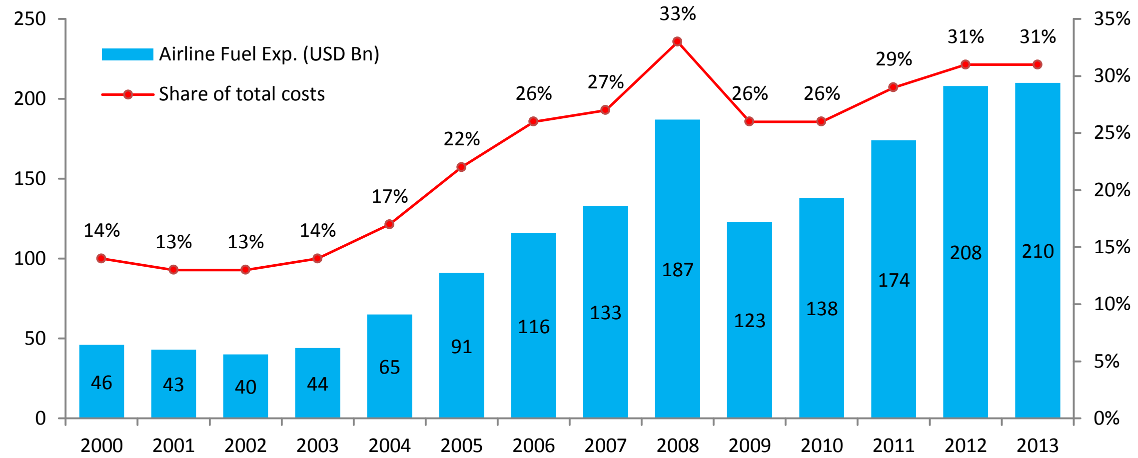
Average Yearly Jet Fuel Price (USD/Gallon)



Source : Bloomberg

On an average, fuel cost accounts for close to 30% of the airline companies' overall operating costs. However, this percentage has been volatile in the past only to stabilize in the recent years. Meanwhile, the fuel requirement for new aircraft is decreasing as they are more fuel efficient. This is one of the reason why full scale carriers, with their legacy fleet of aircrafts, have a higher percentage of fuel as their expense. Moreover, as fuel prices increased affecting profitability of airline companies, aircrafts manufacturers were forced to improve the fuel efficiency of aircrafts they produce.

Fuel Price vs. Total Airline Operating Costs



Source : Airbus Global Market Forecast - 2014-2033

Fragmented industry with concentrated demand and supply in specific regions

This one of the most important factors that affects the profitability of the Aviation sector resulting in losses for a majority of the airline carriers globally. Excessive competition from both domestic players as well as international players operating flights in a given market has resulted in thinner margins and a cap on prices. The carriers have limited pricing power in key high volume markets that experience intense competition. The cap on prices puts an upper limit on the revenue scalability of the companies. This coupled with volatile operating expenses exacerbates the profit potential of the carriers as fuel prices has historically accounted for close to 40% of the overall operating expenses (only to decline in the recent years).

The only way the carriers can increase their profitability is by adding additional capacity and running the airline above the breakeven utilization levels. Moreover, the cost of aircrafts further puts a pressure on the carriers profitability by way of additional financial charges or lease obligations.

The global aviation landscape saw significant structural changes with the introduction of low cost carriers about a decade ago. According to IFC, emphirical evidence shows that when a low cost carrier enters the markets, costs go down by 20% and traffic increases by about 50%. The low cost carriers, which now account for close to 25% of the global fleet size, has been the favored mode of airline start-up with a number of full scale carriers spreading their wings in this area with either a separate LCC brand or as a subsidiary of the parent carrier in order to serve this surging segment. Initially started as short haul low cost carriers, airline companies have also launched long haul low cost carrier services. LCCs have also taken a big leap in terms of capacity, featuring among the top airlines globally.

Listed below are some of the key airline companies globally and their respective operating statistics:

Key Global Airline Companies

Name	LCC/FSC	Country	Mkt Cap (USD Bn)	ASK	Load Factor	RPK	Fleet Size	Return on Assets	Return on Equity	Net Debt to Equity
Delta Air Lines	FSC	US	36.62	65.9	86.4	57.0	1,260	20.1	158.4	47.0
American Airlines	FSC	US	31.57	69.1	83.4	57.6	136	0.8		189.7
Southwest Airlines	LCC	US	26.44	33.8	84.4	28.5	1,535	5.8	16.0	(11.1)
United Airlines	FSC	US	20.70	65.4	85.8	56.1	685	3.3	44.5	170.3
Ryanair	LCC	Ireland	14.58	23.3	91.0	21.3	619	7.5	18.2	(14.2)
Japan Airlines	FSC	Japan	9.97	21.7	74.1	16.1	421	12.4	24.7	(37.1)
Air China	FSC	China	9.86	93.1	80.6	75.1	137	1.3	5.0	176.1
easyJet	LCC	Britain	9.64	33.4	89.0	30.2	360	9.2	24.3	(27.0)
Singapore Airlines	FSC	Singapore	9.28	30.6	81.9	25.0	552	0.9	1.6	(33.3)
Cathay Pacific	FSC	Hong Kong	7.92	65.5	83.6	54.7	239	1.8	5.0	69.4
Lufthansa	FSC	Germany	7.51	76.0	85.0	64.6	299	1.8	10.8	49.6
Alaska Air Group	FSC	US	7.34	9.6	86.0	8.2	223	8.8	26.5	(23.2)
Spirit Airlines	LCC	US	5.54	4.2	87.6	3.7	117	16.8	25.5	(62.0)
China Southern	FSC	China	5.12	98.4	79.2	77.9	199	0.4	1.8	229.6
JetBlue Airways	LCC	US	3.68	11.8	86.2	10.1	123	4.7	16.3	67.9
WestJet Airlines	LCC	Canada	3.50	6.5	83.1	5.4	162	6.1	16.0	(12.4)
Air France-KLM	FSC	France	2.70	70.1	87.8	61.5	58	-	-	-
Allegiant Air	LCC	US	2.31	2.1	88.7	1.9	99	9.4	26.6	72.5
Gol	LCC	Brazil	1.39	-	75.2	-	216	-	-	985.2
Norwegian	LCC	Norway	1.24	13.9	84.6	11.8	148	-	-	274.4
Cebu Air Inc	LCC	Philippines	0.97	4.9	78.2	3.9	62	2.8	8.7	129.1
Jet Airways	FSC	India	0.50	38.1	78.2	29.7	69	-	-	-
Tiger Airways	LCC	Singapore	0.23	2.9	82.5	2.4	45	-	-	925.8
Air Berlin	FSC	Germany	0.18	17.7	87.2	15.5	764	-	-	-
SpiceJet Ltd	LCC	India	0.12	19.0	72.0	13.7	175	-	-	-

Source : Bloomberg, Airfleets.net, KAMCO Research

Increasing airport traffic amid rising demand

According to Airports Council International's (ACI) 2013 World Air Traffic Report, airport passenger traffic continued to increase at almost the same rate as seen in 2012, growing at 4.3% during 2013. The growth comes despite the weak economic performance at several developed nations in Europe and weak growth in the US. Passenger traffic in developing and emerging economies increase by 8.7% during the year with emerging economies accounting for 42% of the global passenger traffic which more than compensated for the slow growth in advanced economies that recorded moderate passenger growth of 1.8%. The BRICS nations accounted for 20% of the global passenger traffic or 1.3 billion passengers seeing a growth of 8.6% over 2012 levels.

Global Airport Traffic in 2013

	Passengers (Mn)	% Change	Aircraft Movements (Mn)	% Change	Total Cargo (Mn MT)	% Change
Asia-Pacific	2,060	8.7%	18.3	7.2%	37.0	2.1%
Europe	1,730	3.2%	20.8	1.6%	17.8	0.2%
North America	1,570	1.1%	29.4	1.4%	27.9	0.1%
LatAm-Caribbean	501	5.5%	8.3	1.8%	5.1	0.8%
Middle East	**278**	**7.0%**	**2.5**	**3.7%**	**6.5**	**3.9%**
Africa	164	0.5%	2.7	1.2%	1.8	3.4%
Total	**6,303**	**4.3%**	**82**	**0.6%**	**96**	**0.9%**

Source : ACI (Airports Council International)

During 2013, domestic airports in Atlanta and Beijing recorded the highest number of passengers recorded at 84.2 Mn and 67.5 Mn passengers, respectively, followed by the Heathrow international airport in London with total annual passengers recorded at 67.3 Mn. The strongest absolute growth in passenger traffic was recorded at the Dubai International airport which moved from the 10th position in 2012 to the 7th position in 2013 carrying a total of 65.9 Mn passengers during the year, recording a growth of 15.3%. Meanwhile, London remained the world's largest airport system handling almost 140 Mn passengers at its six airports followed by New York with 112 million passengers at three airports and Tokyo with 105 million passengers.

In terms of monthly statistics, according to the latest available monthly airport passenger traffic figures from ACI (August 2014), Atlanta, Beijing and Tokyo were the top three cities by passenger traffic whereas Dubai ranked 6th recording a growth of almost 10.8% during the month.

On the other hand, aircraft movement increased at a marginal rate of 0.6% to 82 Mn whereas air cargo traffic increased by close to 1% over 2012 levels to 96 Mn metric tonnes. Hong Kong, Memphis, Shanghai, Incheon and Dubai were the top five busiest air cargo airports handling more than 16 Mn metric tonnes of air cargo during 2013.

Passenger Traffic Monthly Ranking - July 2014

Rank	Airport	Monthly Traffic (Mn)	% Change
1	ATLANTA GA, US (ATL)	8.57	2.6%
2	BEIJING, CN (PEK)	7.82	0.7%
3	TOKYO, JP (HND)	7.23	6.0%
4	LONDON, GB (LHR)	7.05	1.3%
5	LOS ANGELES CA, US (LAX)	6.72	6.1%
6	DUBAI, AE (DXB)	6.65	10.8%
7	CHICAGO IL, US (ORD)	6.62	4.4%
8	PARIS, FR (CDG)	6.51	6.2%
9	FRANKFURT, DE (FRA)	6.11	5.4%
10	DALLAS/FORT WORTH TX, U	5.79	6.3%
11	HONG KONG, HK (HKG)	5.77	3.3%
12	AMSTERDAM, NL (AMS)	5.62	5.3%
13	ISTANBUL, TR (IST)	5.52	11.0%
14	NEW YORK NY, US (JFK)	5.48	7.6%
15	JAKARTA, ID (CGK)	5.28	-4.7%

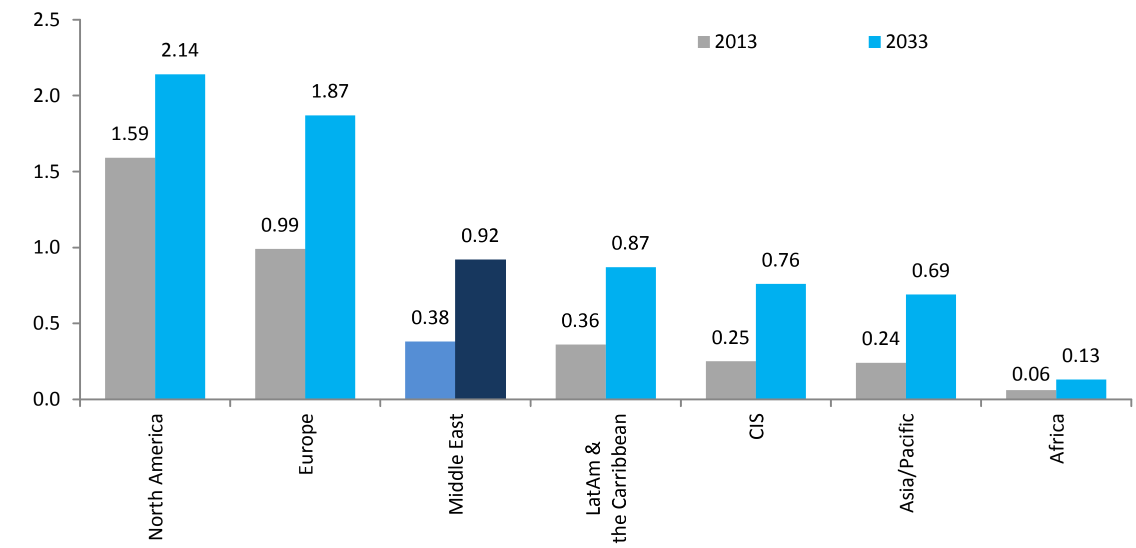
Source : ACI (Airports Council International)

According to ACI, growth continued in 2014 with encouraging statistics for the first half of 2014 in terms of global passenger traffic and cargo movement. Passenger traffic increased by 4.8% during the first six months of the 2014, whereas the cargo market saw an overall growth rate of 3.7% as compared to corresponding period in the previous year.

Propensity to Travel

The propensity to travel, which is defined as the average number of trips per capita, is one of the key measures tracked to ascertain the level of air travel that people in a given region would undertake. The GDP per capita is one of the key tools to measure the propensity to travel. Higher the GDP per capita higher is the propensity to travel and vice versa. According to Bombardier, the propensity to travel increases exponentially as the GDP per capita enters the USD 5,000 - USD 15,000 per year threshold.

Average Trips Per Capita



Source : Airbus Global Market Forecast - 2014-2033

The North American region has one of the highest level of GDP per capita driving average trips per capita for the region recorded at 1.59, according to Airbus calculations. Europe ranks second in terms of GDP per capita and its propensity to travel score is at 0.99 trips per capita. The Middle East region, although ranks third in terms of propensity to travel, has fairly uneven distribution of GDP, skewed especially towards the GCC region. For instance, Qatar recorded the second highest GDP per capita during 2012 and stood at the third position during 2013 behind Luxemburg and Norway. The propensity to travel is expected to increase by more than 150% over the next 20 years, according to Airbus forecasts.

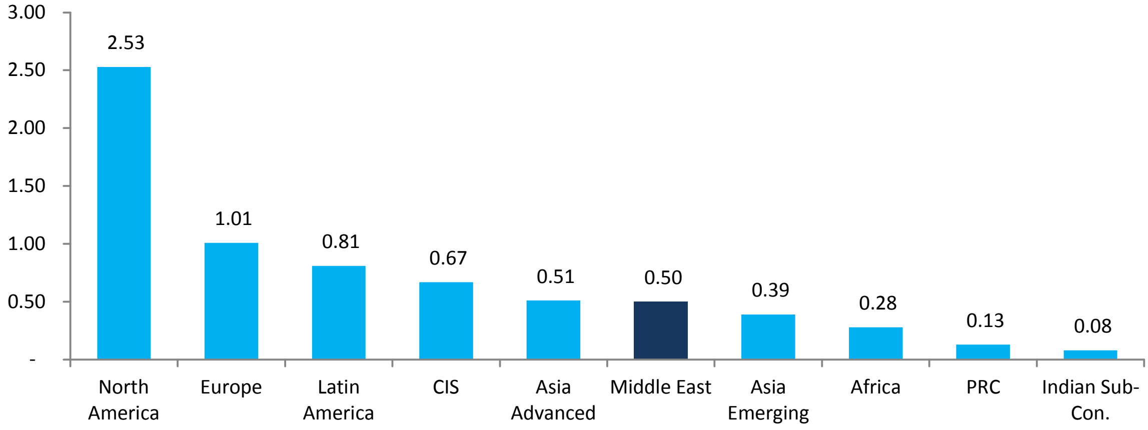
Logistical bottlenecks to persist

Lack of adequate infrastructure facilities limits the growth of the airline business. One of the most important of these bottlenecks is the number and size of airports in a given country measured in terms of airports per million inhabitants (APMI). In the case of emerging markets, the APMI is significantly low as compared to developed economies, which affects the accessibility to airline facilities.

Approachability in the case of developing nations in Asia and Africa also affects the access to airlines.

North America leads in terms of APMI recorded at 2.53 which is more than double the relative number of airports as compared to the second ranked Europe with an APMI of 1.01 followed by Latin America at 0.81. As said earlier, more densely populated regions like the Indian Sub-continent and China have a significantly lesser number of airports to serve their bulging population. Nevertheless, the APMI score also depends on the propensity to travel, as explained in the previous point, which is primarily a function of GDP per capita.

Airports Per Million Inhabitant



Source : Airbus Global Market Forecast - 2014-2033

Although there are efforts made to expand the capacity of existing airports as well as construction of new airports, the time required for completion could be excessively large primarily due to regulatory issues concerning the airline business. The GCC region is frontrunner in terms of airport expansion with airport related projects valued at close to USD 40 Bn under way in the in the Arabian Gulf region and a further USD 48 Bn at the bid or design stage. The urgent need for expansion plan is evident from the fact that during Q1-14, Dubai International Airport overtook London Heathrow as the world's busiest airport in terms of international passenger traffic. The respective governments in the region are making investments in a series of airport schemes in order to build the infrastructure needed to accommodate the increased flights and passenger arrivals.

In terms of construction activity in the Middle East region, the UAE ranks first with a combined USD 18.8 Bn in construction and expansion plans and within the UAE, Dubai alone accounts for USD 15.9 Bn of construction plans. Meanwhile, Qatar has plans to invest USD 15.5 Bn in its airport in Doha, whereas Saudi Arabia is aiming for a combined future capacity of 140mn passengers per year by expanding its three major airports in Damman, Jeddah and Riyadh.

Some of the key projects being undertaken in the Middle East include the construction of the Midfield Terminal at Abu Dhabi International airport as part of the government's Plan Abu Dhabi 2030. In addition, Dubai has a number of airport capacity expansion projects, which far surpass previous investment requirements. In Saudi Arabia, which is grappling with the sharp increase in religious tourism, a number of delayed airport contracts are being executed. This includes USD 2.9 Bn expansion of Riyadh's King Khaled International Airport. In Kuwait, the Public Works Ministry is preparing for bids to build a KWD 900 Mn (USD 3.2 Bn) new terminal at Kuwait International that will increase the capacity of the airport to 13 Mn passengers a year.

Huge demand for new aircrafts as ariilnes announce expansion plans

Globally, a majority of the airline companies are building up capacity to meet future demand. According to estimates, China is expected to be the biggest aviation market in the next two decades with almost 50% of the future demand emanating from the domestic market.

New Passenger Aircraft Deliveries by Region

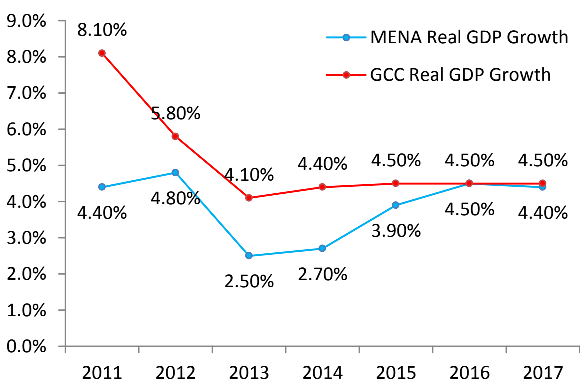
	Africa	Asia-Pacific	CIS	Europe	LatAm & Caribbean	Middle East	North America	Total
Single-Aisle	734	8,066	1,036	4,895	1,784	**826**	4,730	22,071
Small Twin-Aisle	158	2,510	132	754	349	**481**	569	4,953
Intermediate Twin-Aisle	54	1,055	25	368	102	**500**	199	2,303
Very Large Aircraft	27	622	25	150	28	**341**	35	1,228
Total	**973**	**12,253**	**1,218**	**6,167**	**2,263**	**2,148**	**5,533**	**30,555**

Source : Airbus Global Market Forecast - 2014-2033

On the supply front, low cost carriers would play a major role in meeting this demand and are fast catching up with the global trend of low cost carriers. Moreover, with space constraints at airports and significant aircraft movements in a majority of the airports globally, new orders of aircrafts are primarily concentrated for single-aisle and small twin-aisle aircrafts. According to Airbus estimates, these two type of aircrafts together account for more than 88% of future aircraft deliveries or close to 27,000 new aircrafts by 2033.

Middle East Aviation Sector

Real GDP Growth: MENA vs. GCC



Source : IMF World Economic Outlook - Oct 2014

Being a part of emerging markets, the MENA region is characterized by high GDP growth rates led by a number of economic initiatives in pipeline for key sectors. The MENA region has seen above average GDP growth rate over the past several years. According to the IMF, the combined real GDP of the MENA countries grew at 2.5% during 2013 whereas the GDP growth in the GCC was recorded at 4.1%. The IMF expects higher growth in both the regions, with the rate of growth converging by 2016 at 4.5%. The GCC region is the economic center of the MENA region accounting for close to 50% of the GDP but the growth rate of GDP in this region is expected to slowdown in the coming years.

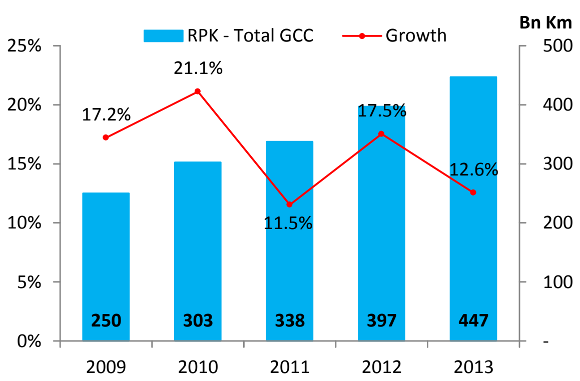
Economic indicators in the GCC have remained strong, especially in the UAE and Qatar. The corporate sector in the GCC demonstrated strong recovery from the financial and real estate crisis in collaboration with a supportive government which played a key role in implementing economic reforms across the GCC. In addition, the growing significance of the Gulf region as a global transportation hub due to its open economic policies and ease of doing business provides it with ample opportunities for the aviation sector.

Although oil continues to account for most of the economic activity in the region, the Tourism sector emerged as key area of focus, especially in Dubai and Qatar, which provided a significant push to the Aviation sector. Further, the business friendly policy adopted by these countries resulted in a number of companies setting up regional headquarters in Dubai. Meanwhile, the GCC remains a favored employment destination with strong corporate fundamentals and higher salaries mobilizing talents from across different geographies. Currently, more than half of the population in the GCC are expatriates which results in an embedded demand for international travel.

Economic activity fueling RPK growth

In terms of statistics from the International Civil Aviation Organization (ICAO), the 5-year CAGR of RPK in the GCC was recorded a strong 15.9% for the period 2008-2013. The strongest growth in terms of absolute RPKs was recorded in UAE which stood at 290.3 Bn Kms followed by Qatar at 79.8 Bn Kms and Saudi Arabia at 49.3 Bn Kms.

RPK Growth in the GCC



Source : International Civil Aviation Organization (ICAO)

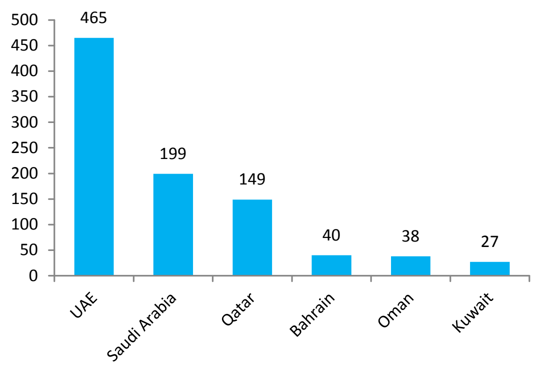
Infrastructure and support factors

Logistical bottlenecks like the size of the airport and support services that is affecting expansion of air fleet and passenger handling capacity has been consistently looked into by the respective governments in the region and ambitious expansion efforts are being carried out to handle record number of passengers each year. Dubai plans to spend USD 32 Bn for its airport expansion plan for the city's second airport that will eventually become the world's biggest in terms of passenger handling capacity. Qatar also undertook a similar strategy with an eye on hosting the Fifa World Cup 2020. The country has launched Phase 3 of the Hamad International airport, which already boasts one of the world's largest cargo handling capacity, to increase its final capacity to handle close to 70-90 million passenger a year till 2022.

Government Support and the Need for Privatization

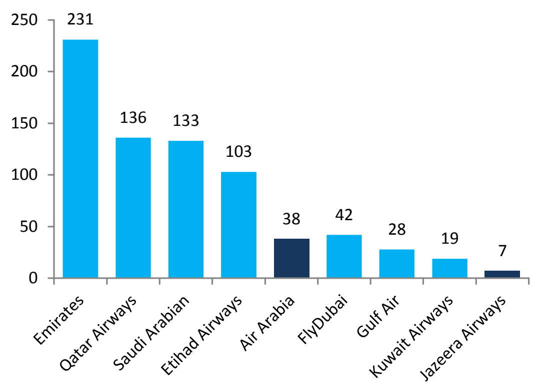
Although a majority of the flag carriers are owned by the government, there has been a major shift towards privatizing these players. A majority of these flag carriers suffer from traditional inefficiencies of a government-owned entity worsened by high fixed costs, overregulation and a huge debt pile that result into large losses for the airline company which ultimately results into fiscal budgetary pressure. Privatization is a viable option for governments that are in need of financing to modernize the existing fleet, facilities and equipment. However, there are a number of cases where the airline carrier failed after privatization. According to International Finance Corp. (IFC), which has advised a number of airline privatization deals, a successful privatization requires a dedicated government and a genuine wish for reform. Privatization leads to more competition which lowers prices and attracts more tourists thereby developing the tourist industry.

Active Fleet Size of GCC Carriers by Country



Source : Airfleets.net

Fleet Size by GCC Carriers



Source : Airfleets.net

In line with the rest of the world, airline companies in Middle East are either fully or partially controlled by their respective governments. However, the exception is that with the fiscal surpluses accumulated over the years on the back of higher oil prices, these governments have enough cash to financially support the airline companies. And some of these carriers are professionally managed, like a private sector company. Emirates, Etihad and Qatar Airways that feature as some of the leading airline companies in the world are all largely owned by the government. These governments also invest in expanding airline infrastructure. Further, with the government support, banks in the region and internationally are not reluctant to lend money to the airline companies to purchase aircrafts.

Bilateral travel strengthening with Asia Pacific region

Airline passenger traffic between the Middle East & Africa region and the Asia Pacific region topped the yearly growth chart with an of 10.3% during 2013. Passenger traffic between Middle East and Asia Pacific ranked second registering a growth of 9%. The significant growth seen in the above regions was driven by high economic growth in both the Asia Pacific and the Middle East & Africa markets.

Bilateral passenger travel between regions, 2009-2013

Region Pair	2010	2011	2012	2013	2009-2013
ME Africa-Asia Pacific	**11.5%**	**6.4%**	**1.7%**	**10.3%**	**33.1%**
Asia Pacific - Asia Pacific	11.1%	5.4%	8.6%	9.0%	38.5%
ME Africa - Europe	**7.8%**	**1.0%**	**3.9%**	**7.6%**	**21.7%**
Asia Pacific - Americas	6.9%	9.0%	4.9%	6.2%	29.8%
Asia Pacific - Europe	9.5%	9.0%	7.1%	5.4%	34.7%
ME Africa-ME Africa	**9.1%**	**6.4%**	**1.8%**	**3.1%**	**21.9%**
Europe-Europe	4.7%	5.3%	3.7%	3.1%	17.8%
Americas-Americas	4.1%	1.4%	3.0%	2.4%	11.3%
ME Africa-Americas	**7.8%**	**4.7%**	**2.9%**	**1.6%**	**18.0%**
Europe-Americas	1.9%	4.2%	-1.0%	0.9%	5.9%

Source : Oxford Economics, Amadeus

Further, due to the strategic geographical location, airport hubs in the Middle East region benefits from long haul transfer passenger traffic between Asia, Africa, and Europe. The Dubai airport is at the forefront to take advantage of this factor.

Cross border talent transfer continues to be strong towards the Middle East

Increasing labor migration across countries led by easing of regulations and higher level of skills is one of the key factors that has led to an increase in passenger traffic in some of the significant pockets of employment opportunities. According to United Nations Department of Economic and Social Affairs (UN-DESA), the Asia & Oceania region as a destination reported the highest level of migration followed by the Middle East / Western Asia region. This further justifies the strong growth in international airline passenger flows to these regions. Migrations to North America was reported at 53.1 Mn and primarily originated from the Latin America / Caribbean region.

Labor Migration (Mn)

				Origin			
Destination	World	Asia & Oceania	Europe	Africa & RoW	LatAm & Carribean	Middle East / Western Asia	North America
World	231.52	78.31	58.50	37.58	36.70	**16.12**	4.32
Europe	72.45	13.05	37.89	10.20	4.46	**5.88**	0.96
North America	53.09	14.66	7.91	2.05	25.93	**1.34**	1.20
Asia & Oceania	45.64	33.63	7.66	2.29	0.76	**0.72**	0.58
ME / Western Asia	**33.14**	**16.44**	**2.94**	**6.19**	**0.07**	**7.31**	**0.19**
Africa & RoW	18.64	0.28	0.85	16.64	0.02	**0.80**	0.05
LatAm & Carribean	8.55	0.26	1.24	0.21	5.45	**0.07**	1.33

Source : United Nations Department of Economic and Social Affairs

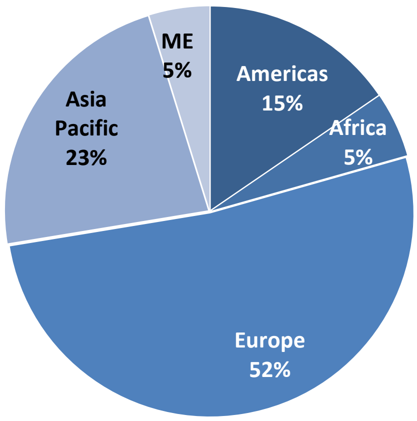
In terms of origin of migration, North America was at the bottom with 4.3 Mn migrations followed by the Middle East / West Asia region with 16.1 Mn migrations.

Tourism as the strongest catalyst for growth

In addition to fundamental factors like the growth in population and improving economic health, there are several event-based factors that would pump up demand for air travel in some of the key regions. Sport events like the cricket and football world cup temporarily increase demand to a particular destination and are generally met by rerouting the existing aircrafts. However, in case of some of the extended events like the Expo 2020 to be held in Dubai that would go on for up to six months would require an elaborate plan in terms of airport and airline capacity. This was one of the reason for record orders placed by Middle-East based airline companies. Moreover, such events give a big push to the tourism sector and the host government targets that these events have a sustainable impact on tourist arrivals.

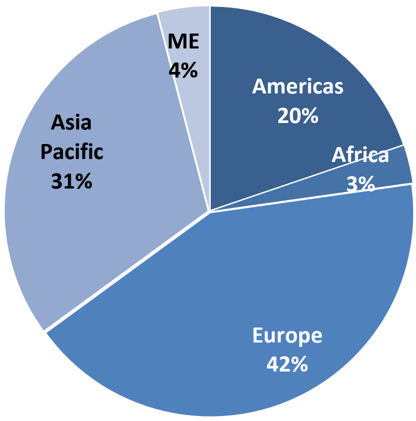
In order to diversify the economy from over dependence on the oil sector, governments especially in the GCC are making efforts to develop the tourism sector. The number of tourist arrivals in the GCC is expected to increase significantly over the next few years owing to the two upcoming mega events in the Middle East, the Expo 2020 in Dubai and the Fifa World Cup in Qatar in 2022.

International Tourist Arrivals in 2013



Source : UNWTO

International Tourism Receipts in 2013



Source : UNWTO

According to UNWTO, international tourist arrivals totaled 1.1 Bn globally during 2013. Europe attracted the largest pie of international tourists accounting for 51.8% of global arrivals or 563 Mn tourists. Asia Pacific region attracted the second highest number of tourists accounting for 22.8% global arrivals or 248 Mn tourists. Despite significant increase in arrivals in UAE, Middle East attracted the lowest number of international tourist at just 52 Mn or 4.8% of global tourists due to the ongoing tensions in several parts of this region.

In terms of tourism receipts, the revenue share of Europe was recorded at 42% or USD 489 Mn followed by Asia Pacific at 31% implying the fact that Asia attracted a higher share of high-spending tourists.

In its outlook for the global tourism sector, the UNWTO

Expected Growth in Tourism

	Expected Tourist Arrivals		Average Annual Growth		Global Share	
Region	2020	2030	2010-20	2020-30	2020	2030
Africa	85	134	5.4%	4.6%	6.3%	7.4%
Americas	199	248	2.9%	2.2%	14.6%	13.7%
Asia Pacific	355	535	5.7%	4.2%	26.1%	29.6%
Europe	620	744	2.7%	1.8%	45.6%	41.1%
Middle East	**101**	**149**	**5.2%**	**4.0%**	**7.4%**	**8.2%**
World	**1,360**	**1,809**	**3.8%**	**2.9%**	**100.0%**	**100.0%**

Source : UNWTO

expects a total growth of 25% till 2020 as compared to 2013 levels and a further growth of 33% in the following decade. The average annual growth is expected to be 3.8% during the current decade and 2.9% during the next decade. In terms of ranking, Middle East is expected to acquire the fourth spot for number of tourist arrivals overtaking Africa. The share of the Middle East region is also expected to increase from 4.8% at the end of 2013 to 7.4% by the end of 2020 and further to 8.2% by the end of 2030. Total tourist arrivals in the Middle East region is expected to double till 2020 and further increase by three times by 2030.

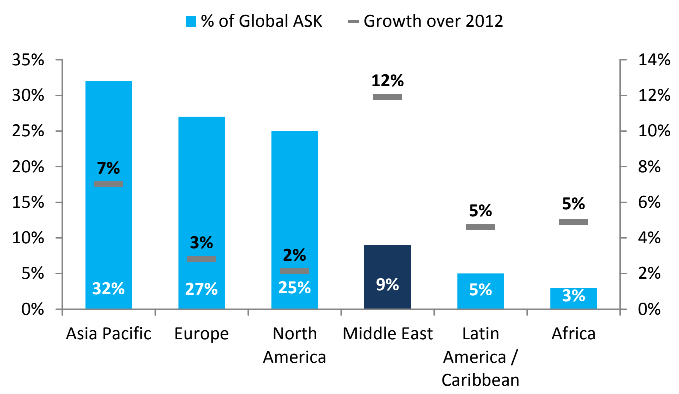
High growth over a relatively smaller base

With strong government support and high propensity to travel, the Middle East region presents ample opportunity for the aviation sector with more than 20 airline companies operating in the region. As discussed earlier, with the geographical advantage as the physical center of the earth, medium and long-haul routes between Middle East to Asia-Pacific or Middle East to Europe represent the core growth markets for traffic in the region. As a consequence, the share of passenger aircraft as a percentage of global passenger count operated by Middle East carriers has doubled in 10 years.

Moreover, due to the locational advantage, the Middle East region accounts for 14% of all wide-body aircrafts in the world with a mere 4% global population represented by the region. According to Airbus, the Middle East is the only region in the world where the wide-body fleet is larger than single-aisle fleet.

Further, in order to cater to the huge domestic and intra-regional market, single aisle aircrafts are also in great demand, especially from low cost carriers. Consequently, single-aisle fleet has multiplied by three in the last ten years in the region.

Aviation Capacity - 2013



Source : Airbus

Although, total air traffic, measured in terms of ASK, is dominated by the Asia Pacific region accounting for 32% of the total global ASK as of 2013, in terms of capacity addition, the Middle East region recorded the highest growth in ASK recorded at 12% as compared to 2012. The Asia Pacific region ranked second with 7% increase in ASK. In fact, air traffic in the region has increased over 3.5 times between 2003 and 2013 versus global air traffic doubling over a 15 year time. Tourism has played a key role in developing the sector with the number of tourists visiting the Middle East has doubled.

With RPKs expected to grow at an accelerated rate as compared to the global RPK growth, the region offers ample opportunities in all three type of markets. According to Airbus, the growth in RPK traffic in the Middle East is expected to be 6.2% between 2013 to 2033 as compared to 4.7% for globally. Large airlines would continue to focus on long haul markets, whereas the smaller and more efficient players would focus on medium haul and short haul opportunities with an increasing number of low cost carriers serving the inter and intra regional traffic in this segment.

Traffic flow in the Middle East

Passenger and cargo traffic flow is expected to increase at an accelerated rate in the Middle East in the, according to Airbus forecasts. The average growth rate of passenger traffic over the next 20 years (2013 - 2033) is expected to be the strongest between Middle East and Russia, which remains a relatively less explored route (and thus the significant growth over a lower base), at 8.3% followed by traffic between Middle - East and the Sub Sahara Africa region for the same reason. Passenger traffic between Middle East and the Asian Region is expected to be high volume and grow at above 5% for most of the region pairs.

Traffic Flow Forecast

Passenger Traffic Flow	CAGR 2013-2033
Asia advanced - Middle East	5.3%
Asia emerging - Middle East	6.8%
Australia/NZ - Middle East	5.2%
Canada - Middle East	5.5%
Caribbean - Middle East	4.7%
Central America - Middle East	5.1%
Central Europe - Middle East	7.6%
CIS - Middle East	7.0%
Domestic Middle East	3.2%
Indian SC - Middle East	6.8%
Intra Middle East	6.2%
Japan - Middle East	6.7%
Middle East - North Africa	5.8%
Middle East - Pacific	4.7%
Middle East - PRC	7.6%
Middle East - Russia	8.3%
Middle East - South Africa	7.0%
Middle East - South America	7.8%
Middle East - Sub Sahara Africa	8.0%
Middle East - USA	6.6%
Middle East - Western Europe	4.6%

Cargo Traffic Flow	CAGR 2013-2033
Africa to Middle East	5.6%
Asia advanced to Middle East	4.5%
Asia emerging to Middle East	4.5%
Central America to Middle East	5.0%
CIS - Middle East	2.1%
Europe to Middle East	3.8%
Indian SC to Middle East	7.0%
Intra Middle East	2.0%
Japan to Middle East	4.5%
Middle East to Africa	4.5%
Middle East to Asia advanced	4.1%
Middle East to Asia emerging	4.1%
Middle East to Central America	4.4%
Middle East to CIS	5.2%
Middle East to Europe	2.9%
Middle East to Indian SC	5.7%
Middle East to Japan	4.1%
Middle East to North America	3.4%
Middle East to Pacific	5.1%
Middle East to PRC	6.7%
Middle East to South America	4.4%
North America to Middle East	4.3%
Pacific to Middle East	4.8%
PRC to Middle East	6.5%
South America to Middle East	5.0%

Source : Airbus Global Market Forecast - 2014-2033

The cargo traffic flow between the Indian Sub Continent and Middle East is expected to be the strongest over the next 20 years with an expected average growth rate of 7% for flow from Indian Sub Continent to Middle East and 5.7% for flows in the opposite direction. Cargo traffic flow from Middle East to China is expected grow at an average rate of 6.7% and 6.5% in the opposite direction.

Competition

There are almost 20 well established airline companies in the middle east region with overlapping target markets. According to MEED, the combined aircraft orders (and options) from the top three players in the Middle East - Emirates, Etihad Airways and Qatar Airways - aggregates to more than 800 new planes. In addition, according to IATA, Emirates topped the list of international scheduled passenger kilometers flown recorded at 209.4 Bn Km followed by United Airlines and Lufthansa at 141.4 Bn Km and 139.1 Bn Km, respectively.

Major Middle East Airlines

Airline	Revenues ($m)	Net profit ($m)	ASK (Mn)	RPK (Mn)	Load Factor	Average daily departures	Average daily seats	Cities	Countries	Aircrafts	Average age (years)
Emirates	23,895	1,112	271,133	215,353	79%	466	171,448	142	80	217	6.4
Qatar Airways	na	na	94,352	71,945	76%	373	79,483	141	71	134	5.4
Etihad Airways	6,100	62	71,100	55,500	78%	210	44,386	103	52	95	5.3
Saudia	na	na	61,163	43,792	72%	472	80,928	84	35	114	8.9
Egypt Air	2,034	(434)	28,335	18,501	65%	216	32,740	77	50	79	11.1
Royal Air Maroc	1,678	(5)	18,708	12,556	67%	176	25,850	82	47	48	9.4
FlyDubai	1,007	61	na	na	na	151	28,447	66	35	32	2.6
Air Arabia	**867**	**118**	**15,270**	**12,400**	**81%**	**133**	**21,603**	**90**	**24**	**35**	**2.5**
Gulf Air	na	na	14,547	10,836	74%	128	19,072	36	23	26	5.6
Oman Air	991	(294)	13,352	10,281	77%	131	18,522	43	24	30	6.3
Royal Jordanian	1,070	(55)	12,069	8,431	70%	94	12,877	58	35	33	8.5
Kuwait Airways	782	(239)	9,954	7,303	73%	48	10,163	36	25	19	19.6
Air Algerie	na	na	8,771	5,831	66%	134	16,334	66	25	43	10.5
Tunisair	738	(82)	7,697	5,568	72%	95	14,559	59	28	32	15.6
FlyNas	na	na	5,988	4,182	70%	84	15,097	26	8	27	6.0
Middle East Airlines	708	63	5,794	3,952	68%	62	9,593	30	21	17	4.7
Jazeera Airways	**232**	**59**	**na**	**na**	**70%**	**na**	**na**	**20**	**11**	**8**	**4.3**
Yemenia	228	(9)	2,890	1,815	63%	36	6,982	29	30	7	15.0
Libyan Airlines	na	na	2,001	1,519	76%	54	7,091	22	9	21	5.1
Afriqiyah Airways	na	na	1,359	911	67%	34	5,174	20	14	11	4.2

Source : MEED

Due to the excessive competition from larger rivals, some of the airline companies in the region failed to breakeven and had to shut their operations. Some of these failed airline companies include RAK Airways in the UAE, Saudi Arabia's Sama, Wataniya Airways in Kuwait, and Bahrain Air. On the other hand, there are some airlines that have quickly scaled up their operations and within years they have a sizable number of aircraft fleet. Most of these companies are in the LCC segment, including FlyNas in Saudi Arabia, FlyDubai and Air Arabia, that also have new aircrafts to be delivered in the coming years. Moreover, there are new regional airline companies expected to be launched towards the end of the year or early next year which includes Saudi Gulf Airways and Al-Maha Airways, a unit of Qatar Airways.

Meanwhile, in terms of profitability, according to IATA, the aviation industry generates profit of USD 18 Bn per year from more than 3 Bn passengers a year which equates to a profit of $5.42 a passenger. Middle East airlines generally do far better, making a profit of $8.98 a passenger, putting them second only to their North American peers.

Furthermore, since most of the airline companies in the Middle East have majority stake owned by their respective governments, these shareholders are rethinking their airline investment. Some of these governments, in order to better compete with private players, are mulling privatization opportunities. These include Saudi Airlines Cargo Company and Kuwait Airways that are in the process of getting privatized.

Largest Airport Projects in the Middle East

Project	Value (USD Mn)	Completion date
Al-Maktoum International airport	8,154	2,020
Kuwait International Airport: New Terminal	4,800	2,016
King Abdulaziz Intl. Airport: Ph 1 - New Terminal: Package 1	4,034	2,014
King Abdulaziz Intl. Airport: Ph 1 - New Terminal: Package 2	3,194	2,014
Abu Dhabi Airport Expansion: Midfield Terminal Complex	2,960	2,017
Muscat & Salalah Intl. Airport Expansion: Pax Terminal, MC3	1,834	2,015

Source : MEED, KAMCO Research

Increasing global footprint through the M&A route

The Middle East region is a vibrant source of mergers and acquisitions (M&A) spread across a number of sectors. Currently, the total value of ongoing M&A deals in the region is close to USD 60.5 Bn and out of this the Aviation sector accounts for USD 1.7 Bn worth of deals. Historically, the Aviation sector in this region witnessed a number of high profile deals as the cash rich government-backed carriers look out for ways to expand their global network. Further, as the global aviation industry remains concentrated only on specific regions, the competition in the industry has resulted into a number of loss making carriers that are lucrative consolidation targets. The key to growth in the industry remains liquidity that gives access to new technologically advanced aircrafts which in turn helps in reducing the overall operating costs. Legacy airline companies with aging aircrafts are finding it increasingly difficult to compete with new players armed with the latest model of aircrafts.

Some of the recent high value M&A deals in emanating from the Middle East region are enlisted below:

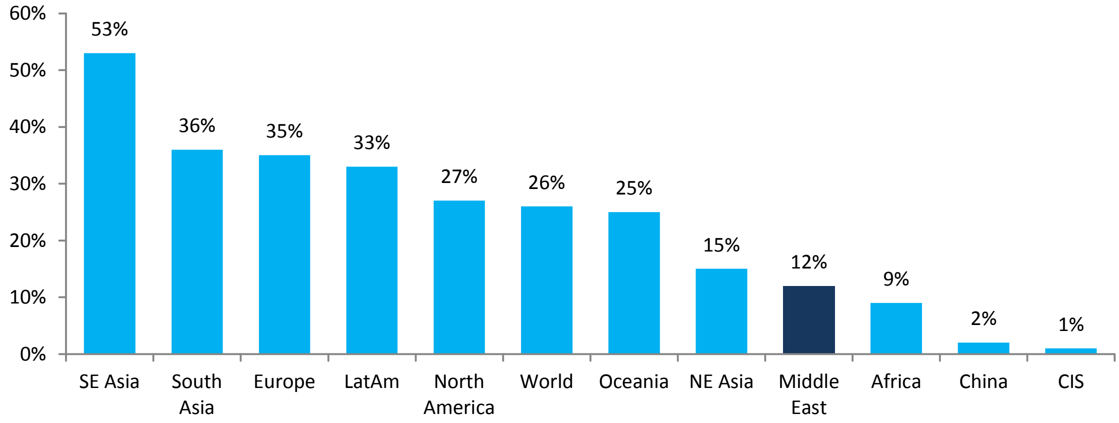
Deal	Description	Year	Value
Etihad Airways / Virgin Australia	Etihad increased its stake in Virgin Australia to 21.24%	2014	N/A
Etihad Airways / Alitalia	Etihad acquired a 49% stake in Alitalia for EUR 1.76 Bn (USD 2.4 Bn)	2014	USD 2.4 Bn
Etihad Airways / Darwin Airlines	Etihad announced plans to acquire 33.3% stake in Swiss National Carrier Darwin Airilnes.	2013	N/A
Etihad Airways / Air Serbia	Etihad acquired a 49% equity stake in Air Serbia	2013	N/A
Etihad Airways / Jet Airways	Etihad Airways purchased 24% stake in Jet Airways	2013	USD 379 Mn
Dnata (Emirates) / Servair Airchef	Dnata, the airlines services arm of Emirates, bought out Air France-KLM's stake in Servair Airchef	2013	N/A
Etihad Airways / Air Seychelles	Etihad Airways bought a 40 percent stake in Air Seychelles	2012	USD 20 Mn
Etihad Airways / Air Berlin	Etihad Airways bought 30% stake in Germany's Air Berlin	2011	USD 95 Mn

Source : Bloomberg, KAMCO Research

LCCs in the Middle East

The low cost carrier (LCC) phenomenon is fast catching up in the Middle East aviation market. The primary aim of the LCCs is to adopt a business model with minimal costs that significantly stimulates traffic. These players tend to drive down airline costs and pass on the saving to customers. Although fuel costs remains the same for both LCCs and traditional network carriers, LCCs tend to optimize other operating costs including labor costs, high load factors, and relying on direct sales.

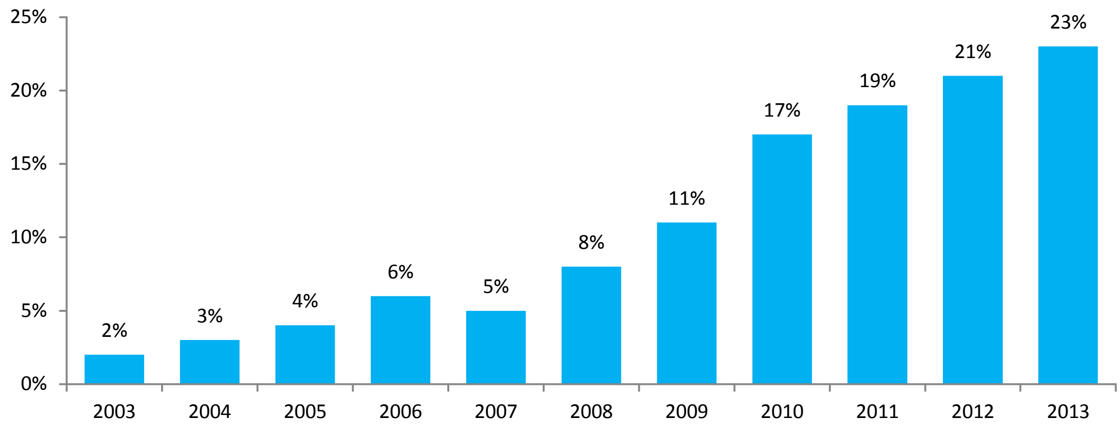
2013 LCC Market Share by Airline Domicile



Source : Boeing - Current Market Outlook 2014-2033

LCCs play a dominant role in the Asia Pacific region with market share in excess of 50% in some countries (53% in South East Asia). The low GDP per capita in the Asian region which impacts the propensity to travel is offset by affordability offered by LCCs. In Europe, Ryanair is the biggest player in this segment and has altered the competitive landscape with its low cost model. The market share of LCCs in the Middle East remains well below the global average. According to Boeing, 12% of annual seats of Middle East-domiciled airline companies were offered by LCCs in 2013 as compared to a global average of 26%.

Share of ASK Operated by LCCs in Middle East Short-haul Markets



Source : Airbus Global Market Forecast - 2014-2033

The ASK share of LCCs on Middle Eastern short-haul markets has consistently increased over the years and currently stands at 23% from a merely 2% share in 2003. LCC market share in the Middle East got a major boost after the financial crisis, which pushed the market share from 11% in 2009 to 17% in 2010.

Air Arabia PJSC

30-November -2014

CMP (30-Nov-2014)	Target Price	Upside / Downside	Recommendation
AED 1.49	AED 1.64	10.3%	Outperform

In this Section...

Investment Thesis

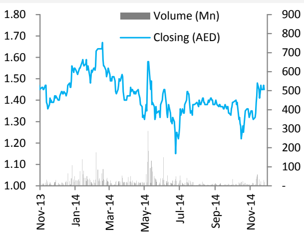
We are initiating coverage on Air Arabia PJSC with an Outperform rating and a price target of AED 1.64 per share representing an upside of 10.3% on the stock. *The company's topline grew at a five-year CAGR of 9.0% (2009-2013) supported by continuous fleet expansion that enabled it to increase passenger count. For the forecast period 2014-2018, we expect passenger revenue and other revenue to increase at a CAGR of 10%. We forecast a slight decline in yield per passenger for FY-14 and FY-15 and marginal increase for the remainder of the forecast period. We expect negative free cash flows during 2014 and 2015 primarily on the back of the current aircraft purchases that is expected to conclude in 2016. FCF is expected to be positive for the remaining three years.*

Air Arabia operates one of the youngest fleet of aircrafts with an average age of 2.5 years. *This gives the company a competitive edge in terms of fuel efficiency as well as type of aircraft. The company covers almost 100 destinations spread across the Middle East, North Africa, the Indian Subcontinent, Central Asia and Europe. The company's fleet size consists of 38 Airbus A320s, considered as one of the world's best-selling and most modern single aisle aircraft, split between 32 owned and 6 leased aircrafts. During 2007-08, the company placed order for 44 Airbus A320s valued at approximately USD 3.0 Bn. The company expects that the delivery of the order of 44 aircrafts would be complete by 2016.*

We expect the company to place a new order for aircrafts during 2015 with deliveries expected commence from 2017. *Consequently, in our projections, we have estimated two additional aircrafts deliveries each in 2017 and 2018 as part of the expected order. We expect ample scope for low cost carriers in the Middle East and any expected slowdown in the economic activity would have an initial impact on full scale carriers and minimal impact on LCCs as passengers shift to travelling in LCCs.*

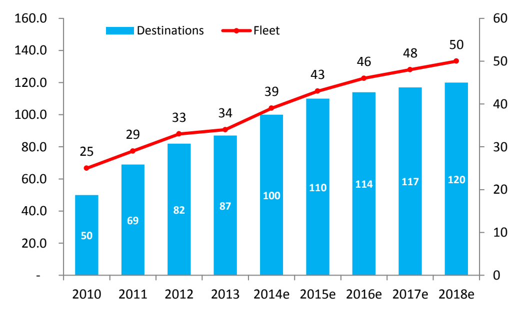
We see continued demand for LCCs that would support ambitious fleet expansion plans in the near term. *Further support comes from a favorable fund market resulting in low cost financing at favorable terms from regional and international banks. The focus of would remain higher utilization of aircrafts by maintaining 80% plus load factor levels.*

Price Chart



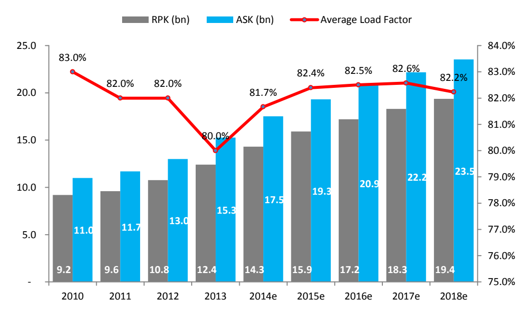
Price Perf.	1M	3M	12M
Absolute	12.9%	8.0%	4.9%
Relative to Mkt.	20.3%	21.1%	-40.4%

Fleet Size vs. Destinations Covered



Source : Air Arabia Financials, KAMCO Research

Capacity Utilization



Source : Air Arabia Financials, KAMCO Research

Key Indicators	2013	2014e	2015e
Passengers (Mn)	6.1	6.8	7.4
Load Factor	80.0%	81.7%	82.4%
EBITDAR Margin	21.1%	28.5%	27.6%
Net Margin	13.2%	19.7%	18.1%
P/E	17.2	9.6	9.4
P/BV	1.3	1.2	1.1
Div. Yield	4.7%	4.9%	6.7%
ROAE	7.6%	12.6%	12.2%
ROAA	4.8%	7.2%	6.5%

Stock Data	
Bloomberg Ticker	AIRARABI UH
Reuters Ticker	AIRA.DU
Last Price (AED)	1.49
YTD Change	-3.9%
M-Cap (AED Mn)	6,953.38
M-Cap (USD Bn)	1,891.32
52-week range	1.68 / 1.13
52-week Avg. Daily Volume (Mn)	25.68
52-week Avg. Daily Value (AED Mn)	37.61

Company Overview

Operating as one of the biggest low cost carriers in the region, Air Arabia PJSC was incorporated in June 2003 and was the first listed airline company in Middle East. The company is based in Sharjah, UAE, and is also the first airline company in the MENA region to operate as a low cost carrier airline or a budget airline company. The company was formed with a vision to be one of the world's leading budget airline companies in terms of profit margin, innovation, reputation and operational excellence. The company operates 8 subsidiaries across Egypt, Morocco and United Arab Emirates and subsidiary controlled entities in Qatar and Saudi Arabia.

The company covers almost 100 destinations spread across the Middle East, North Africa, the Indian Subcontinent, Central Asia and Europe. During 2014, the company added 10 additional destinations including Antalya, Al Jof, Abadan, Samara and Tiblisi. During the year, the company started the Ras Al Khaima Hub to bring total operational hubs to four including Sharjah, Morocco and Egypt. The new hub along with the Sharjah hub are aimed at serving the Middle East and Indian routes while the Casablanca hub in Morocco provides access to Europe and the Alexandria hub to Africa.

Air Arabia operates one of the youngest fleet of aircrafts with an average age of 2.5 years. This gives the company a competitive edge in terms of fuel efficiency as well as type of aircraft. The company's fleet size consists of 38 Airbus A320s, considered as one of the world's best-selling and most modern single aisle aircraft, split between 32 owned and 6 leased aircrafts. During 2007-08, the company placed order for 44 Airbus A320s valued at approximately USD 3.0 Bn. The company expects that the delivery of the order of 44 aircrafts would be complete by 2016.

Management Team

Name	Designation
Sheikh Abdullah Bin Mohamed Al Thani	Chairman
Adel Abdullah Ali	Group CEO
Paul Suckling	Director of Finance
Captain Mohamed Ahmed	Director of Operations

Source : Air Arabia Annual Report 2013, Kuwait Stock Exchange

The company has a stable and a supportive management team with years of experience in the airline business, particularly in the low cost carrier business.

Shareholding Structure and Share Price Performance

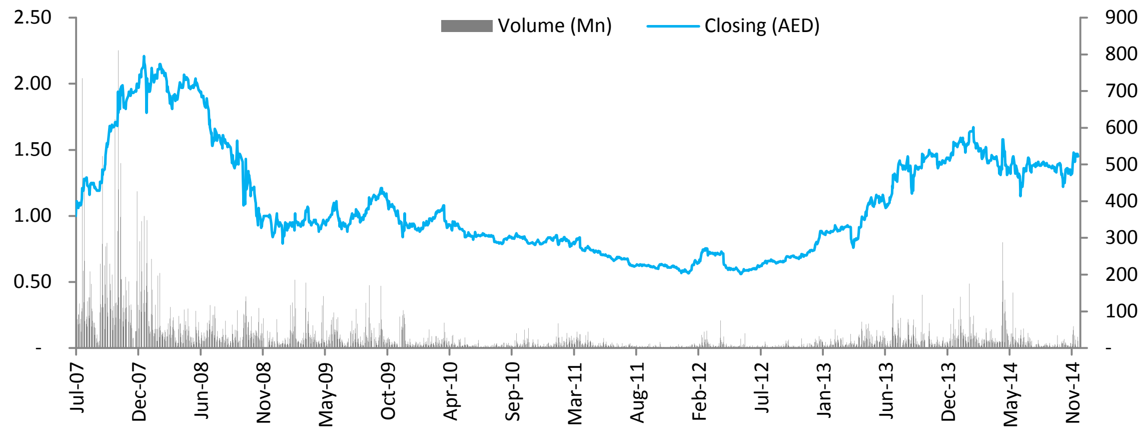
Shareholder Name	Type	Country	Holding
Sharjah Asset Management	Government	UAE	17.40%
Al Maha Holding Company (FZE)	Corporate	UAE	9.21%
Infrastructure and Growth Capital Fund	Corporate	UAE	5.36%
Public	-	-	68.03%

Nationality	Holding
UAE	68.73%
GCC	5.81%
Arab	3.93%
Foreigners	21.53%

Source : Air Arabia Annual Report 2013, Dubai Financial Market & Bloomberg

Air Arabia has a total share capital of AED 4.67 Bn with 82.6% of the shares listed as free float shares. Shares of the company has been fairly liquid with 52-week average daily shares trades recorded at close to 25.7 Mn whereas the average value traded during the same period totaled AED 37.6 Mn. In terms of share ownership, a two thirds of the shares are held by UAE nationals whereas the permitted foreign ownership limit is 49%.

Share Price and Volume Trend



Source : Bloomberg, KAMCO Research

Since listing, Air Arabia shares had its strongest run in 2013, gaining almost 85.6% during the year. The performance was led by a combination of fundamental factors as well as the overall positive market sentiments in the Dubai.

Key Subsidiaries / Joint Ventures / Associates

Name	Country	Holding	Description
Air Arabia Maintenance Hangar	UAE	100%	A fully owned subsidiary of Air Arabia designed to meet all MRO requirements for entire Air Arabia fleet while serving other airlines and aircraft.
Centro Sharjah [Centro] & Radisson Blu Hotel - Dubai	UAE	100%	100%-owned hotels situated in Sharjah and Dubai providing Air Arabia with a great expansion into hospitality.
Information Systems Associates (FZC)	UAE	100%	ISA develops and provides software solutions and offers information technology consultancy services. The company has developed a reservation system called 'AccelAero' that is now used by many low cost airlines across the world.
Alpha Flight Services UAE LLC	UAE	51%	A joint venture with the Dubai government providing in-flight catering services.
Cozmo Travel LLC	UAE	51%	A subsidiary of Air Arabia offering travel agency and tour operator services. Cozmo Travel LLC has two 100%-owned subsidiares namely Cozmo Travel Limited Company in Saudi Arabia and Cozmo Travel Qatar.
Air Arabia Egypt Company (S.A.E.)	Egypt	50%	A joint venture between Travco Group, an Egyptian travel and tourism company, and Air Arabia. The unit caters to African, Europe and Middle East routes.
Alpha Aviation Academy	UAE	50%	This academy helps Air Arabia meet its own internal needs for pilots to man its expanding aviation fleet.
Sharjah Aviation Services LLC (SAS)	UAE	50%	SAS is a joint venture with the Sharjah Aviation Authority delivering a comprehensive range of passenger, ramp and cargo handling services for airline operators and their customers at the airport.
Air Arabia Maroc, S.A.	Morocco	40%	Air Arabia (Maroc) is a joint venture company between Moroccan investors (including airline companies) and Air Arabia. The airline serves as the second hub for Arabia and was launched on April 29, 2009. It offers services to a wide range of Europien destinations.

Source : Zawya, Company Financials

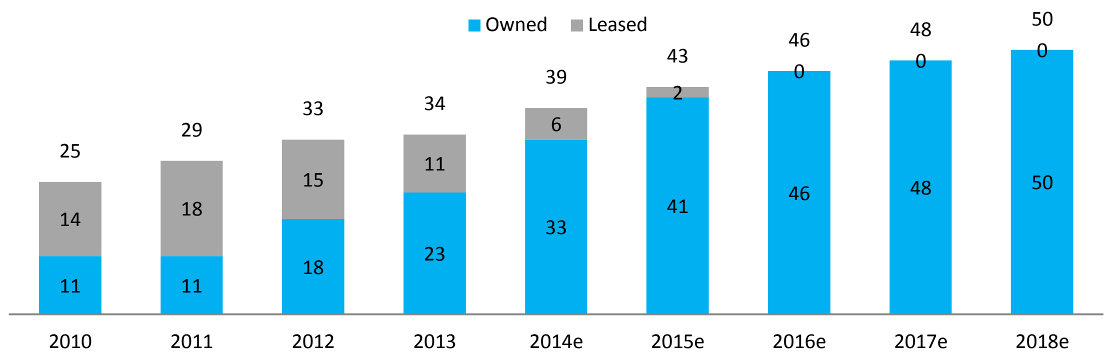
Operating Performance and Forecasts

Being a low cost carrier, Air Arabia has maintained an efficient operating model right since inception. This has enabled the company to remain profitable since 2004 as compared to losses reported by much larger players in the industry.

Developing the critical mass for fleet size

During 2007-08, the company placed order for 44 Airbus A320 aircrafts that with deliveries stretched till 2016. The new fleet of aircrafts started flowing in right after the 2008 financial crisis and the Arab spring events when business activity started picking up. This enabled the company to garner market share at a relatively accelerated pace with its new more efficient fleet of aircrafts offering low cost travel option to businesses and individuals looking at cutting costs. Currently, the company boasts one of the youngest fleet of 38 Airbus A320 aircrafts with an average age of 2.5 years split into 32 owned

Fleet Evolution



Source : Air Arabia Financials, KAMCO Research

and 6 leased aircrafts. The company financed the purchase of the first 9 aircrafts from regional banks and the 12 additional aircrafts are funded through finance supported by the European ECAs at competitive rates. The company expects to finance the remaining aircrafts via a mixture of ECA financing, commercial finance and sale and lease back options. The company expects to receive one more aircraft by year end 2014 and remaining aircrafts in 2015 and 2016.

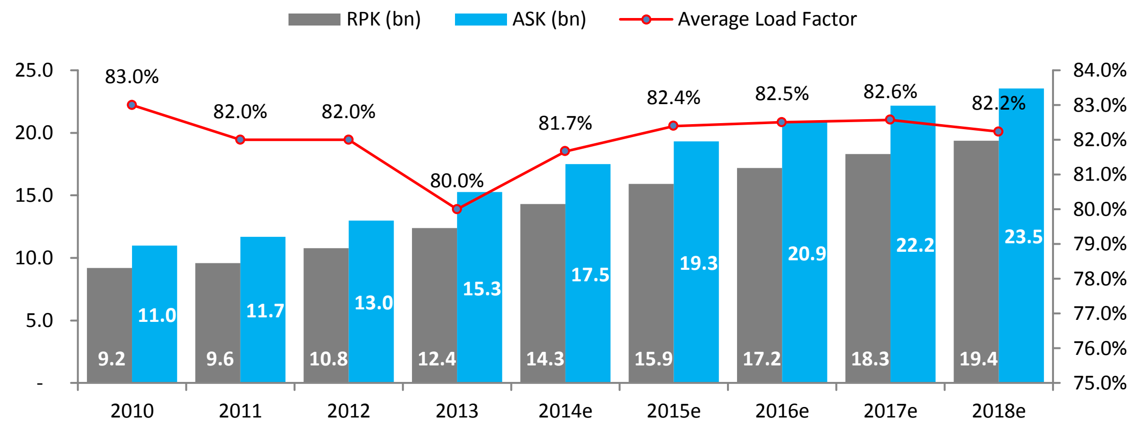
We have estimated six additional aircraft deliveries during 2015 and the remaining 5 aircrafts in 2016 to complete the order for 44 aircrafts. Meanwhile, as projected by the company leased aircraft count is expected to declined from 6 at the end of 2014 to 2 by the end of 2015 and operate a completely owned aircraft fleet by the end of 2016. We expect the additional aircrafts to have an accelerated incremental impact on seat capacity and RPK when they are inducted in mainstream operation.

We expect the company to place a new order for aircrafts during 2015 with deliveries expected commence from 2017. Consequently, in our projections, we have estimated two additional aircrafts

Key Operating Metrics	2010	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Total Aircraft	25	29	33	34	39	43	46	48	50
Growth	*19.0%*	*16.0%*	*13.8%*	*3.0%*	*14.7%*	*10.3%*	*7.0%*	*4.3%*	*4.2%*
Passengers (Mn)	4.5	4.7	5.3	6.1	6.8	7.4	7.8	8.2	8.5
Growth	*9.8%*	*4.4%*	*12.8%*	*15.1%*	*12.0%*	*8.0%*	*6.0%*	*4.3%*	*4.2%*
Base Fare (AED)	419.7	466.6	484.0	453.6	467.2	481.2	495.6	510.5	525.8
Growth	*-4.6%*	*11.2%*	*3.7%*	*-6.3%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*
RPK (Bn)	9.2	9.6	10.8	12.4	14.3	15.9	17.2	18.3	19.4
Growth	*8.2%*	*4.3%*	*12.2%*	*15.1%*	*15.4%*	*11.2%*	*8.1%*	*6.4%*	*5.7%*
ASK (Bn)	11.0	11.7	13.0	15.3	17.5	19.3	20.9	22.2	23.5
Growth	*4.8%*	*6.4%*	*11.1%*	*17.5%*	*14.7%*	*10.3%*	*8.0%*	*6.3%*	*6.2%*
Load Factor	83.0%	82.0%	82.0%	80.0%	81.7%	82.4%	82.5%	82.6%	82.2%

Source : Air Arabia Financials, KAMCO Research

Capacity Utilization



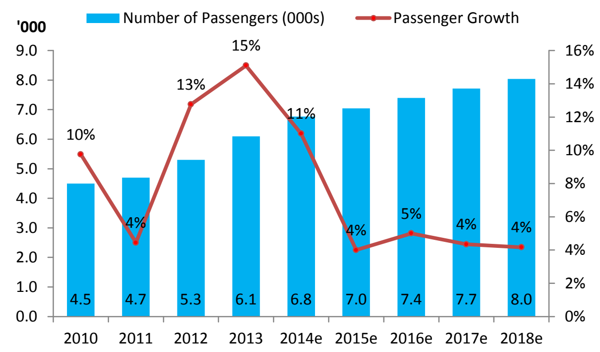
Source : Air Arabia Financials, KAMCO Research

deliveries each in 2017 and 2018 as part of the expected order. We expect ample scope for low cost carriers in the Middle East and any expected slowdown in the economic activity would have an initial impact on full scale carriers and minimal impact on LCCs as passengers shift to travelling in LCCs.

Monetizing additional capacity

An expanding fleet size coupled with a load factor of above 80% despite new fleet additions helped both topline and profitability. Although average load factor has been declining marginally since 2010 and was recorded at 80% during 2013, Air Arabia has consistently maintained it at above the 80% mark, which is essential for an LCC to run a profitable operation. Nevertheless, we see no pressure on load factor and it is expected to remain well above the average load factor of Middle East airline players, estimated to be at 72%. Further, based on YTD load factors for 2014, we expect a slight improvement by the end of the year led by strong quarterly result during the first half of the year (Q2-14 load factor was reported at 84%).

Passenger Growth

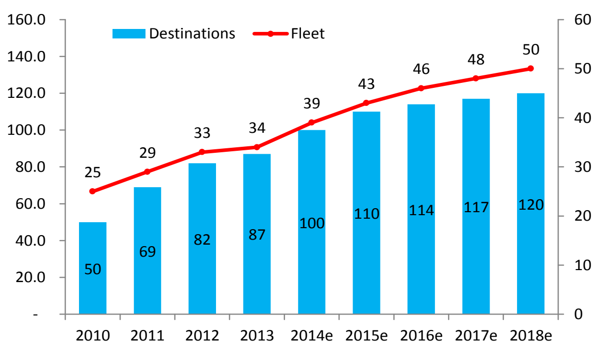


Source : Air Arabia Financials, KAMCO Research

We expect future average load factors to remain above the 80% level despite additional capacity as the company utilizes and expands into new destinations. The Ras Al Khaima hub would be instrumental in utilizing the additional aircraft capacity resulting in higher RPKs.

We expect available seat kilometers to increase to 17.5 Bn Km by the end of 2014 as compared to 15.3 Bn Km during 2013. Meanwhile revenue passenger kilometers is

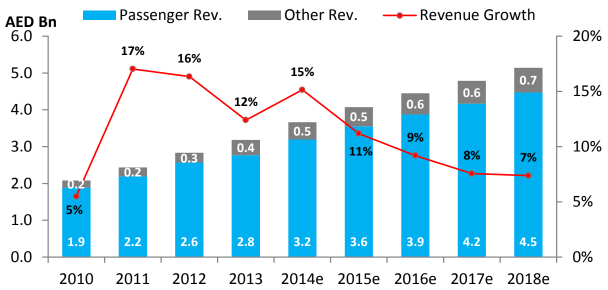
Fleet size vs. Destinations Covered



Source : Air Arabia Financials, KAMCO Research

expected to increase to 14.5 Bn Km by the end of 2014 as compared to 12.4 Bn Km at the end of 2013. Both RPK and ASK are expected to increase at a CAGR of close to 8% from 2013 to 2018. This increase will be primarily supported by increase in passenger count that we estate to grow at 11% during 2014. Passenger growth is expected to normalize from the double digit growth seen in the past 3 years to mid single digit for the forecast period. RPK growth will also be driven by additional destinations in Asia, possibly new routs in India. The company indicated that they are following up with the relevant authorities in India for flying permission.

Revenue Growth by Segment



Source : Air Arabia Financials, KAMCO Research

Over the last five years, Air Arabia has doubled its route network from 50 destinations in 2010 to 100 destinations by the end of September-14 with the help of four operational hubs. The company is actively seeking to add additional destinations from its newly established Ras Al Khaima Hub and is targeting India and related regional destinations to connect from this hub. The company added 13 destinations in 2014 and we expect marginal increase in the number of covered destinations in the future years and believe it to be in line with the increase in fleet size.

Financial Performance and Forecasts

Favorable market conditions help topline growth

Being the first LCC in the region, Air Arabia had the first mover advantage in tapping a big market opportunity. As a consequence, topline grew at a strong five-year CAGR of 9.0% (2009-2013) supported by continues fleet expansion that enabled the company to increase its passenger count. The company reported consistent growth in Passenger revenues, which currently accounts for close to 90% of total revenues whereas Other revenues reported uneven but positive performance over the years. Yield per RPK declined slightly during 2013 primarily due to a decline in base fares. However, yields at AED 0.25 per km continues to remain well above the average historical yields.

Meanwhile, favorable market conditions during Q3-14 resulted in strong Q3-14 y-o-y revenue growth of 24.5% and higher average load factor during the quarter (80.3% in Q3-14 vs. 77.8% in Q3-13). In addition, an 11.5% increase in seat capacity allowed the company to carry 15% more passengers during the quarter. The YTD-14 load factor also increased to 81.6% as compared to 80.7% during 9M-13 despite 11.4% increase in capacity.

Our FY-14 revenue estimates are based on the strong 9M-14 topline performance. We expect FY-14 revenues of AED 3.67 Bn, an increase of 15.1% as compared to 2013, in line with the increase in expected passenger revenues for the full year. Further, our passenger revenue expectations are based on increase in passenger count which depends on fleet expansion and load factors. We have also factored a 3% increase in base fares in 2014. For the forecast period 2014-2018, we expect passenger revenue and other revenue to increase at a CAGR of 10%. We forecast a slight decline in yield per passenger for FY-14 and FY-15 and marginal increase for the remainder of the forecast period.

Fuel cost to benefit in the short term but other cost savings to sustain higher EBITDAR

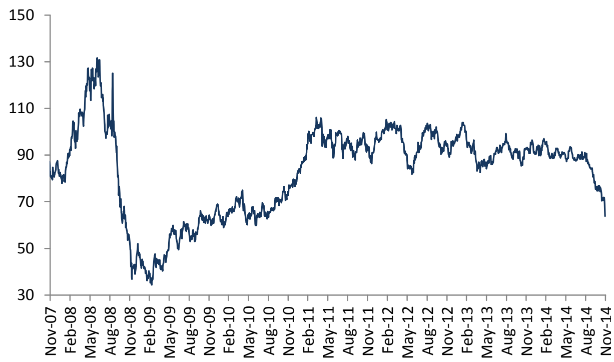
Fuel cost as a percentage of total revenue has remained flat at 42% over the past three years (2011-2013) due to stable oil prices which remained around the USD 100/barrel level. The company actively hedges its oil exposure and as of 9M-14 the company had hedged 65% of its 2014 fuel requirements, 50% for 2015 and 25% for 2016. Hedging is essential when oil prices are increasing. However, the drastic decline in oil prices in the past few months could result into higher hedging losses in 2014. Nevertheless, the unhedged portion of the oil provides some cushion to protect against oil price decline. Moreover, in terms of hedging impact on the competitive front, all major airline companies

Financial Indicators	2010	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Income Statement (AED Bn)									
Passenger Revenue	1.89	2.19	2.57	2.77	3.19	3.55	3.88	4.17	4.47
Other Revenue	0.19	0.24	0.27	0.42	0.47	0.53	0.57	0.62	0.67
Total Revenue	**2.08**	**2.43**	**2.83**	**3.18**	**3.67**	**4.08**	**4.45**	**4.79**	**5.14**
Growth	*5.5%*	*17.0%*	*16.3%*	*12.4%*	*15.1%*	*11.2%*	*9.2%*	*7.6%*	*7.4%*
Yield per RPK (AED Fils)	22.61	25.36	26.30	25.68	25.63	25.61	25.87	26.14	26.55
Yield per ASK (AED Fils)	18.91	20.81	21.79	20.85	20.93	21.10	21.34	21.58	21.83
Cost per RPK (AED Fils)	19.22	22.00	21.91	21.62	19.72	20.06	19.81	19.85	19.98
Cost per ASK (AED Fils)	16.08	18.05	18.15	17.56	16.10	16.53	16.35	16.39	16.43
Fuel Cost	0.70	1.02	1.19	1.34	1.32	1.51	1.65	1.77	1.90
Fuel Cost as % of Revenue	*33.8%*	*42.0%*	*41.9%*	*42.0%*	*36.0%*	*37.0%*	*37.0%*	*37.0%*	*37.0%*
Other Costs Costs	1.07	1.1	1.1	1.3	1.5	1.7	1.8	1.9	2.0
Gross Profit	**0.31**	**0.32**	**0.52**	**0.50**	**0.85**	**0.88**	**1.04**	**1.15**	**1.27**
Gross Profit Margin	15.0%	13.3%	18.5%	15.8%	23.1%	21.7%	23.4%	24.1%	24.8%
EBIT	**0.20**	**0.18**	**0.35**	**0.34**	**0.68**	**0.70**	**0.87**	**0.97**	**1.11**
EBIT Margin	9.6%	7.6%	12.5%	10.8%	18.6%	17.3%	19.6%	20.3%	21.6%
EBITDAR	**0.48**	**0.43**	**0.62**	**0.67**	**1.05**	**1.12**	**1.32**	**1.44**	**1.61**
EBITDAR Margin	23.1%	17.7%	21.9%	21.1%	28.5%	27.6%	29.7%	30.2%	31.3%
Net Profit	**0.31**	**0.27**	**0.42**	**0.42**	**0.72**	**0.74**	**0.89**	**0.97**	**1.08**
Net Margin	14.7%	11.1%	14.8%	13.2%	19.7%	18.1%	20.0%	20.2%	20.9%

Source : Air Arabia Financials, KAMCO Research

hedge their oil exposure (except for Jazeera Airways). So the pricing impact on base fares is uniform for all the players in the industry.

Jet Fuel Prices (USD/barrel)

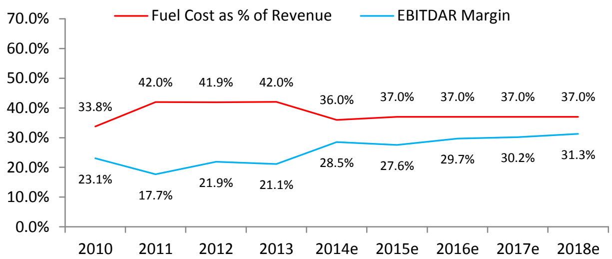


Source : Bloomberg

The 9M-14 decline in jet fuel prices was recorded at 12.3%, which further declined to 32.5% by the end of November-14. This drop was reflected in 9M-14 results with gross profits up by 320 basis points to 21.0% as compared to 17.8% for 9M-13. We expect full year gross margin at 22.0% with fuel accounting for 36% of total revenue. SG&A expenses are expected to increase slightly as a percentage of revenue as compared to previous levels. The increase comes primarily from higher general expenses while scaling up operations at new hubs.

We expect EBITDAR margins to increase to 28.5% for FY-14 on the back of lower fuel prices. However, as fuel prices normalize during future forecast period at around $90/ barrel, EBITDAR margin is expected to decline slightly as compared FY-14 levels but remain elevated as compared to historical levels. Lower fuel prices are also reflected in cost per available seat kilometer which we estimate to decline to AED Fils 16.10 in FY-14 and gradually increasing to AED Fils 16.43 by 2018.

Fuel cost vs. EBITDAR Margin



Source : Air Arabia Financials, KAMCO Research

Improving bottomline

Air Arabia has consistently reported positive net profit since 2004. Although net profit margin bottomed in 2011 when it reached 11.1% due to high fuel cost expense, the margin has shown significant jump in the subsequent years as fuel cost normalized and the increase started reflecting in the base fares. During 9M-14, net profit margin reached 17.4% as compared to 13.9% during 9M-13 and 23.2% for Q3-14 as compared to 23.7% for Q3-13. Third quarter has historically been seasonally strong for Middle East airlines due to the holiday season, which pushes margins for the full year. We expect FY-14 net profit margin of 19.7% on the back of fuel cost savings. We estimate it to normalize to 18.1% in 2015 but remain elevated as compared to historical levels resulting in a net profit CAGR of 20.7% for the forecast period.

Valuation & Recommendation

"Outperform" rating with a Price Target of AED 1.64 representing an upside of 10.3%

We have valued the company using Discounted Cash Flow (DCF) and relative valuation based on peer EV/EBITDAR multiple. We have assigned 75% weight to the DCF-based valuation and 25% weight to the relative valuation in order to calculate our fair value estimate.

Valuation Method	Value (AED)	Weight (%)
Discounted Cash Flow (DCF)	1.57	75%
EV/EBITDAR	1.86	25%
Weighted Average Fair Value	**1.64**	
Current Market Price	**1.49**	
Upside / Downside	**10.3%**	

DCF Model

Our DCF valuation is based on explicit forecast of free cash flow for the next five fiscal years (2014e-2018e) and a terminal value afterward. Our discount factor is based on a modified Capital Asset Pricing Model which takes into account various risk premiums pertaining to equity market risk, company specific risk, as well as industry related risk factors on top of the risk free rate. The forecasted cash flows over the projected horizon are discounted back using a weighted average cost of capital of 11.08% using a target debt to equity ratio that goes in line with the company's future expansion plans. We assumed a terminal growth rate of 3% in computing the terminal value considering the long term growth in the economy and its impact on the sector and the company.

DCF Valuation	Fair Value of Equity (AED Mn)	Fair Value per Share (AED)
Present Value of FCF (2014e - 2018e)	717.1	0.15
Present Value of Terminal Value	7,336.5	1.57
Present Value of Cash Flows	8,053.6	1.73
Investments (3Q14)	1,034.7	0.22
Cash (3Q14)	1,285.3	0.28
Debt (3Q14)	(3,039.4)	(0.65)
Enterprise Value	10,373.6	2.22
Equity Fair Value	**7,334.2**	**1.57**

Based on the above assumptions, we arrived at an estimated fair value for Air Arabia's equity at AED 7.3 Bn, which, considering 4.7 bn outstanding shares, translates to per share fair value price of AED 1.57. We believe that the positive 9M-14 results is already factored in the current share price and there should not be a major earnings surprise when the company announces full year results, unless the fourth quarter, which is typically the smallest in terms of revenues, performs significantly well as compared to historical levels.

Sensitivity analysis

The sensitivity analysis for the change in fair value share price to the changes in WACC and the terminal growth rate is mentioned in the below table.

Terminal Growth Rate	Weighted Average Cost of Capital					
		10.5%	11.0%	11.1%	12.0%	12.5%
	2.00%	1.52	1.40	1.38	1.21	1.12
	2.50%	1.62	1.49	1.47	1.28	1.19
	3.00%	1.74	1.59	**1.57**	1.35	1.25
	3.50%	1.87	1.71	1.68	1.44	1.33
	4.00%	2.02	1.84	1.81	1.54	1.42

Relative Valuation

Company	Country	M-Cap (USD Mn)	Net Profit 2015e (USD Mn)	P/E 2015e	EV to EBITDAR
Southwest Airlines	US	26,926	1,722	15.6	8.1
Ryanair	Ireland	14,572	1,044	14.0	8.2
EasyJet	UK	9,446	891	10.6	6.9
Spirit Airlines	US	5,554	329	16.9	8.8
JetBlue	US	3,712	352	10.5	5.9
WestJet	Canada	3,472	324	10.7	4.4
Allegiant Air	US	2,359	135	17.5	9.7
AirAsia	Malaysia	2,006	219	9.1	11.6
Air Arabia	UAE	1,891	139	13.6	8.2
Norwegian	Norway	1,248	73	17.0	8.6
Cebu Air	Philippines	968	90	10.8	7.1
Volara	Mexico	820	56	14.7	NM
Jazeera Airways	Kuwait	630	66	10.0	7.5
Tigerair	Singapore	228	(16)	NM	26.7
Peer Group		**73,833**	**5,423**	**13.6**	**7.7**

Source : Company Financials, Bloomberg , KAMCO Research

For peer-based valuation, we have used the average EV/EBITDAR multiple for the sector of 7.7x for 2015e which resulted in relative share price of AED 1.86, based solely on the relative valuation.

Keeping in mind the mature markets in which a majority of the peer group members operate and the wide variation in their leverage ratios, we decided to use the EV/EBITDAR ratio. We believe that EV/ EBITDAR ratio adequately covers the leverage aspect of the valuation.

Key Risks to our Valuation

Sensitivity to political events

The aviation industry is extremely sensitive to geopolitical events, especially the airline companies operating in the Middle East region, which is marred by several geopolitical issues. The current situation in the Syria, Iraq and other places in the Middle East has forced airline companies, including Air Arabia and Jazeera Airways, to either stop services to a target market or if they are flying over the disputed area, have to re route the flights to an alternative direction. All such actions either result in additional cost or lead to loss of revenue.

Competitive pressure

Although LCCs have a good growth opportunity in the underserved region, a strategic decision by a larger player in the market to enter the LCC market, as seen in several other markets, could put pressure on base fares, yield and load factors, thus affecting profitability. Emirati-backed flydubai is the closest competitor to Air Arabia in terms of fleet size, destinations and type of business model. Both the airlines have almost 40 overlapping destinations. flydubai operates an all Boeing fleet of aircrafts totaling 42 aircrafts as of November-14. In early 2014, flydubai placed a bigger order for 75 Boeing 737 MAXs and 11 Next-Generation 737-800s, valued at USD 8.8 Bn at list prices. In addition, the airline retains purchase rights for 25 more 737 MAXs. The delivery of aircrafts under the new order is expected to commence from 2017.

At present, flydubai has a competitive advantage in terms of fleet size and passenger traffic. However, Air Arabia has a more diversified route network as it operates from four different hubs catering to Europe, Africa, Middle East and Asian regions. On the other hand, flydubai has a strong market share in traffic flow to Russia and the CIS.

Nevertheless, despite the significant competition, we estimate that the expected market size for LCCs in the Middle East regions is large enough to accommodate the existing players and their expansion plans. We believe Air Arabia would focus on expanding its route network and leverage on its geographic diversification advantage.

Fuel price fluctuations

High volatility in fuel prices leads to hedging losses to an airline company. Although high oil price is not good for the health of the sector, its affects the entire industry and, as seen recently, leads to a structural shift from full scale carriers to LCCs. However, when the prices are too volatile, airlines have to be extremely careful with their hedging strategies.

Oversupply of seat capacity

Overcapacity is one of the key risks for the airline industry. With record orders being placed for the expansion of fleet capacity, each airline company have their respective estimates of the market growth. However, every addition to industry fleet size leads to additional competition.

Further, every airline company have their own estimate of adding additional routes in the future. However, due to the long huge order backlog of orders with aircraft manufacturers, there is a long delivery time required to receive the new aircrafts. In the mean time, companies have to manage their existing capacity in the most prudent way without losing market share in the existing market. Moreover, companies placer order for new aircrafts expecting to start operations to new set of routes, but, any failure to secure the rights to operate in a target market could affect load factors.

Financial Indicators

Balance Sheet (AED Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Assets								
Bank Balances & Cash	1,345	1,307	1,391	735	1,054	1,687	2,236	2,887
Trade and Other Receivables	416	459	498	598	717	789	868	955
Short Term Investments	-	-	-	200	200	200	200	200
Current Assets	**1,873**	**1,844**	**1,980**	**1,628**	**2,070**	**2,778**	**3,410**	**4,151**
Property and Equipment	2,423	3,263	4,332	5,660	6,732	7,118	7,392	7,639
Advances for New Aircrafts	597	650	708	715	751	826	908	999
Intangible Assets & Goodwill	1,282	1,282	1,282	1,302	1,302	1,302	1,302	1,302
Non-Current Assets	**5,242**	**6,199**	**7,415**	**8,950**	**10,099**	**10,605**	**10,955**	**11,339**
Total Assets	**7,114**	**8,043**	**9,395**	**10,579**	**12,170**	**13,383**	**14,365**	**15,489**
Liabilities								
Trade and other payables	649	976	1,129	1,275	1,418	1,579	1,758	1,961
Finance Lease Liabilities	934	1,370	2,127	2,659	2,925	3,575	3,932	4,326
Ijara Facility From DIB	-	-	-	-	846	761	685	616
Total Liabilities	**1,865**	**2,602**	**3,819**	**4,657**	**6,814**	**7,515**	**7,964**	**8,498**
Shareholders' Equity								
Share Capital	4,667	4,667	4,667	4,667	4,667	4,667	4,667	4,667
Reserves	361	388	472	617	764	942	1,135	1,351
Retained Earnings	223	336	346	585	708	954	1,214	1,516
Total Shareholders Equity	**5,249**	**5,441**	**5,576**	**5,921**	**6,201**	**6,629**	**7,086**	**7,607**
Total Equity & Liability	**7,114**	**8,043**	**9,395**	**10,579**	**12,170**	**13,383**	**14,365**	**15,489**

Income Statement (AED Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Revenue	**2,435**	**2,942**	**3,184**	**3,666**	**4,076**	**4,450**	**4,787**	**5,140**
Direct Costs	(2,112)	(2,418)	(2,681)	(2,821)	(3,192)	(3,409)	(3,634)	(3,867)
Gross Profit	**323**	**524**	**503**	**845**	**884**	**1,041**	**1,152**	**1,272**
SG&A	(138)	(171)	(159)	(165)	(179)	(169)	(182)	(164)
Operating Profit	**184**	**353**	**344**	**680**	**705**	**872**	**970**	**1,108**
Interest Income From Bank Deposits	72	58	50	55	60	66	73	80
Finance Cost	(21)	(35)	(43)	(56)	(73)	(95)	(123)	(160)
Other Income / (Expense)	39	49	85	59	62	66	69	72
Net Profit	**274**	**425**	**435**	**738**	**755**	**909**	**989**	**1,100**
Minority Interest	5	5	14	16	17	19	21	23
Net Profit Excluding Minority Interest	**269**	**420**	**421**	**722**	**737**	**890**	**968**	**1,077**

Cash Flow Statement (AED Mn)	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Cash Flow from Operating Activities	202	848	690	1,038	1,049	1,289	1,397	1,543
Cash Flow from Investing Activities	(394)	(484)	(433)	(1,976)	(1,394)	(779)	(646)	(694)
Cash Flow from Financing Activities	(475)	(425)	(369)	282	664	122	(202)	(199)
Change in Cash	(667)	(62)	(112)	(656)	319	633	549	651
Cash and equivalents at the end	**1,345**	**1,307**	**1,391**	**735**	**1,054**	**1,687**	**2,236**	**2,887**

Key Ratios	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Profitability Ratios								
Revenue Growth	17.0%	16.3%	12.4%	15.1%	11.2%	9.2%	7.6%	7.4%
EBITDA Growth	16.4%	75.4%	9.3%	65.6%	8.2%	19.3%	10.2%	12.2%
Net Profit Growth	-12.0%	55.9%	0.3%	71.7%	2.0%	20.8%	8.7%	11.3%
Gross Profit Margin	13.3%	17.8%	15.8%	23.1%	21.7%	23.4%	24.1%	24.8%
EBITDA Margin	12.2%	17.7%	17.9%	25.7%	25.0%	27.3%	28.0%	29.2%
EBITDAR Margin	17.7%	21.1%	21.1%	28.5%	27.6%	29.7%	30.2%	31.3%
Operating Margin	7.6%	12.0%	10.8%	18.6%	17.3%	19.6%	20.3%	21.6%
Net Profit Margin	11.1%	14.3%	13.2%	19.7%	18.1%	20.0%	20.2%	20.9%
Asset Structure & Liquidity Ratios								
Current Ratio (x)	2.2	1.5	1.2	0.8	1.0	1.2	1.3	1.5
Quick Ratio (x)	2.2	1.5	1.2	0.8	0.9	1.2	1.3	1.5
Debt-to-Equity (x)	0.18	0.25	0.44	0.51	0.67	0.71	0.71	0.70
Debt-to-EBITDA (x)	3.15	2.63	4.25	3.19	4.05	3.86	3.72	3.53
ROAA	4.0%	5.5%	4.8%	7.2%	6.5%	7.0%	7.0%	7.2%
ROAE	5.1%	7.8%	7.6%	12.6%	12.2%	13.9%	14.1%	14.7%
Valuation Ratios								
Price (AED)	0.586	0.835	1.550	1.490	1.490	1.490	1.490	1.490
Number of Shares (Bn)	4.67	4.67	4.67	4.67	4.67	4.67	4.67	4.67
M-Cap (AED Bn)	2.73	3.90	7.23	6.95	6.95	6.95	6.95	6.95
EPS (AED)	0.058	0.090	0.090	0.155	0.158	0.191	0.207	0.231
Book Value Per Share (AED)	1.12	1.16	1.19	1.26	1.32	1.41	1.51	1.62
P/E Ratio (x)	10.2	9.3	17.2	9.6	9.4	7.8	7.2	6.5
P/BV Ratio (x)	0.5	0.7	1.3	1.2	1.1	1.1	1.0	0.9
EV/EBITDA	16.9	12.6	19.4	11.4	11.9	11.0	10.6	10.1
EV/EBITDAR	11.7	10.6	16.4	10.2	10.8	10.1	9.8	9.4
Dividend Payout	104.1%	77.9%	80.4%	64.6%	63.3%	57.7%	57.9%	56.3%
Dividend Yield	10.2%	8.4%	4.7%	4.9%	6.7%	6.7%	7.4%	8.1%

Source : Air Arabia Financials, KAMCO Research

Note: Forward Valuation ratios are based on current market prices

Jazeera Airways K.S.C.P

30-November-2014

CMP (30-Nov-2014)	Target Price	Upside / Downside	Recommendation
KWD 0.435	KWD 0.501	15.1%	Outperform

In this Section...

Investment Thesis

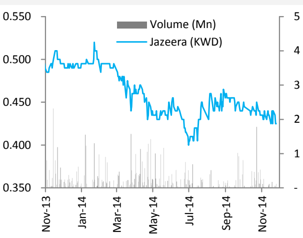
We are initiating coverage on Jazeera Airways K.S.C.P with an Outperform rating and a price target of KWD 0.501 per share representing an upside of 15.1% on the stock. *We believe that marginal increase in topline coupled with low fuel prices and a no-hedging policy would directly translate into better margins. During 9M-14, passenger revenue increased by 3.2%to KWD 47.6 Mn and leasing revenue increased by 2.9% to KWD 4.8 Mn, resulting in a total revenue growth of 3.1%.*

Jazeera Airways operates as a low cost carrier from Kuwait serving almost 20 destinations. *It also owns Sahaab Leasing, an aircraft leasing company, established as a private company by key shareholders and financiers of Jazeera Airways in October 2008. Passenger Airline revenue accounted for 91% of total revenues during 2013 and averaged at 10% during the period 2011-2013.*

For full year 2014, we expect 3% growth in passenger revenues on the back of marginal increase in passengers flown coupled with 1% increase in passenger fares. *The increase in average passenger fares is estimated to be modest due to the low prevailing jet fuel prices as compared to 2013. Further, the consistent decline in fuel prices during 2014 would directly translate into better margins. However, some of the fuel price decline is already factored in base fares by competitors resulting in a decline in topline. We expect fuel prices as a percentage of revenue to bottom in 2014 at 28% and gradually increase to historical levels by 2018.*

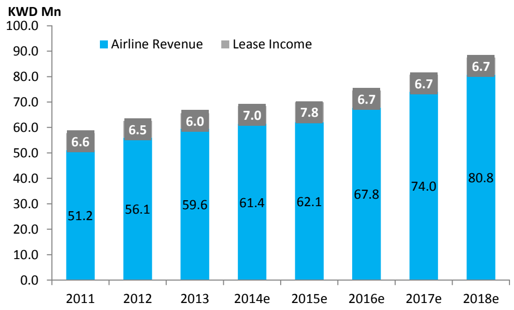
We expect the company to carry additional passengers during 2016 to 2018 with the deployment of new aircrafts in future. *We estimate passengers numbers to increase at a CAGR of 5.3% over the next five years (2014e - 2018e). We have forecasted passenger revenue CAGR of 6.3% for the next five years (2014-2018) on the back of an average 2.4% increase in passenger fares coupled with higher passenger count. Revenue from the leasing business is expected to increase at 2.3% over the forecasted period based on the current number of lessees.*

Price Chart



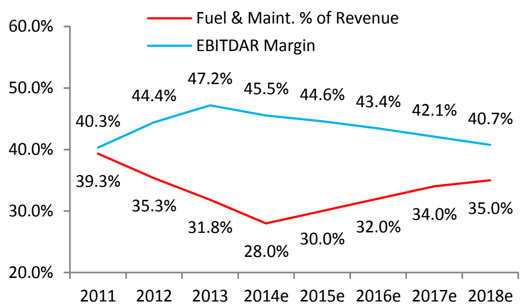
Price Perf.	1M	3M	12M
Absolute	*0.0%*	*-4.4%*	*-12.1%*
Relative to Mkt.	*5.4%*	*3.0%*	*-11.1%*

Revenue Growth by Segment



Source : Jazeera Airways Financials, KAMCO Research

Fuel Cost vs. Margin



Source : Jazeera Airways Financials, KAMCO Research

Key Indicators	2013	2014e	2015e
Passengers (Mn)	1.1	1.1	1.2
Passenger Rev(KWD Mn)	59.6	61.4	62.1
EBITDAR Margin	47.2%	45.5%	44.6%
Net Margin	26.6%	24.3%	23.1%
P/E	12.5	11.5	11.8
P/BV	2.8	2.2	2.0
Div. Yield	3.0%	3.4%	3.4%
ROAE	25.1%	20.0%	17.3%
ROAA	8.2%	7.1%	6.4%

Stock Data	
Bloomberg Ticker	JAZEERA KK
Reuters Ticker	JAZK.KW
Last Price (KWD)	0.435
YTD Change	-11.1%
M-Cap (KWD Mn)	178.50
M-Cap (USD Mn)	630.46
52-week range	0.520 - 0.400
52-week Avg. Daily Volume (Mn)	0.23
52-week Avg. Daily Value (KWD Mn)	0.10

Company Overview

Established in 2004, Jazeera Airways operates as a low cost carrier from Kuwait serving almost 20 destinations. The company got listed on the Kuwait Stock Exchange in 2008 and as of the latest quarter, it operates a fleet of seven Airbus A320 aircrafts for its airline business. Jazeera Airways also owns Sahaab Leasing, an aircraft leasing company, established as a private company by key shareholders and financiers of Jazeera Airways in October 2008. Sahaab Leasing acquires and leases commercial aircrafts for customers and started with Jazeera Airways as it first customer.

Management Team

Name	Designation
Marwan Marzouk Boodai	Chairman
Jassim Marzouk Boodai	Vice Chairman
Donald Hubbard	Chief Finance Officer
Abdullah Al-Hudaid	Chief Operating Officer
Ali Fairooz	VP Ground Operations & Product

Source : Jazeera Airways Annual Report - 2013

Over the past four years, there has been no change in the company's fleet size which stood at 6 by the end of 2013. However, during 2014, the company added an additional aircraft and expanded its route network to 20 destinations. The company carried 1.2 million passengers during 2013 and 0.9 Mn passengers during YTD-14. Jazeera Airways flies to some of the high-demand business, leisure, family, and weekend destinations which include Dubai, Bahrain, Beirut, Alexandria and Cairo.

Shareholding Structure and Share Price Performance

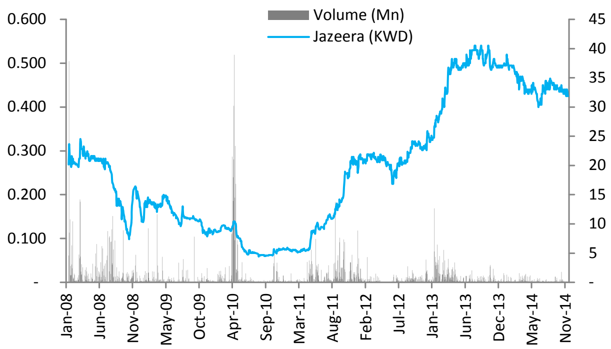
Shareholder Name	Type	Country	Holding
Boodai Corporation W.L.L.	Corporate	Kuwait	16.89%
Jassim Mohammed Al Moussa Corporation for General Trading	Corporate	Kuwait	9.24%
Al Bawadi International Real Estate Company	Corporate	Kuwait	9.09%
Wings Credits & General Trading and Contracting Company	Corporate	Kuwait	9.09%
United Bridge Real Estate Company	Corporate	Kuwait	8.39%
Public	-	-	47.30%

Source : Zawya, Kuwait Stock Exchange

Jazeera Airways has a total share capital of KWD 42 Mn with 66% of the shares held by minority shareholders primarily based in the GCC. Shares of the company has been fairly liquid with YTD-14 shares turnover recorded at 11.9% with 49.8 Mn shares traded during the current year.

The 52-week average daily shares traded stood at 0.23 Mn and average daily value traded totaled KWD 0.10 Mn. During 2013, the company was inducted as one of the constituents of the Kuwait 15 index, which tracks daily performance of 15 key companies in Kuwait. The company's shares got a liquidity boost after it was inducted in the index.

Share Price and Volume Trend



Source : Bloomberg, KAMCO Research

Key Subsidiaries / Joint Ventures / Associates

In February 2010, Jazeera Airways acquired Sahaab Leasing just two years after its formation for KWD 25.6 Mn as part of its vertical integration strategy to invest in services that compliment passenger airline operations.

Name	Country	Holding
Al Sahaab Aircraft Leasing Company W.L.L.	Kuwait	100%
Jazeera Leasing Company [JLC] [via Al Sahaab Aircraft Leasing Company W.L.L.]	Cayman Islands	100%
Sahaab Aircraft Leasing Company -1 [SALC-1] [via Al Sahaab Aircraft Leasing Company W.L.L.]	Cayman Islands	100%
Sahaab Aircraft Leasing Company -2 [SALC-2] [via Al Sahaab Aircraft Leasing Company W.L.L.]	Cayman Islands	100%
Sahaab Aviation LLC [via Al Sahaab Aircraft Leasing Company W.L.L.]	Cayman Islands	100%

Source : Zawya

This acquisition gave Jazeera an opportunity to diversify its business and achieve a more predictable revenue stream in addition to getting a stronghold in the aircraft leasing business. Immediately after the acquisition, Jazeera Airways pumped an additional KWD 9 Mn capital in Sahaab Leasing to take advantage of the new market opportunities. Sahaab Leasing has currently leased eight aircrafts, which includes the recently leased two aircrafts to TAP Portugal.

Operating Performance and Forecasts

Jazeera Airways has reported pretty stable performance over the years. Although the company suffered losses in the initial years of operations, it has reported positive results over the past 17 quarters.

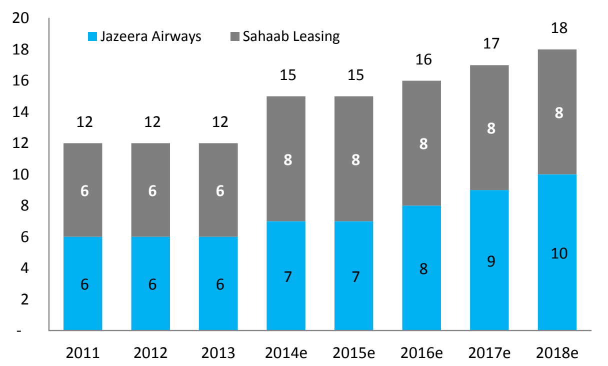
Key Operating Metrics	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Aircrafts - Jazeera Airways	6	6	6	7	7	8	9	10
Aircrafts - Sahaab Leasing	6	6	6	8	8	8	8	8
Total Aircraft	12	12	12	15	15	16	17	18
Growth	-	*0.0%*	*0.0%*	*25.0%*	*0.0%*	*6.7%*	*6.3%*	*5.9%*
Passengers (Mn)	1.2	1.1	1.1	1.1	1.2	1.3	1.4	1.5
Growth	-	*-3.8%*	*0.9%*	*0.6%*	*5.0%*	*7.0%*	*7.0%*	*7.0%*
Average Fare (KWD)	40.5	46.3	48.7	49.2	51.6	52.6	53.7	54.8
Growth	-	*14.3%*	*5.1%*	*1.0%*	*5.0%*	*2.0%*	*2.0%*	*2.0%*

Source : Jazeera Airways Financials, KAMCO Research

Fleet size set to expand to take advantage of market opportunities

For the years 2011 to 2013, Jazeera Airways maintained a constant fleet size of 6 aircrafts each in the airline business and the leasing business. The company received two aircrafts during 2013 and one in 2014 as part of the order placed back in 2005 increasing the fleet size to 15. The company's general policy is to place new aircrafts in the airline business and then gradually shift it for leasing. During 2014, the company leased two aircrafts to TAP Portugal and added one in the airline business to serve additional destinations, which currently stands at 20, although it includes flights to Syria that are temporarily suspended.

Fleet Evolution



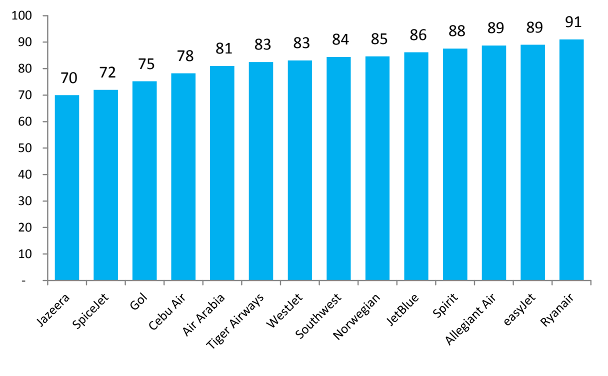
Source : Air Arabia Financials, KAMCO Research

The company has a new strategic plan called Strategic Evolution Plan ("STEP") which is expected to be implemented over 2015 to 2018. The company plans to give additional color on its new strategy during early 2015, however, according to previous statements from its CEO, the company plans to order additional aircrafts to be delivered starting 2016. Accordingly, we have projected one aircraft addition each for the year 2016 to 2018.

Load factor expected to scale up

Jazeera Airways reported one of the lowest load factors in the industry recorded at 70% during 2013 despite operating a relatively small number of aircrafts. Low cost carriers typically tend to achieve significantly high load factor levels as compared to full scale carriers in order to increase the utilization of their seat capacity. Nevertheless, despite the low load factors, Jazeera Airways has reported positive results over the past four years led by prudent cost management and the diversification offered by the leasing business.

LCC Load Factors

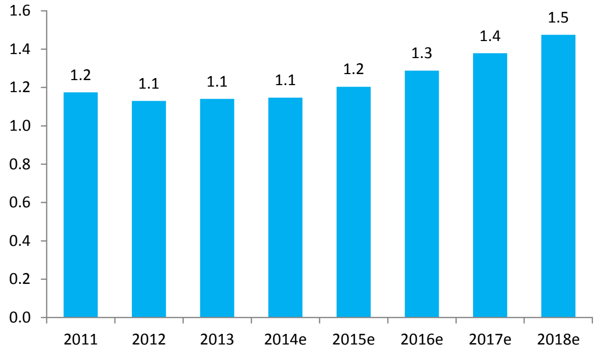


Source : MEED, Bloomberg

Modest but gradual growth in passengers

Constant fleet size coupled with marginal change in already low load factors over the past three years resulted in marginal change in overall passenger count. Moreover, the company had to suspend operations on several of its destinations owing to security issues (Aleppo, Damascus, Deir Ezzor). During Q3-14, the company reported a strong 11% increase in passengers primarily due to the shift in the holiday season. However, 9M-14 passenger growth was only marginal recorded at 0.7%.

Passenger Growth (Mn)



Source : Jazeera Airways Financials, KAMCO Research

In its latest monthly operational statistics report (August-14) the company highlighted a 26% y-o-y increase in total flown passengers primarily due to the summer holidays season. According to the report, passenger count increased on 12 routes served during the month. The company saw a 19% y-o-y increase in flown passengers on routes serving Istanbul, Beirut and Amman. During the month, the company recorded a market share of 64% on the luxor route followed by 55% and 46% market share on the Sham El Sheikh route and Sohag route, respectively. On the Amman and Dubai route, the company could achieve a market share of 35% and 14% respectively.

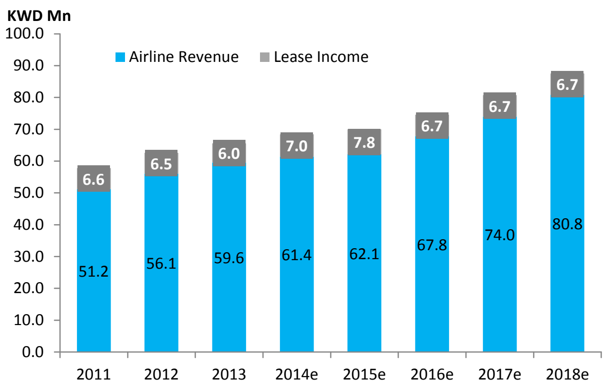
With the deployment of new aircrafts in future, we expect the company to carry additional passengers during 2016 to 2018. We estimate passengers numbers to increase at a CAGR of 5.3% over the next five years (2014e - 2018e).

Financial Performance and Forecasts

Marginal revenue growth in the short term

The revenue split between passenger airline revenue and leasing revenue has remained constant over the past three years in line with the constant fleet size. Passenger Airline revenue accounted for 91% of total revenues during 2013 and averaged at 10% during the period 2011-2013.

Revenue Growth by Segment



Source : Jazeera Airways Financials, KAMCO Research

During 9M-14, passenger revenue increased by 3.2% to KWD 47.6 Mn and leasing revenue increased by 2.9% to KWD 4.8 Mn, resulting in total revenue growth of 3.1%. For full year 2014, we expect 3% growth in passenger revenues on the back of marginal increase in passengers flown coupled with 1% increase in passenger fares. The increase in average passenger fares is estimated to be modest due to the low prevailing jet fuel prices as compared to 2013. On the other hand, we expect revenue from the leasing business to increase by 17% during 2014 to KWD 7 Mn primarily due to the addition of TAP as a leasing client during 2014. Consequently, total revenue is expected to increase by 4.4% during 2014.

We have forecasted passenger revenue CAGR of 6.3% for the next five years (2014-2018). This growth is estimated to be fueled by a CAGR 5.3% for passengers flown coupled with an expected average 2.4% increase in passenger fares. Revenue from the leasing business is expected to increase at 2.3% over the forecasted period based on the current number of lessees.

Gross margin to peak in 2013

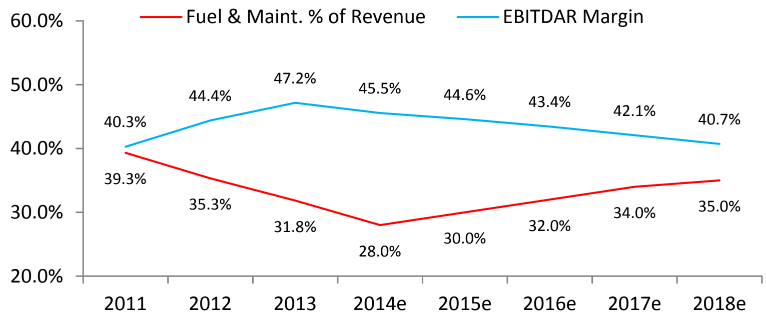
Gross profit margin increased to 37.5% during 2013 on the back of higher average fare and passenger yields. Nevertheless, Jazeera Airways' gross margin remains at a significantly high level as compared to the competition. The company has a no fuel hedging policy which paid off during a declining oil price scenario. During 9M-14, gross margin declined marginally and stood at 35.9%. For full year 2014, we expect a slight y-o-y decline in gross margin expected to be at 36.2%. For future projections, we forecast a declining trend in gross margin despite increase in capacity and revenue as we expect competitive pressure to puts a pressure on base fares.

Financial Indicators	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Income Statement (KWD Mn)								
Passenger Revenue	51.16	56.06	59.56	61.44	62.14	67.82	74.01	80.78
Lease Income	6.63	6.55	6.00	7.00	7.82	6.73	6.73	6.73
Total Revenue	**57.79**	**62.60**	**65.56**	**68.44**	**69.96**	**74.55**	**80.75**	**87.51**
Growth	-	*8.3%*	*4.7%*	*4.4%*	*2.2%*	*6.6%*	*8.3%*	*8.4%*
Aircraft Fuel & Maintenance	18.72	18.49	17.67	17.20	18.64	21.70	25.16	28.27
Fuel & Maint. % of Revenue	*39.3%*	*35.3%*	*31.8%*	*28.0%*	*30.0%*	*32.0%*	*34.0%*	*35.0%*
Other Costs Costs	20.3	21.9	23.3	26.5	26.8	27.6	29.2	31.6
Gross Profit	**18.76**	**22.26**	**24.58**	**24.76**	**24.53**	**25.20**	**26.37**	**27.60**
Gross Profit Margin	32.5%	35.6%	37.5%	36.2%	35.1%	33.8%	32.7%	31.5%
EBIT	**16.20**	**19.00**	**21.02**	**21.06**	**20.78**	**21.27**	**22.10**	**22.95**
EBIT Margin	28.0%	30.3%	32.1%	30.8%	29.7%	28.5%	27.4%	26.2%
EBITDAR	**23.29**	**27.80**	**30.92**	**31.17**	**31.19**	**32.38**	**33.98**	**35.65**
EBITDAR Margin	40.3%	44.4%	47.2%	45.5%	44.6%	43.4%	42.1%	40.7%
Net Profit	**11.08**	**14.31**	**17.45**	**16.66**	**16.17**	**16.36**	**16.90**	**18.01**
Net Margin	19.2%	22.9%	26.6%	24.3%	23.1%	21.9%	20.9%	20.6%

Source : Jazeera Airways Financials, KAMCO Research

The consistent decline in fuel prices during 2014 would directly translate into better margins. However, some of the fuel price decline is already factored in base fares by competitors resulting in a decline in topline. We expect fuel prices as a percentage of revenue to bottom in 2014 at 28% and gradually increase to historical levels by 2018.

Fuel Cost vs. Margin



Source : Jazeera Airways Financials, KAMCO Research

One of the key factors that affected revenues as well as led to higher operating costs during most of 2014 was the closure of routes to some of the key destinations due to geopolitical issues. Jazeera Airways suspended flight services to cities it used to serve in Syria that led to loss of revenue from these routes. In addition, the company had to re route flight over geopolitically unstable regions for safety reasons. This led to higher operating costs for the firm, affecting margins. We have forecasted a gradual recovery from such situations which would be accretive to both topline and margins.

Leasing income resulting in higher overall profitability

Income from Sahaab Leasing accounted for 10% of the revenue during 2014 which directly translates into profitability margins. In line with gross margins, EBITDAR and net profit margins are expected to have peaked during 2013. According to our estimates, EBITDAR margin is expected to decline by 170 bps to 45.5% in 2014 and gradually decline to 40.7% by 2018 as we expect costs to increase at a faster pace as compared to revenues. Net profit margin stood at 24.7% during 9M-14 as compared to 27.7% during 9M-13. We expect full year 2014 net margin of 24.3% due to a seasonally slow fourth quarter partially offset by decline in oil prices. We expect net profit margin to move more in line with the industry at around the 20% level by 2018 (20.6% as per our projection).

Valuation & Recommendation

"Outperform" rating with a Price Target of KWD 0.501 representing an upside of 15.1%

We have valued Jazeera Airways using Discounted Cash Flow (DCF) and relative valuation based on peer EV/EBITDAR multiple. We have assigned 75% weight to the DCF-based valuation and 25% weight to the relative valuation in order to calculate our fair value estimate. Jazeera Airways has significant spare capacity with load factor of just below 70% as compared to more than 80% in the case of other low cost carriers in the region as well as globally. In addition, the company's leasing arm, Shahab leasing provides diversification and stability to net profit estimates with 8 aircrafts on long-term lease to Asian, European and US-based airline companies.

Valuation Method	Value (KWD)	Weight (%)
Discounted Cash Flow (DCF)	0.477	75%
EV/EBITDAR	0.572	25%
Weighted Average Fair Value	**0.501**	
Current Market Price	**0.435**	
Upside / Downside	**15.1%**	

DCF Model

Our DCF valuation is based on explicit forecast of free cash flow for the next five fiscal years (2014e-2018e) and a terminal value afterward. Our discount factor is based on a modified Capital Asset Pricing Model which takes into account various risk premiums pertaining to equity market risk, company specific risk, as well as industry related risk factors on top of the risk free rate. The forecasted cash flows over the projected horizon are discounted back using a weighted average cost of capital of 10.50% using a target debt to equity ratio that goes in line with the company's future expansion plans. We assumed a terminal growth rate of 3% in computing the terminal value considering the long term growth in the economy and its impact on the sector and the company.

DCF Valuation	Fair Value of Equity (KWD Mn)	Fair Value per Share (KWD)
Present Value of FCF (2014e - 2018e)	81.6	0.194
Present Value of Terminal Value	185.2	0.441
Present Value of Cash Flows	266.8	0.635
Investments (3Q14)	-	-
Cash (3Q14)	66.6	0.158
Debt (3Q14)	120.4	0.287
Enterprise Value	320.7	0.764
Equity Fair Value	**200.3**	**0.477**

Based on the above assumption, we arrived at the estimated fair value for Jazeera Airways equity at KWD 200.3 Mn, which considering 420 Mn outstanding shares, translates to per share fair value price of KWD 0.477. The company is expected to generate positive free cash flows during the forecast period led by positive contribution from the leasing income. Further, the company's strong cash balance provides a cushion for further financing of aircrafts.

Sensitivity Analysis

The sensitivity analysis for the change in fair value share price to the changes in WACC and the terminal growth rate is mentioned in the below table:

Terminal Growth Rate	Weighted Average Cost of Capital				
	9.5%	10.0%	10.5%	11.0%	11.5%
2.00%	0.493	0.455	0.421	0.391	0.364
2.50%	0.528	0.485	0.447	0.414	0.384
3.00%	0.568	0.519	**0.477**	0.440	0.407
3.50%	0.615	0.559	0.511	0.469	0.432
4.00%	0.671	0.605	0.550	0.502	0.461

Relative Valuation

For peer-based valuation, we have used the EV/EBITDAR multiple which for 2015e is estimated at 7.7x for 2015e which resulted in relative share price of KWD 0.572, based solely on the relative valuation.

Company	Country	M-Cap (USD Mn)	Net Profit 2015e (USD Mn)	P/E 2015e	EV to EBITDAR
Southwest Airlines	US	26,926	1,722	15.6	8.1
Ryanair	Ireland	14,572	1,044	14.0	8.2
EasyJet	UK	9,446	891	10.6	6.9
Spirit Airlines	US	5,554	329	16.9	8.8
JetBlue	US	3,712	352	10.5	5.9
WestJet	Canada	3,472	324	10.7	4.4
Allegiant Air	US	2,359	135	17.5	9.7
AirAsia	Malaysia	2,006	219	9.1	11.6
Air Arabia	UAE	1,891	139	13.6	8.2
Norwegian	Norway	1,248	73	17.0	8.6
Cebu Air	Philippines	968	90	10.8	7.1
Volara	Mexico	820	56	14.7	NM
Jazeera Airways	Kuwait	630	66	10.0	7.5
Tigerair	Singapore	228	(16)	NM	26.7
Peer Group		**73,833**	**5,423**	**13.6**	**7.7**

Source : Company Financials, Bloomberg , KAMCO Research

Keeping in mind the mature markets in which a majority of the peer group members operate and the wide variation in their leverage ratios, we decided to use the EV/EBITDAR ratio for relative valuation. We believe that EV/EBITDAR ratio adequately covers the leverage aspect of the valuation.

Key Risks to our Valuation and Outlook

Kuwait continues to remain an underserved market

In line with our expectations for Air Arabia, we expect strong demand for LCCs in the GCC region. However, the demand in Kuwait is expected to outweigh demand in other regions as we believe that the Kuwaiti aviation market is largely underserved, especially by LCCs. There is a huge embedded demand from budget traveler, and after the closure of Wataniya Airlines, base fares between some of the high demand destinations from Kuwait, like Lebanon, has increased phenomenally. This demand is expected to persist in the near term as we don't expect significant competition from other LCCs in the region.

Stabilizing regional geopolitical situation should be a positive

Any sign of easing of the regional conflict would be positive for Jazeera Airways as it will help the company resume its services to such destinations. Moreover, the company will not have to add additional capacity to serve this demand as the company's load factor continues to remain at significantly low level as compared to other LCCs.

Inorganic expansion would be negative for margin

We believe that the company's expansion via the inorganic route would be negative for the margins. Jazeera Airways is widely seen as one of the bidders of stake in the privatization of Kuwait Airways further supported by the management's intention in this direction for upto a 35% stake in the national carrier. We believe that the Kuwait Airways' legacy cost issues and losses coupled with high gestation period required to turnaround operations would result into lower overall profitability. Although Jazeera Airways would gain by capitalizing on Kuwait Airways' international routes, we believe that issues would outweigh possible benefits from the stake acquisition.

Financial Indicators

Balance Sheet	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Assets								
Cash, Bank Balances & Time Deposits	15.6	47.9	43.3	67.8	75.4	101.8	102.2	103.8
Inventories, Trade and Other Receivables	2.0	1.7	1.6	2.3	2.3	2.5	2.7	2.9
Current Assets	**17.6**	**49.6**	**44.9**	**70.1**	**77.8**	**104.3**	**104.9**	**106.8**
Property and Equipment	148.1	140.9	154.0	158.1	153.5	157.3	160.8	164.2
Advance for Maintenance	6.3	3.5	3.8	6.1	6.7	7.4	8.1	8.9
Goodwill	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Non-Current Assets	**158.5**	**148.7**	**162.1**	**168.6**	**164.7**	**169.4**	**173.9**	**178.3**
Total Assets	**176.1**	**198.2**	**207.0**	**238.7**	**242.5**	**273.7**	**278.8**	**285.0**
Liabilities								
Term Loans	8.1	17.6	21.2	19.5	22.3	26.5	25.1	23.9
Deferred Revenue	6.3	7.2	7.9	8.3	8.2	8.9	9.2	9.6
Trade and Other Payables	15.0	10.9	9.2	11.0	11.2	11.2	12.1	13.1
Current Liabilities	**41.8**	**35.9**	**38.6**	**39.3**	**42.4**	**47.4**	**47.5**	**47.7**
Term Loans	62.8	76.2	80.5	98.1	89.3	105.9	100.6	95.5
Advance Received from Lessee	7.8	10.4	9.8	13.0	12.4	11.8	11.2	10.6
Non-Current Liabilities	**108.4**	**104.3**	**93.6**	**115.0**	**106.4**	**123.2**	**118.5**	**114.2**
Total Liabilities	**150.2**	**140.2**	**132.2**	**154.3**	**148.8**	**170.6**	**166.0**	**162.0**
Shareholders' Equity								
Share Capital	22.0	42.0	42.0	42.0	42.0	42.0	42.0	42.0
Legal Reserve	1.3	2.7	4.5	4.5	4.5	4.5	4.5	4.5
Retained Earnings	4.0	14.3	29.2	38.8	48.1	57.5	67.1	77.5
Foreign Currency Translation Reserve	(1.4)	(1.0)	(0.9)	(0.9)	(0.9)	(0.9)	(0.9)	(0.9)
Total Shareholders Equity	**25.9**	**58.0**	**74.8**	**84.4**	**93.7**	**103.1**	**112.7**	**123.1**
Total Equity & Liability	**176.1**	**198.2**	**207.0**	238.7	242.5	273.7	278.8	285.0

Income Statement	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Revenue	**57.8**	**62.6**	**65.6**	**68.4**	**70.0**	**74.5**	**80.7**	**87.5**
Operating Costs	(39.0)	(40.3)	(41.0)	(43.7)	(45.4)	(49.3)	(54.4)	(59.9)
Gross Profit	**18.8**	**22.3**	**24.6**	**24.8**	**24.5**	**25.2**	**26.4**	**27.6**
General & Administrative Expense	(3.9)	(3.7)	(4.0)	(4.2)	(4.3)	(4.5)	(4.9)	(5.3)
Operating Profit	**14.9**	**18.5**	**20.6**	**20.5**	**20.2**	**20.7**	**21.4**	**22.3**
Finance Costs	(5.1)	(4.7)	(3.6)	(4.4)	(4.6)	(4.9)	(5.2)	(4.9)
Net Profit	**10.6**	**13.9**	**16.7**	**15.9**	**15.4**	**15.6**	**16.1**	**17.2**

Cash Flow Statement	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Cash Flow from Operating Activities	21.1	15.6	25.7	28.9	27.4	28.8	30.7	32.0
Cash Flow from Investing Activities	(1.7)	10.9	(19.4)	(13.3)	(3.0)	(11.9)	(12.1)	(12.5)
Cash Flow from Financing Activities	(12.9)	5.4	(11.9)	8.9	(16.8)	9.5	(18.2)	(17.9)
Change in Cash	6.5	31.9	(5.6)	24.6	7.6	26.4	0.4	1.6
Net Cash at End	**12.0**	**42.9**	**37.0**	62.8	70.4	96.8	97.2	98.8

Key Ratios	2011	2012	2013	2014e	2015e	2016e	2017e	2018e
Profitability Ratios								
Revenue Growth	35.8%	8.3%	4.7%	4.4%	2.2%	6.6%	8.3%	8.4%
EBITDA Growth	299.8%	21.1%	11.0%	0.3%	-0.8%	3.2%	4.3%	4.2%
Net Profit Growth	NM	32.1%	19.6%	-4.6%	-3.0%	1.2%	3.3%	6.6%
Gross Profit Margin	32.5%	35.6%	37.5%	36.2%	35.1%	33.8%	32.7%	31.5%
EBITDA Margin	35.9%	40.1%	42.5%	40.8%	39.7%	38.4%	37.0%	35.5%
EBITDAR Margin	40.3%	44.4%	47.2%	45.5%	44.6%	43.4%	42.1%	40.7%
Operating Margin	25.7%	29.6%	31.4%	30.0%	28.9%	27.7%	26.6%	25.4%
Net Profit Margin	18.3%	22.3%	25.4%	23.2%	22.1%	21.0%	20.0%	19.7%
Asset Structure & Liquidity Ratios								
Current Ratio (x)	0.4	1.4	1.2	1.8	1.8	2.2	2.2	2.2
Quick Ratio (x)	0.4	1.3	1.1	1.7	1.8	2.2	2.2	2.2
Debt-to-Equity (x)	3.2	1.6	1.4	1.4	1.2	1.3	1.1	1.0
Debt-to-EBITDA (x)	4.0	3.7	3.7	4.2	4.1	4.7	4.2	3.9
ROAA	6.0%	7.5%	8.2%	7.1%	6.4%	6.1%	5.8%	6.1%
ROAE	51.1%	33.2%	25.1%	20.0%	17.3%	15.9%	15.0%	14.6%
Valuation Ratios								
Price (KWD)	0.455	0.320	0.495	0.435	0.435	0.435	0.435	0.435
Number of Shares (Mn)	220.0	420.0	420.0	420.0	420.0	420.0	420.0	420.0
M-Cap (KWD Mn)	100.1	134.4	207.9	182.7	182.7	182.7	182.7	182.7
EPS (KWD Fils)	0.029	0.038	0.040	0.038	0.037	0.037	0.038	0.041
Book Value Per Share (KWD)	0.118	0.138	0.178	0.201	0.223	0.245	0.268	0.293
P/E Ratio (x)	11.0	9.6	12.5	11.5	11.8	11.7	11.3	10.6
P/BV Ratio (x)	4.5	2.3	2.8	2.2	2.0	1.8	1.6	1.5
EV/EBITDA	8.1	7.2	9.6	8.3	7.9	7.5	6.9	6.4
EV/EBITDAR	7.2	6.5	8.6	7.5	7.0	6.6	6.1	5.6
Divident Payout	20.8%	0.0%	37.8%	38.8%	40.5%	41.3%	42.6%	40.0%
Dividend Yield	2.2%	0.0%	3.0%	3.4%	3.4%	3.5%	3.8%	3.8%

Source : Jazeera Airways Financials, KAMCO Research
Note: Forward Valuation ratios are based on current market prices

Notes

Notes

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