

Air Arabia PJSC

Strong demand for air travel and cost control measures boosted profitability

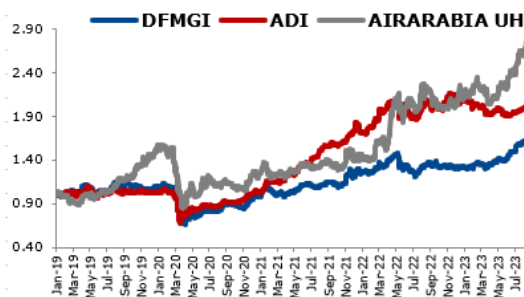
Current Price
AED 2.78

Target Price
AED 2.92

Upside/Downside (%)
+5.0%

Rating
HOLD

- Air Arabia' served more than 7.7 Mn passengers traveling through seven hubs located in the UAE, Morocco, Egypt, Armenia, and Pakistan with a load factor of 81% in 1H23.
- The Company's net profit grew from AED 160 Mn in 2Q22 to AED 459 Mn in 2Q23, whereas turnover rose 25.0% YOY to AED 1.39 Bn in 2Q23 as compared to AED 1.11 Bn in 2Q22. The increase in net profit was also supported by an exceptional one-off receivable that the Company received from one of its suppliers.
- Air Arabia operated 71 aircraft in service, including 62 Airbus A320 and 9 Airbus A321 at the end of 2Q23. The Company added three new aircrafts to its fleet and launched 18 new routes across seven hubs.



2Q23 Net Profit higher than our estimate

Air Arabia's (The Company/ AIRARABIA PJSC) net profit substantially grew from AED 160 Mn in 2Q22 to AED 459 Mn in 2Q23, higher than our estimate of AED 336 Mn. The increase in net profit was mainly due to a rise in revenue, finance income, lower G&A expenses and profit contribution from equity-accounted investments partially offset by an increase in selling & marketing expenses. The increase was also supported by an exceptional one-off receivable that the Company received from one of its suppliers.

P&L Highlights

Air Arabia's revenue grew significantly 25.3% YOY to AED 1,396 Mn in 2Q23 driven by the sustained high demand for air travel. It served more than 3.8 Mn passengers in 2Q23 across seven hubs compared to 2.7 Mn passengers in 2Q22, whereas the seat load factor stood at 76% in 2Q23. On the other hand, Air Arabia's direct cost rose 7.0% YOY and declined 9.2% QOQ to AED 937 Mn in 2Q23. Thus, gross profit rose significantly from AED 238 Mn in 2Q22 to AED 459 Mn in 2Q23 with an increase in gross profit margin from 21.4% in 2Q22 to 32.9% in 2Q23. Furthermore, the Company's selling and marketing expenses rose 16.6% YOY to AED 19 Mn in 2Q23. G&A expenses declined 6.0% YOY to AED 57 Mn in 2Q23 due to a strong focus on cost control measures. Thus, operating profit more than doubled from AED 161 Mn in 2Q22 to AED 382 Mn in 2Q23. Air Arabia's EBITDA also grew significantly from AED 161 Mn in 2Q22 to AED 382 Mn in 2Q23 primarily due to an increase in fleet size, strong growth in revenue and further supported by cost control measures undertaken by Air Arabia. The Company's finance income grew from AED 47 Mn in 2Q23 as compared to AED 17 Mn in 2Q22 due to higher benchmark rates in the economy, whereas finance cost declined 8.4% YOY to AED 26 Mn in 2Q23 due to a fall in lease liabilities and bank borrowings.

Stock Information

Market Cap (AED, mm)	12,973.43
Paid Up Capital (mm)	4,666.70
52 Week High	2.82
52 Week Low	2.00
3M Avg. daily value (AED)	10,046,260

2Q23 Result Review (AED, mm)

Total Assets	14,483
Total Liabilities	7,562
Total Equity	6,921
EBITDA	541
Net Profit	459

Financial Ratios

Dividend Yield (12m)	5.36
Dividend Pay-out (%)	0.00
Price-Earnings Ratio(x)	8.31
Price-to-Book Ratio (x)	1.89
Book Value (AED)	1.48
Return-on Equity (%)	23.51

Stock Performance

5 Days	0.00%
1 Months	2.96%
3 Months	20.87%
6 Months	19.83%
1 Year	23.01%
Month to Date (MTD%)	3.35%
Quarter to Date (QTD%)	14.88%
Year to Date (YTD%)	29.30%

Air Arabia's other income grew 1.9% YOY to AED 31 Mn in 2Q23. Thus, profit before non-controlling interest grew from AED 160 Mn in 2Q22 to AED 459 Mn in 2Q23.

Balance Sheet Highlights

Air Arabia's borrowings continued to decline marginally from AED 136 Mn in 1Q23 to AED 134 Mn in 2Q23. Lease liabilities declined from AED 2.6 Bn in 1Q23 to AED 2.4 Bn in 2Q23. The Company's cash and bank balance stood declined from AED 5.1 Bn in 1Q23 to AED 4.7 Bn in 2Q23. Similarly, Air Arabia cash from operations declined from AED 657 Mn in 1Q23 to AED 590 Mn in 2Q23.

Target Price and Rating

We maintain our HOLD rating on Air Arabia with a revised target price of AED 2.92. Air Arabia delivered strong growth in profitability owing to a solid growth in turnover supported by sustained high customer demand for air travel and the Company's strong operational performance. The net profit was also boosted due to the exceptional one-off receivable during the period. During 1H23, the passenger demand rose 47.0% YOY to 7.7 Mn travelling through seven hubs located in the UAE, Morocco, Egypt, Armenia, and Pakistan. The substantial growth highlights the airline's success in attracting more passengers during the period. However, the Company seat load factor decreased from 85% in 1Q23 to 76% in 2Q23. Air Arabia maintained its global network expansion by introducing 18 additional routes worldwide from its seven strategic hubs in 1H23. The Company operated 71 aircraft in service including 62 Airbus A320 and 9 Airbus A321 at the end of 2Q23. In addition, the Company ordered 120 Airbus A320 family aircraft whose delivery will be scheduled to start from 2024 which will strengthen its market positioning going forward. Additionally, Air Arabia's management commitment to improving its operational efficiency and undertaking cost-control measures supported the company's performance in 2Q23. The company's management is giving particular focus to effective fleet management, aiming to ensure robust growth supported by the adoption of new technologies. Despite all the positives, we expect the reduction in energy supply from the OPEC+ countries might lead to higher fuel prices that can affect Company's profitability going forward. Hence, based on our analysis, we recommend a HOLD rating on the stock.

Air Arabia - Relative valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
PE	NA	13.2	NA	18.2	10.7	9.6
PB	2.9	2.4	2.9	2.2	1.9	1.6
EV/EBITDA	11.2	7.1	25.4	7.3	5.0	4.4
Dividend yield	NA	3.2%	NA	3.0%	5.4%	5.7%

FABS Estimates & Co Data

Air Arabia – P&L

AED mm	2Q22	1Q23	2Q23	2Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Revenue	1,114	1,429	1,396	1,393	0.2%	25.3%	-2.3%	5,242	5,837	11.4%
Direct costs	-875	-1,032	-937	-1,005	-6.8%	7.0%	-9.2%	-3,810	-4,237	11.2%
Gross profit	238	398	459	389	17.9%	92.5%	15.4%	1,432	1,600	11.8%
Selling & mkt expense	-17	-20	-19	-22	-11.7%	16.6%	-2.1%	-68	-93	37.2%
G&A expenses	-61	-76	-57	-74	-22.6%	-6.0%	-24.9%	-286	-298	3.9%
EBITDA	318	461	541	440	22.9%	70.1%	17.2%	1,710	1,925	12.6%
EBIT	161	301	382	293	30.4%	137.7%	26.8%	1,077	1,209	12.2%
Finance income	17	41	47	40	16.8%	179.0%	14.4%	89	128	44.5%
Finance costs	-28	-26	-26	-28	-7.7%	-8.4%	-1.9%	-115	-130	12.9%
Other income	30	26	31	31	0.2%	1.9%	20.9%	136	152	11.9%
Share of profit on eq invt	-20	0	25	0	NM	NM	NM	36	0	NM
Profit before NCI	160	342	459	336	36.7%	187.0%	34.4%	1,222	1,359	11.2%
Non-controlling int.	0	0	0	0	NM	NM	NM	1	0	NM
Net Profit	160	342	459	336	36.7%	186.9%	34.4%	1,222	1,359	11.2%

FABS estimate & Co Data

Air Arabia - Margins

	2Q22	1Q23	2Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Gross Profit	21.4%	27.8%	32.9%	1,147	506	27.3%	27.4%	10
EBITDA	28.5%	32.3%	38.7%	1,021	646	32.6%	33.0%	35
Operating Profit	14.4%	21.1%	27.4%	1,294	629	20.5%	20.7%	16
Net Profit	14.4%	23.9%	32.9%	1,853	900	23.3%	23.3%	-3

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash flow (DCF) and Relative Valuation (RV) to value Air Arabia. We have assigned 70% weight to DCF and 30% to RV.

Valuation Method	Target	Weight	Weighted Value
DCF Method	2.89	70.0%	2.03
Relative Valuation (RV)	2.99	30.0%	0.90
Weighted Average Valuation (AED)			2.92
Current market price (AED)			2.78
Upside/Downside (%)			+5%

1) DCF Method:

Air Arabia is valued using free cash flow to equity since the Company is nearly debt free. We have discounted the cash flow using the cost of equity of 8.4%. Cost of equity is calculated by using 10-year government bond yield of 5.1%, beta of 1.01 and equity risk premium of 3.2%. Government bond yield is calculated after adding Dubai 10-year spread over 10-year US risk free rate. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (AED, Mn)	4,232
Terminal value (AED, Mn)	9,277
FV to Common shareholders (AED, Mn)	13,509
No. of share (Mn)	4,667
Current Market Price (AED)	2.80
Fair Value per share (AED)	2.89

DCF Method

(All Figures in AED Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
Net Income	1,359	1,334	1,354	1,291	1,199
D&A	716	809	901	1,010	1,127
Capex	-866	-982	-1,066	-1,145	-1,204
Net change in working capital	-261	-34	-78	-98	-302
Net change in debt	1,359	1,334	1,354	1,291	1,199
Free Cash Flow to Equity (FCFE)	947	1,127	1,111	1,058	820
Discounting Factor	0.97	0.90	0.83	0.76	0.70
Discounted FCFE	919	1,010	918	807	578

Source: FAB Securities

2) Relative Valuation:

We have used local and international peers to value Air Arabia and it is valued using the EV/EBITDA multiple. It is valued at 2023 EV/EBITDA multiple of 6.2x in-line with peers.

Company	Market 7(USD Mn)	EV/EBITDA (x)		P/E (x)	
		2023F	2024F	2023F	2024F
Gol Linhas Aereas inteligentes SA	687	5.2	4.5	5.6	6.3
Pegasus Hava Tasimacigli anonim sirketi	3,483	6.1	4.7	8.2	7.6
Jetblue Airways corporation	2,153	6.2	4.8	23.1	6.6
Interglobe aviation limited	11,837	8.4	7.3	16.1	14.4
Capital A Berhad	935	7.7	6.3	52.3	10.7
Chorus Aviation Inc.	429	5.7	6.1	7.4	7.1
Allegiant Travel Company	1,777	5.4	4.7	9.3	8.4
Exchange Income Corporation	1,728	7.3	6.3	14.7	12.1
Average		6.5x	5.6x	17.1x	9.1x
Median		6.2x	5.4x	12.0x	8.0x
Max		7.4x	6.3x	17.9x	11.1x
Min		5.6x	4.7x	8.0x	7.0x

Source: FAB Securities

Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

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