

Air Arabia PJSC

Robust passenger demand with higher other income and cost control management drives profitability

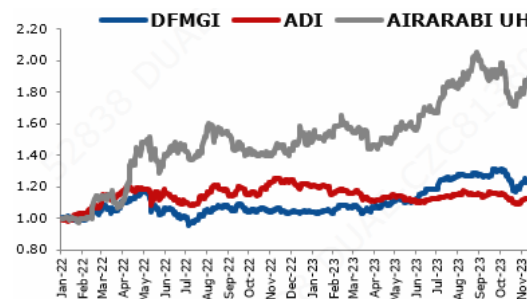
Current Price
AED 2.75

Target Price
AED 3.10

Upside/Downside (%)
+13%

Rating
ACCUMULATE

- Air Arabia' served 12.4 Mn passengers travelling through seven hubs located in the UAE, Morocco, Egypt, Armenia, and Pakistan with a load factor of 80% in 9M23.
- The Company's net profit grew from AED 416 Mn in 3Q22 to AED 522 Mn in 3Q23, whereas turnover rose 16% YOY to AED 4.45 Bn in 9M23 as compared to AED 3.84 Bn in 9M22.
- Air Arabia is operating 72 aircraft including 63 Airbus A320ceo and 9 Airbus A321 neo LR at the end of 3Q23. The Company added two leased Airbus A320 aircraft in 3Q23 to its total fleet and added 17 new routes across seven hubs in 9M23 with a global network of 206 routes.



3Q23 Net Profit higher than our estimate

Air Arabia's (AIRARABIA PJSC/the Company) net profit grew from AED 416 Mn in 3Q22 to AED 522 Mn in 3Q23, higher than our estimate of AED 391 Mn. The increase in net profit is mainly due to a rise in revenue, finance income, lower G&A expenses, and higher profit contribution from equity-accounted investments partially offset by an increase in selling & marketing expenses.

P&L Highlights

Air Arabia's revenue grew 1.5% YOY to AED 1,630 Mn in 3Q23 driven by the robust passenger demand and effective cost control measures. The Company served more than 4.7 Mn passengers in 3Q23 across seven hubs compared to 3.9 Mn passengers in 2Q23, whereas the seat load factor stood at 79.6% in 3Q23 compared to 79.8% in 3Q22. Air Arabia is adding new routes to enhance the carrier's global network and served 12.4 Mn passengers during 9M23. Moreover, AIRARABIA's direct cost declined 0.3% YOY to AED 1,183 Mn in 3Q23. Thus, gross profit rose from AED 420 Mn in 3Q22 to AED 447 Mn in 3Q23, with a gross profit margin of 26.2% in 3Q22 to 27.4% in 3Q23. Air Arabia's selling and marketing expenses rose 40.2% YOY to AED 23 Mn in 3Q23. While G&A expenses declined 4.2% YOY to AED 61 Mn in 3Q23 mainly due to a strong focus on cost control measures. Thus, operating profit rose 6.7% YOY from AED 340 Mn in 3Q22 to AED 363 Mn in 3Q23. Air Arabia's EBITDA grew from AED 498 Mn in 3Q22 to AED 523 Mn in 3Q23 attributed to an increase in fleet size, healthy revenue growth, and strong cost control measures undertaken by the company. Air Arabia's finance income more than doubled from AED 24 Mn in 3Q23 to AED 60 Mn in 3Q22 due to higher benchmark rates whereas finance cost declined 10.8% YOY to AED 26 Mn in 3Q23 due to a decline in lease liabilities and bank borrowings. Air Arabia's other income grew 20% YOY to AED 32 Mn in 3Q23. Share of profit on investments rose from equity and joint ventures rose from AED 54 Mn

Stock Information

Market Cap (AED, mm)	12,833.43
Paid Up Capital (mm)	4,666.70
52 Week High	2.99
52 Week Low	2.00
3M Avg. daily value (AED)	8,860,829

3Q23 Result Review (AED, mm)

Total Assets	14,787
Total Liabilities	7,357
Total Equity	7,430
EBITDA	523
Net Profit	522

Financial Ratios

Dividend Yield (12m)	5.47
Dividend Pay-out (%)	0.00
Price-Earnings Ratio(x)	7.70
Price-to-Book Ratio (x)	1.73
Book Value (AED)	1.59
Return-on Equity (%)	23.55

Stock Performance

5 Days	3.00%
1 Months	10.89%
3 Months	-6.14%
6 Months	18.03%
1 Year	34.15%
Month to Date (MTD%)	4.58%
Quarter to Date (QTD%)	-2.49%
Year to Date (YTD%)	27.44%

in 3Q22 to AED 93 Mn in 3Q23. Furthermore, profit attributable to non-controlling interest holders amounted to AED 0.21 Mn in 3Q23.

Balance Sheet Highlights

Air Arabia's borrowings declined marginally from AED 134 Mn in 2Q23 to AED 130 Mn in 3Q23. Lease liabilities also declined from AED 2.4 Bn in 2Q23 to AED 2.2 Bn in 3Q23. The Company's cash and bank balance rose from AED 4.7 Bn in 2Q23 to AED 4.9 Bn in 3Q23. Moreover, Air Arabia's cash from operations further declined from AED 590 Mn in 2Q23 to AED 412 Mn in 3Q23 due to higher investment in working capital.

Target Price and Rating

We revise our rating on Air Arabia from BUY to ACCUMULATE with a revised target price of AED 3.10. Air Arabia delivered healthy growth in profitability owing to a solid growth in turnover supported by sustained high passenger demand for air travel. The Company's strong operational and commercial strategy demonstrates Air Arabia's steadfast commitment to diversify and expand its business. The net profit was boosted due to effective cost-control management. During 9M23, the passenger demand rose 36.0% YOY to 12.4 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, AIRARABIA seat load factor decreased from 79.8% in 2Q23 to 79.6% in 3Q23. Air Arabia maintained its global network expansion by introducing 17 additional routes worldwide from its seven strategic hubs in 9M23. The Company operated 72 aircraft in service including 63 Airbus A320 and 9 Airbus A321 at the end of 3Q23. In addition, Air Arabia ordered 120 Airbus A320 family aircraft whose delivery will be scheduled to start from 2024 which will strengthen its market position going forward. Additionally, AIRARABIA's management is committed to improving its operational efficiency and undertaking cost-control measures to support its performance in 3Q23. The company's management is focusing on effective fleet management, aiming to ensure robust growth supported by adopting 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 the Company's profitability going forward. Hence, based on our analysis, we recommend an ACCUMULATE rating on the stock.

Air Arabia - Relative valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
PE	NA	13.0	NA	17.8	10.5	7.1
PB	2.8	2.3	2.8	2.1	1.8	1.6
EV/EBITDA	11.0	7.0	24.8	7.2	4.8	3.9
Dividend yield	NA	3.3%	NA	3.1%	5.5%	5.8%

FABS Estimates & Co Data

Air Arabia – P&L

AED mm	3Q22	2Q23	3Q23	3Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Revenue	1,606	1,396	1,630	1,521	7.1%	1.5%	16.8%	5,242	6,102	16.4%
Direct costs	-1,186	-937	-1,183	-1,095	8.0%	-0.3%	26.3%	-3,810	-4,306	13.0%
Gross profit	420	459	447	426	4.9%	6.4%	-2.6%	1,432	1,796	25.5%
Selling & mkt expense	-17	-19	-23	-24	-4.3%	40.2%	19.9%	-68	-92	34.5%
G&A expenses	-64	-57	-61	-65	-6.7%	-4.2%	6.6%	-286	-262	-8.4%
EBITDA	498	541	523	517	1.2%	5.0%	-3.2%	1,710	2,084	21.9%
EBIT	340	382	363	336	7.9%	6.7%	-5.1%	1,077	1,442	33.9%
Finance income	24	47	60	46	31.6%	NM	28.8%	89	189	113.2%
Finance costs	-29	-26	-26	-37	-30.0%	-10.8%	-1.1%	-115	-106	-8.4%
Other income	26	31	32	46	-30.5%	20.1%	2.1%	136	122	-10.0%
Share of profit on eq invt	54	25	93	0	NM	72.9%	NM	36	153	NM
Profit before NCI	416	459	522	391	33.4%	25.5%	13.6%	1,222	1,801	47.3%
Non-controlling int.	0	0	0	0	NM	NM	NM	1	0	NM
Net Profit	416	459	522	391	33.4%	25.5%	13.6%	1,222	1,801	47.4%

FABS estimate & Co Data

Air Arabia - Margins

	3Q22	2Q23	3Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Gross Profit	26.2%	32.9%	27.4%	127	-545	27.3%	29.4%	213
EBITDA	31.0%	38.7%	32.1%	108	-664	32.6%	34.2%	154
Operating Profit	21.2%	27.4%	22.2%	109	-513	20.5%	23.6%	309
Net Profit	25.9%	32.9%	32.0%	612	-90	23.3%	29.5%	620

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash flow (DCF) and Relative Valuation (RV) to value Air Arabia. We have assigned 80% weight to DCF and 20% to RV.

Valuation Method	Target	Weight	Weighted Value
DCF Method	3.08	70.0%	2.15
Relative Valuation (RV)	3.14	30.0%	0.94
Weighted Average Valuation (AED)			3.10
Current market price (AED)			2.75
Upside/Downside (%)			+13%

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 9.3%. Cost of equity is calculated by using 10-year government bond yield of 5.7%, beta of 1.00 and equity risk premium of 3.6%. 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)	5,170
Terminal value (AED, Mn)	9,193
FV to Common shareholders (AED, Mn)	14,362
No. of share (Mn)	4,667
Current Market Price (AED)	2.75
Fair Value per share (AED)	3.08

DCF Method

(All Figures in AED Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
Net Income	1,801	1,557	1,599	1,536	1,476
D&A	642	695	775	873	977
Capex	-866	-852	-979	-1,099	-1,193
Net change in working capital	-273	-53	-86	-106	-312
Free Cash Flow to Equity (FCFE)	1,303	1,347	1,310	1,204	948
Discounting Factor	0.99	0.91	0.83	0.76	0.69
Discounted FCFE	1,291	1,221	1,086	913	658

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 5.8x in line with peers.

Company	Market cap (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2023F	2024F	2023F	2024F
Pegasus Hava Tasimacigli anonim sirketi	2,616	5.3	3.9	6.6	5.4
Jetblue Airways corporation	1,403	8.6	7.4	NA	NA
Capital A Berhad	779	8.1	5.8	24.1	8.3
Chorus Aviation Inc.	338	4.6	4.2	5.5	5.8
Allegiant Travel Company	1,219	5.8	5.8	11.3	8.7
Average		6.5x	5.4x	11.9x	7.0x
Median		5.8x	5.8x	8.9x	7.1x
Max		8.1x	5.8x	14.5x	8.4x
Min		5.3x	4.2x	6.3x	5.7x

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%

FAB Securities Contacts:**Research Analyst**

Ahmad Banihani +971-2-6161629 ahmad.banihani@Bankfab.com

Sales & Execution

Abu Dhabi Head Office

Trading Desk +971-2-6161700/1 Online Trading Link
+971-2-6161777

Institutional Desk +971-4-4245765

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