VIETJET AIR JSC (VJC)

Current Price	Target Price	Dividend Yield	Recommendation	Sector
VND130,000	VND121,500	0.70%	Hold	INDUSTRIALS

Outlook – Short term	Outlook – Long term	Valuation
Negative / Neutral / Positive	Negative / Neutral / Positive	Negative / Neutral / Positive

5 May 2017
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Vietjet Air JSC (VJC) is the fastest growing low-cost carrier (LCC) in Vietnam, holding 43% domestic market share in term of passengers carried. In the medium run, VJC will strengthen its net profit after tax (NPAT) growth momentum by deepening its domestic penetration, expanding its fleet and slashing operating costs. However, the current valuation is quite high since the listing date 28 February 2017. VJC is trading at 2017 adjusted EV/EBITDAR of 9.1x, higher than its regional peer companies. Investors should wait for possible price correction before opening position for the stock.

In medium run, double-digit net profit after tax (NPAT) growth rate supported by: 1) Fleet expansion: +37 aircrafts net of retirement (+90%) in the next three years. The expansion will be leveraged by sale and lease back (SLB) transactions which also temporally boost gross profit (GP); 2) Growing travel demand of middle-income passengers. 3) The transition of passengers to airplanes from rail and road transport; 4) Further cost cutting by using the new fuel-saving A320Neos and A321Neos.

2017 Outlook: Expected revenue of VND45,655bn (+66% yoy) in which transportation revenue accounts for VND16,868bn (+41% yoy) and aircraft sales is VND23,420bn (+100% yoy). Expected NPAT of VND3,689bn (+61% yoy).

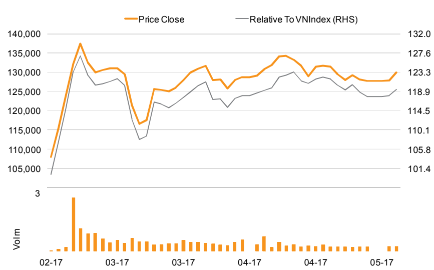
Risks: 1) Fuel prices rebound; 2) Off-balance sheet FX rate losses related to lease obligations; 3) Using Boeing aircrafts could increase maintenance expenses; 4) Competition from Vietnam Airlines (HVN) and other international carriers.

Valuation: VJC is trading at 2017 adjusted EV/EBITDAR of 9.1x, higher than the 4x-7x range of regional LCCs. We expect VJC could be fairly traded at 2017 adjusted EV/EBITDAR of 8.1x, equivalent to target price of VND121,500 a share. VJC will pay FY16 cash dividend of VND1,000 per share and could maintain the payout policy in FY18.

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Revenue (bn)	19,845	27,532	45,655	52,705
Revenue growth	128%	39%	66%	15%
Gross margin	11%	13%	12%	13%
Operating EBITDA (bn)	1,589	2,822	4,519	5,628
Net profit (bn)	1,170	2,292	3,588	4,564
Net profit growth	216%	96%	57%	27%
EPS	10,135	19,614	11,959	15,214
BVPS	14,810	15,085	26,043	40,257
ROAE	75%	69%	58%	46%

Source: VNDIRECT

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	137,400
52w low (VND)	108,000
Average daily turnover (3m)	513,395
Market cap (VND) billion	41,233
Outstanding shares (m)	322
Free float (%)	61
Beta	N/A

Ownership

Shareholder	% Ownership
Sunny Invt Corp	28.6%
Nguyen Thi Phuong Thao	8.8%
Other insiders	1.4%
GIC	5.1%
Others	56.1%

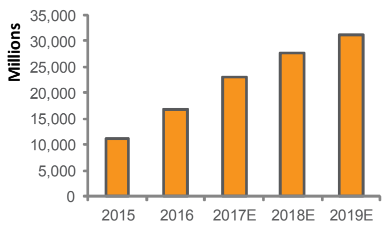
Source: VNDIRECT

INVESTMENT THESIS

For the next 3 years, VJC could be able to grow its NPAT at double-digit rates thanks to several positive drivers.

Rapid fleet expansion leveraged by SLB transactions

VJC ASK



Source: VNDIRECT

VJC plans to increase its fleet size by **14 new aircrafts** (+39%) in 2017**,** and **37 new aircrafts** (+90%) by 2019. Accordingly, ASK is likely to increase from 16,838mn (2016) to 37,984mn (2019, +126%), given unchanged average sector length of 1,068km (2016). Over the same time span, VJC intends to add 8 additional domestics routes (+22%) and 16 additional international routes (+80%). The opening of extra international routes in Southeast Asia could improve the average sector length as an international flight is two times longer than a domestic flight on average. However, we expect the increase of the average sector length is insignificant as new aircrafts are likely to be deployed into existing routes in order to deepen the penetration in the domestic market. VJC prefers to bolster its position in high frequency domestic routes due to two main reasons: 1) There are still growth opportunities in the domestic market and 2) Domestic flights, having load factors as high as 89% compared to international flights' 84%, are safer and more profitable choices. However, we assume that the management will maintain their focus on some existing high frequency international routes (Bangkok, Singapore and Taipei) while exploiting some less frequent but potential international routes.

Fleet expansion, net of retirement

Model	2016	2017	2018	2019
A320ceo	32	28	23	16
A321ceo	10	21	31	34
A320neo			2	6
A321neo		5	10	18
737 Max 200				4
Total	**42**	**54**	**66**	**78**

Source: VJC

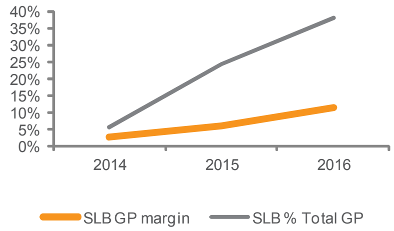
In addition, the new aircrafts could improve general service quality by improving on-time performance. In 2016, VJC faces some punctuality issues as the company fell short of back up aircrafts. Most of airplanes were flying or being on runways at every moment of the day. The bright side is that the fleet's utilization rate is high, represented by daily block hours per aircraft of 13.1, the highest level among Asian LCCs. By contrast, once an aircraft was delayed for technical or other issues, following flights related to that aircraft would be rescheduled like a domino effect. The on-time performance ratio in 2016H1 was 83.6%, 10pp lower than the best punctuality achievement of 93.1% (2013).

Aircraft utilization

Year	2013	2014	2015	2016H1
Block hour/Aircraft per day	11.9	12.4	13.3	13.1
Flight/Aircraft per day	7.2	7.0	6.9	7.2
On-time performance	93.1%	81.9%	82.6%	83.6%

Source: VJC

SLB activity and GP



Source: VNDIRECT

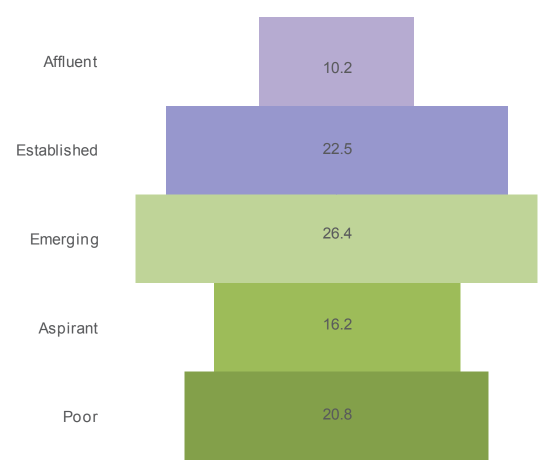
VJC continues to finance aircraft purchases by using SLB transactions which could temporally boost GP growth. Most of existing aircrafts were funded by SLB transactions and reported as operating leases. FY2016 was the most profitable year for SBL activity to date as aircraft sales achieved GP margin of 11.4%, the highest level for the last 3 years. In 2016 SLB activities contributed up to 43% of total revenue and 38% of total GP. We expect VJC has received higher discount rates on recently purchased aircrafts, which translate into higher profit on aircraft sales. We estimate that VJC could have earned USD7.6mn gain per aircraft sold in 2016, compared to USD1.7mn per aircraft sold in 2015. In the future, VJC could achieve a little bit higher discount rates due to large orders. However, gains from higher discount rates could be partly offset by higher lease rates. As SLB contracts involve VJC, the aircraft manufacturer and the lessor, larger profits from aircraft sales usually mean higher lease rates. We estimate that VJC was charged USD422,727 monthly payment per aircraft in 2016, 45% higher compared to the 2014 level of USD290,909. Aircraft lease per ASK in 2016 was 1 US cent, compared to 0.8 cent in 2015.

A growing middle-income population in a low air travel penetration country

In the next 3 years, the middle and affluent class (MAC) population in Vietnam could reach 33mn, twice the current number of around 13mn. According to the Boston Consulting Group, the MAC population could grow at an average rate of 12.9% per year in the next few years and could equal two third of Thailand's in 2020. MAC consumers, having their basic necessities satisfied, are ready to spend to move up the Maslow's pyramid. In addition, the increase of GPD per capital will improve their disposable income. According to the consulting group, the average income per capital will double to reach USD3,400 per year in 2020. This will lead to strong increase in demand for goods and services that improves quality of life including demand for traveling, education, technology products, food services, etc. VJC, positioning itself in the LCC segment, is ready to get the most out of the coming spending trend.

Vietnam MAC population 2012, million

Vietnam MAC population 2020, million

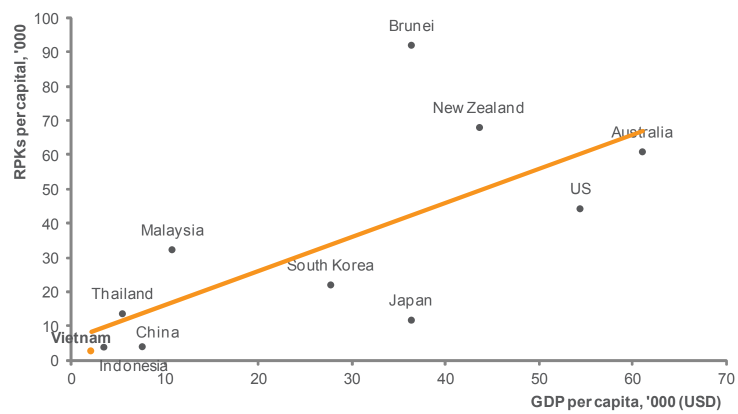


Source: BCG Analysis

The MAC cut off is monthly per capital income of USD190

The Vietnam airline industry has excessive growth opportunity as the country's air travel penetration is the lowest in the APAC region in term of RPKs per capital. RPK is a proxy for the total number of passengers paid and the total travelling distance. A higher level of GDP per capital is highly likely to encourage RPKs growth as passengers tend to travel more and travel longer distance whether the travelling purposes are for holiday, business or personal matter. Vietnam's air penetration is far behind Thailand and Malaysia as the country GDP per capita is only one third of Thailand and one fifth of Malaysia. However, Vietnam's GDP growth rate of 6.2% (2016) is higher than Thailand's 3.2% (2016) and Malaysia's 4.5% (2016). This implies that Vietnam's RPKs per capita is catching up with these countries'.

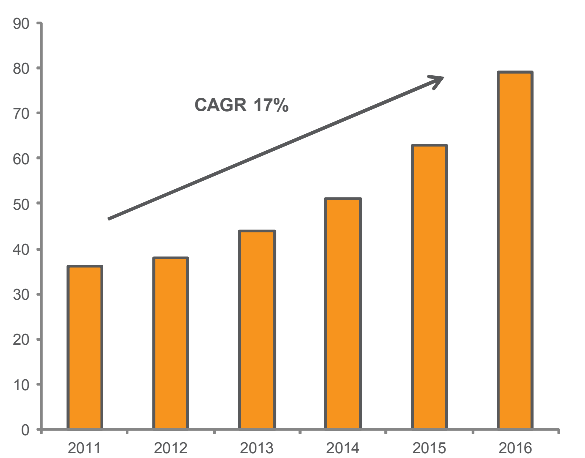
Air travel penetration, 2014



Source: SAP

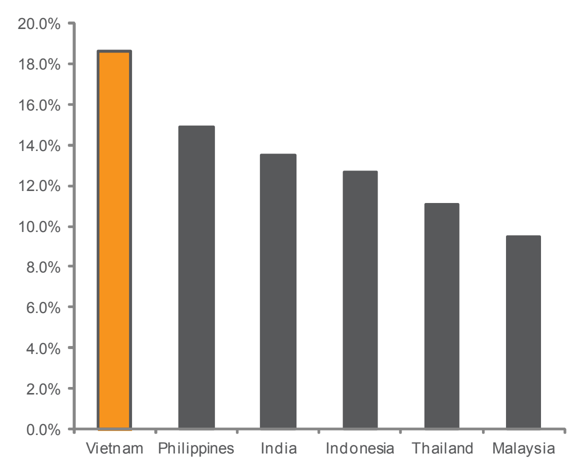
Vietnam has the highest passenger growth rate in Southeast Asia. Over the last 5 years, passenger volume has grown at a compound rate of 17% to reach around 79mn in 2016. Domestic passenger volume grows at 19% on average, outpacing international passenger volume (13% CAGR). The total growth has accelerated to 21% CAGR since 2013 owning to VJC expanded its business. According to the company, one third of its passengers in 2016 are first time flyers. VJC has tapped into the LCC market segment which remains vast and unexploited.

Passenger volume, mn, 2011-2016



Source: VNDIRECT

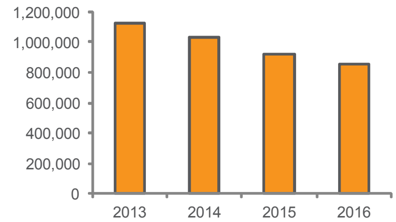
Passenger growth, CAGR 2005-2015



Source: SAP

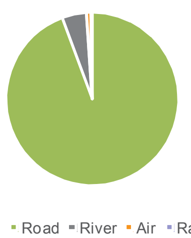
The transition from other modes of travel to air travel

VJC average fare per passenger



Source: VNDIRECT

Mode of travel market share, 2016H1



Source: Goverment data

VJC is reshaping the domestic passenger transportation industry as the company offers cheaper and more convenient traveling options compared to other modes of transport. For example, for the route Hanoi – HCMC, a passenger would have to pay around 900,000VND for a coach trip or VND1mn for a train trip. Moreover, the passenger has to pay for on-the-way expenses such as foods and drink as the trip would take one day and a half. If travelling by airplane, he would have to pay a similar amount but the trip would be 7 times shorter, including waiting time before take-off.

We expect that air travel will gradually replace road and rail travel, especially for trips of 500km and above. For shorter strips where air travel could be unprofitable or unavailable, road and rail travel still hold solid market shares. VJC's average fare per passenger has been decreased by 24% over the last 3 years. We expect that the average fare could be even lower as the company could continue to cut costs. As a result, air travel will be even more affordable. According to SAP, air travel has been growing at 17.2% per year on average, outpacing road travel (7.7% CAGR) and rail travel (-1.5% CAGR), over the last 5 years.

Average fare, 2016

Trip	HCMC - Hanoi		HCMC - Danang	
Mode	Time hrs	Fare VND	Time hrs	Fare VND
VJC	2:05	881,189	1:20	615,000
Coach	35:00	861,385	15:30	405,458
Rail	34:00	1,066,278	17:00	616,833

Source: VJC, VNDIRECT

Further cost cutting by deploying new models of aircrafts

The new A320neo, A321neo and 737 Max 200 could help VJC to reduce total fuel cost by 5% as these new aircrafts will make up 35% fleet size by 2019. As a result, operating CASK could be lowered by 1.9%. Currently, fuel cost accounts for 37.5% of total operating cost. According to Airbus and Boeing, these new narrow-body models could help reducing fuel consumption by 15% due to several improvements compared to the current A320 family used by VJC: 1) New CFM International LEAP-1A or Pratt & Whitney PW1000G engine which is more eco-friendly; 2) Larger winglets to reduce aircrafts' drag using the tip vortex energy; 3) Improved aerodynamics; and 4) Lighter bodies. The A320 family that VJC has been deployed is one of the most fastest-selling jet airline families in the world. It is the first choice of many LCCs due to its reasonable purchase and operating costs. However, the old family A320 and 737, which are very popular since their launches in the 1970s, will likely to be replaced in the near future as the new models were launched in 2011. According to Airbus and Boeing, the orders for the new models have gradually rising since their launches. Being the first Vietnamese airline who replacing its fleet by the new models, VJC will have a first-mover advantage in cost cutting. VJC plans to put 4 A321neo in to operation within 2017.

However, the new A320neo and Max 737-200 could be 10% more expensive, according to Airbus and Boeing. Higher purchase costs mean the new aircraft must reach a certain mileage for the fuel saving effect to be profitable. Given the same discount rate of around 50% applied to new aircrafts, other operating costs constant, and revenue per passenger unchanged, an A320neo could have to fly 12.3mn km to reach the break even mileage due to higher purchase cost. That break even mileage is equivalent to 4.4 years of operation, given 1,068km per flight, 7.2 flight per day, 13.3 block hours per day and no pause for repair and maintenance. In case VJC use this fuel-saving cost to reduce fares, the break even mileage could be even longer.

Per ASK comparison, US cent, 2016

Item	VJC	AirAsia Bhd
RASK	**4.37**	**3.97**
Transportation	3.32	2.52
Ancillary	0.97	0.70
CASK	**4.01**	**2.80**
Fuel	1.48	0.91
Aircraft lease	0.99	0.28
Maintenance and others	0.24	0.17
Ground services, etc	0.31	0.46
Dep & Amort	0.07	0.00

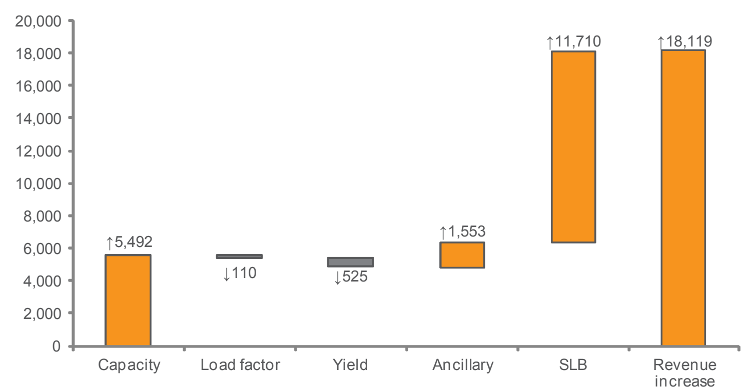
Source: VNDIRECT

In addition, VJC could do further cost cutting by doing ground handling and technical services in-house. Currently, these operations are outsourced to third party companies. These operations account for around 11% of total operating cost. After the inauguration of Vietjet Training Center, we expect VJC could provide itself workforce to handle ground handling and part of technical services. However, some technical services, such as periodic maintenance of aircrafts and engines, will be handled by 3rd parties since doing these services in-house could be costly due to higher required level of engineering. In addition, some maintenance services could be part of SLB contracts, thus carried out by manufacturers. We expect VJC could cut its cost for technical services by a third due to the fact that these costs are 40% higher compared to AirAsia's on ASK basis. VJC's technical services cost is around 0.24 US cent per ASK, while AirAsia has reached 0.17 US cent per ASK in 2016. The reduction could lead to around 2% decrease in operating CASK.

2017 OUTLOOK

We expect VJC could reach 2017 revenue of VND45,655bn (+66% yoy) and NPAT of VND3,613bn (+58% yoy). The growth engines will mainly come from the fleet expansion and SLB activities.

Figure 1 2017 Revenue growth drivers, VND bn



Source: VNDIRECT

In 2017, VJC will receive 16 new aircrafts, including 11 A321s and 5 A320neos, and retire 2 A320s. The fleet size at the end of 2017 could reach 55 aircrafts (+34% yoy). Assuming aircraft utilization ratio remains at 78%, similar to 2016, we expect the number of effective operating aircrafts over the year could be 52. In addition, we expect the total capacity, represented by ASKs, could grow at 47% yoy to 24,686mn ASKs. The main reason for ASKs to grow faster than fleet size is that VJC will deploy more A321s which have +22% seating capacity compared to A320s. Given load factor and passenger yield unchanged, increasing capacity could translate to VND5,492bn (+46% yoy) growth of transportation revenue.

However, as new aircrafts put pressure on operating performance, we expect load factor could decrease by 0.6pp to 88%, translating to VND113bn decrease of revenue. As VJC continue to push their selling activities, passenger yield could decrease by 3% yoy, equivalent to VND829,044 per passenger. As a result, passenger yield could lower revenue by VND525bn. Passenger yield has been decreasing over the last 4 years at CAGR of 8.8%. In 2016, passenger yield decreased by 6% yoy. VJC has RASK of 4.4 USD cent (2016), 13% higher than AirAsia's. It is likely for VJC to continue to lower its RASK when it is possible.

Ancillary revenue per passenger may not increase as it currently accounts for around 22% of revenue excluding aircraft sales. The ratio is in the same level as regional LCCs'. We expect ancillary services could bring in an addition of VND1,553bn (+44% yoy).

In general, 2017 transportation revenue could reach VND16,868bn (+40% yoy).

Aircraft sales could contribute more than 64% of revenue growth, compared to 38% in 2016. We expect VJC will receive similar discount rates on new aircrafts compared to 2016. Higher aircrafts sales are mainly due to larger orders.

Moreover, we expect GP margin of transportation and ancillary revenue could reach 13.1%, an improvement of 1.1pp compared to 2016. The main reasons for the increase are: 1) The economies of scale coming from the deployment of larger aircrafts (A321); 2) The deployment of 5 A321neos which could save 1.4% of total fuel consumption, according to our calculation. As a result, fuel cost per ASK could be reduce to 1.38 US cent (-6.7% yoy). However, the fuel consumption per kilometer per aircraft could increases by 1.8% as A321 could burn 15% more fuel compared to A320. We expect GP margin or aircraft sales remain unchanged at 11.4%. As a result, GP of VJC could stay at 11.9%, 0.8pp lower than 2016 level, as aircraft sales accounts for a larger proportion in 2017 revenue.

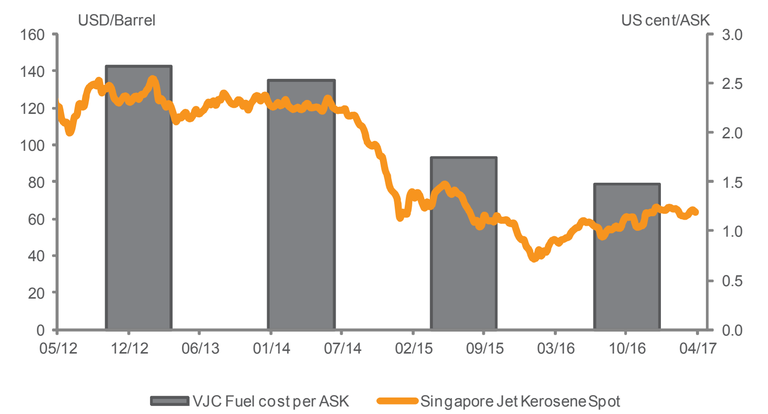
RISK

Fuel prices rebound could hurt GP margin

Fuel cost is the largest component of VJC's operating cost as it accounts for 38% of CASK. As VJC has not implemented any fuel hedge, a surge in jet fuel price will make VJC to make a decision between: 1) Maintain fares and suffer from squeezing GP margin; 2) Pass on all increasing fuel cost to customers.

We believe VJC has the ability to pass on part of increasing fuel cost to buyers and maintain GP margin within a specific range. Fuel price rebound is an industry-wide event that could force all carriers to adjust their fares upwards. Over the last 4 years, VJC has lowered its fares as fuel price decreased.

Fuel price vs. RASK excluding aircraft sales



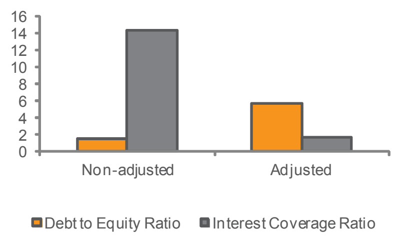
Source: Bloomberg, VNDIRECT

In the worst case scenario, if jet kerosene price recover to the level similar to 2013's, fuel cost per ASK could increase to 2.7 US cent, an increase of 1.2 US cent compared to 2016's. This will cause an operating loss of 0.8 US cent per ASK if VJC does not increase its fares. VJC could mitigate this loss by: 1) Enter fuel hedge contracts: The company has established procedures to hedge up to 50% of fuel costs in case of fuel price surge by entering 1-year forward contracts; 2) Increase fares gradually and apply a better pricing strategy that balance out passengers who plan their flights in advance and passengers who want to fly right away. We believe VJC has applied this dynamic pricing strategy for years so the company could successfully launch sales campaigns such as "VND0 Flights" and "VND5,000 Flights".

However, a scenario of fuel price rebound is still quite far from reality as some oil producers continue to expand production. According to OPEC, 2017 oil supply will increase due to slightly rising oil price and improving productivity in US and Canada. The low oil price environment will be maintained for years. However, the situation could facilitate the expansion of airlines which will strengthen competition. HVN has plans to increase its fleet size to 120 aircrafts (+36%) by 2020, from the current level of 86 aircrafts. Jetstar Pacific Airway (JPA) wants to add another 30 A320 by 2020, from the current level of 14 A320.

FX rate risk related to lease obligations

Financial ratios, adj to off-bs operating lease obligations, FY2016



Source: VNDIRECT, VJC

FX rate risk is the biggest threat to shareholders' value. Due to SLB activities, VJC bears a huge burden of dollar-denominated operating lease obligations. At the end of July 2016, off-balance sheet operating lease obligations account for VND20,892bn, similar to the total asset of VJC at the end of 2016. These obligations are monthly paid in USD. Any deterioration of VND against USD rate will make VJC subjected to losses that are not fully reported in the income statement. Based on the amount of operating lease obligations, if VND deteriorates by 2% against USD, VJC will have to pay another VND428bn to lessors in the future, equivalent to 21% of 2016 NPAT. According to our Macroeconomics team, the VND depreciation could be around 1% in 2017, increasing operating leases obligations by at least VND214bn. The Vietnam government is doing their best to keep the FX rate within range. However, we cannot assure that their efforts always bring in desired results. As VJC expands its fleet, the risk related to operating lease obligation will be even more severe.

Moreover, these off-balance sheet obligations greatly distort solvency and liquidity ratios. Non-adjusted debt-to-equity ratio for 2016 is around 1.5x while the adjusted version is 14.3x tenfold higher. For interest coverage ratio, the adjusted ratio remains at 1.6x while the non-adjusted ratio stays at an elevated level of 14.2x. Although the company appears to have everything under control, these adjusted ratios reflect a finance health which is not as beautiful as presented in financial statements.

Diverging from homogeneous fleet could increase maintenance expenses

VJC has signed contracts to buy 100 Boeing 737 Max 200 which will be delivered between 2019 and 2023. Thus, by operating 2 different families of aircraft, the company may have to incur higher maintenance expenses compare to having only 1 family of aircraft. For the same reason, most LCCs prefer to use only one family of aircraft. For example, AirAsia (Malaysia) and Spirit Airlines (US) have all their fleets as Airbus, while RyanAir (Ireland) uses only Boeing. At the moment, we are not capable to assess the increase of maintenance expenses. We believe VJC could somehow mitigate the problem by training their staff to do part of maintenance services in-house.

Increasing competition from both domestic and foreign airlines

We expect VJC will face growing competition in the next few years from both Vietnamese carriers and international airlines. Benefit from low fuel price, a lot of carriers are planning to increase their fleet size. In domestic market, the main competitors are HVN and JPA. In international market, the largest competitors are Southeast Asia companies such as AirAsia and Lion Air. Full service airlines (FSA) and LCC are not two distinct, separated market segments. Excessive expansion of FSAs could put pressure on fares and attract clients from LCCs. We believe clients are likely to be in favor of FSAs due to extra services compared to LCCs. Clients will choose FSAs if the fares appear to be reasonable. As a result, VJC may not be able to maintain a load factor as high as 88% in years to come.

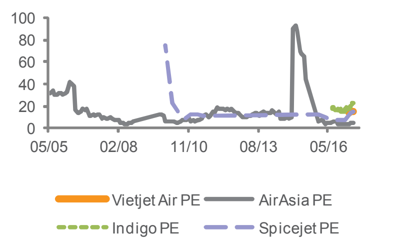
Reacting to VJC's robust expansion, other Vietnamese carriers inaugurate their counter measures. HVN is on the way to rejuvenate its fleet by entering contract to upscale it fleet to 120 aircrafts (+36%) by 2020. The company will focus more to high-end client segment by increasing the number of wide-body aircrafts to 26 (+53%) including up-to-date models such as A350 and 787 Dreamliner. In 2017, HVN will purchase 4 aircrafts using SLB transactions, including 1 B787-9 delivered in May 2017 and 3 A350 delivered in Jun, Sep and Dec 2017. These aircrafts will be deployed to international routes such as HCMC – London. The company has launched a new marketing campaign in 2015 including 1) redesigning the brand recognition system; 2) upgrade in-flight service quality to 4 stars. JPA is planning to upscale its fleet by 30 new aircrafts of A320 family by 2020. 10 will be delivered in 2017. Moreover, HVN and JPA have launched their "dual brands" marketing campaign in 2015: Members of HVN's Lotusmiles program, when buying flexible ticket Starter Plus or optimal ticket Starter Max from JPA, will receive bonus points. This will encourage clients to flexibly change between HVN and JPA. A customer could use JPA for short-haul flights and uses the bonus point received on VNA's 4-stars flights.

AirAsia, the Malaysian budget airline, plans to enter Vietnam through joint venture with Vietnam's Gumin Ltd and Hai Au Aviation JSC. Both parties will pour in around USD44mn in which AirAsia accounts for 30%. The JV will launch its first fly in early 2018. AirAsia has its associates in Indonesia, Thailand, Philippine, and Japan. The group has a book order of 100 A321neo (+56%) delivered in the next several years.

Lion Air, the Indonesian airline, is expanding quickly over the last few years. The company has take delivery of 57 aircrafts in 2015 and 36 aircrafts in 2016. Most of these expansion is coming from it full service airlines Indonesia's Batik Air and Malaysia's Malindo Air. At the end of 2016, Lion Air operates 272 aircrafts, almost twice the number of AirAsia. The group still have a batch of 201 737 Max, delivered since 2017. However, the group is considering canceling part of the batch for fear of oversupply.

VALUATION

Historical PE



Source: Bloomberg

VJC's share price has gone up significantly from the reported IPO price of around VND84,400. The stock reached the highest point since listing date of VND137,400 and fluctuated within the range of VND125,000 - VND135,000 since then. The current price will be adjusted downward as VJC will issue new shares to current shareholders at a ratio of 10:4. Considering the current share outstanding of 322,388,060, the number of new shares will be 128,955,224. Moreover, investors who bought from selling shareholders are not subjected to 1-year lock-in period as required by regulators. Therefore, they could realize their gains any moment. These two factors may help to improve the free float ratio and liquidity of the stock, thus bringing the stock price closer to its intrinsic value.

We use adjusted EV/EBITDAR valuation as the primary valuation methodology to compare VJC with regional LCCs. We prefer the method as it strips out differences in aircraft ownership structures, depreciation, and tax policies. Moreover, we also make adjustments to remove differences related to off-balance sheet obligations, operating lease expenses and non-operating gains such as aircraft sales.

Valuation

Companies	Mkt cap, USD mn	Adj EV/EBITDAR 12M	P/B 12M	1-yr R growth	ROE %	Fleet size	Passengers 2016, mn
VietjetAir	1,897	13.2	8.5	38.7	68.7	41	14.1
AirAsia Bhd	2,315	5.7	1.4	9.9	36.8	80	56.6
Cebu Pacific	1,283	4.4	1.9	9.6	33.4	59	14.1
Indigo	6,263	6.7	21.4	15.2	176.0	133	41.0
Spicejet Ltd	1,090	5.3	na	-2.95	na	49	15.4

Source: VNDIRECT

Compared to regional LCCs, VJC has a quite high valuation at 12M adj EV/EBITDAR of 13.2x. After incorporating the growth of 2017 EBITDAR, VJC is traded at a much more reasonable multiple of 9.1x. We believe these companies are appropriate peers due to several reasons: 1) They operating in South and Southeast Asian countries whose clients could have similar travel behavior compared to Vietnam's; 2) They have similar fleet size; 3) They are leading LCCs in terms of cost cutting.

We initiate coverage on VJC with a Hold rating and target price of VND121,500, based on 2017 adj. EV/EBITDAR of 8.1x. This valuation puts VJC at the upper limit of the 4x-7x range of adj. EV/EBITDAR. We expect VJC deserves some premium compared to peer LCCs due to the following reasons: 1) Higher ROE of 69% while AirAsia Malaysia's & Cebu Pacific's are in a ballpark of 30%; 2) Higher revenue growth rate in the next few years. The target price implies a downside of 6.5% which could be a reasonable correction for the rally since the IPO.

COMPANY PROFILE

Company description

Vietjet Air JSC (HOSE: VJC) is the fastest growing LCC in Vietnam. VJC has launched its first domestic flight in 2011, connecting Hanoi and Ho Chi Minh City (HCMC). At the moment, the company operated only 3 Airbus A320ceo which were leased from the finance company ALAFCO. In 2013, VJC launched its first international route HCMC – Bangkok. Since then, the company has upscaled its fleet to 41 aircrafts and maintained a network of 36 domestics routes and 23 international routes. Over the last 4 years, revenue and earnings skyrocketed as VJC successfully taps into the massive, unexploited LCC market segment which mostly consists of the growing middle-income population. Revenue CAGR reaches 94% (VND27,532bn) and NPAT CAGR reaches 324% (VND2,292bn). At the end of 2016, the company accounts for 43% domestic market share in term of passengers carried. VJC intends to gradually increase and rejuvenate its fleet with more than 180 new aircrafts on order from both Airbus and Boeing.

Management

VJC's management team consists of individuals who have 10+ years of experience in the aviation industry. Some managers have worked as technical and finance managers for peer companies such as Vietnam Airline (HVN) and AirAsia X.

VJC Management Summary

Name	Designation	Profile
Nguyen Thi Phuong Thao	Chief Executive Officer	She is the Co-founder of VJC and Sovico Holdings (4.9% ownership in VJC). Mrs Thao and her husband, Mr Nguyen Thanh Hung, hold 82% ownership of Sovico Holdings. Previously, she was a BoD member of HDBank (2003). Education and certificates: PhD in Economic Cybernetics (Mendeleeve Institute), Bachelor's degreein Credit-Finance (Moscow Commerce Institute), and Bachelor's degree in Labour Economic Management (Moscow National Economics College).
Nguyen Duc Tam	Deputy CEO	He was vice President, Vietnam Airlines for 11 years Head of the Information Technology department, CAAV (1993 - 1996), Deputy Head of the Technical Materials department, CAAV (1988 - 1989) and in charge of technical services in Vietnam Air Force (1968 - 1975).
Dinh Viet Phuong	Vice President	In charge of Business development of VJC since 2012. Previously, he was Deputy General Director of Sovico Holdings, Deputy General Director and BoD member of Vietnam Motors Industry Corporation, BoD member of Petechim JSC. He got MBA degree, CFVG and PhD in transportation, Moscow State Academy of Water Transport.
Nguyen Thuy Binh	Vice President	In charge of commercial, service, sales and marketing activities. Moreover, she has 15 years of experience in the communication industry. She was Chief Commercial Officer of Jetstar Pacific (2008) and Vice Presidend of Strategic Development (2012). Education and certificates: Bachelor's degree in Russian and English interpretation (Hanoi Foreign Language Institute), Bachelor's degree in Electronics and Telecommunicatinos Engineering (Hanoi Polytechnical University), MBA, Belgium Cooperation Programme, National Economic University and Universite Libre de Bruxelles.
To Viet Thang	Vice President	In charge of Safety Security Quality and Assurance Department. He was the project leader of IOSA certification process. He worked for Vietnam Airlines as Deputy Director of SSQA department (2008 - 2014). Education and certificates: Engineering diploma in Aircraft Technic, Czech Technical University, Certificates of IATA, Lufthansa, AQS
Nguyen Duc Thinh	Vice President	Director of the engineering division. He was Deputy Director of the technical department, Vietnam Airlines (1993 - 2004). Education and certificates: Master degree in Civil Aviation Engineering Certificates of IATA.
Tran Hoai Nam	Vice President	In charge of the finance department. He has vast experience in the finance and banking sector as the Deputy CEO of HD Bank. He has worked in various management positions in Citibank, Vietnam International Bank. Education and certificates: Bachelor degree in Hanoi University of Science and Technology, Master degree in Asian Institute of Technology.
Yvonne Abdullah	Chief Finance Officer	She has 22 years of experience in finance and banking sector. Previously, she was CFO at Jet Asia Airways and CFO at AirAsia X. She was responsible for the IPO process of AirAsia X in the Kuala Lumpur Stock Exchange. Other positions: Managing Director and CFO of Redtone (2003 - 2008).

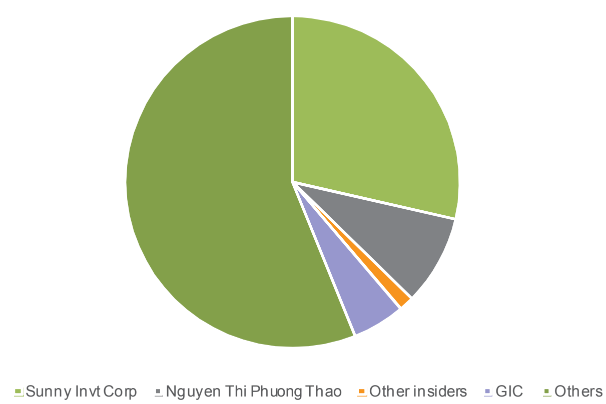
Source: VJC

Out of 8 members, three have worked for Vietnam Airlines, the main competitor of VJC, and one has held key positions in AirAsia X's BoD, a sister company of AirAsia, the second largest LCC Southeast Asia. We believe these members play crucial roles for VJC to obtain high operating performance while keeping operating costs as low as possible.

Ownership structure

VJC's ownership structure is quite condensed as 39% number of shares outstanding belong to Mrs. Nguyen Thi Phuong Thao and management team members. Mrs. Thao is the largest shareholder with total 37.3% ownership in which 28.6% is held through Sunny Investment Corp Ltd, a wholly-owned company of Mrs. Thao, and 4.6% is held through Sovico Holdings. Mrs. Thao maintains her substantial voting power as Sunny Investment Corp Ltd has bought 22.4mn newly-issued VJC shares right after the IPO. Institutional and foreign investors hold about 24.4% ownership. It should be noted that investors participating in the IPO in early 2017 are not subject to the 1-year lock-in period as required by regulators. Instead of getting newly-issued shares, these investors received outstanding shares from selling shareholders. We expect these investors to sell their shares in the near future as VJC has up by 50% since the IPO. The selling could improve the stock's liquidity which is quite low (513,395 shares per day on average over 35 trading days since the listing date 28 February 2017).

VJC Ownership structure

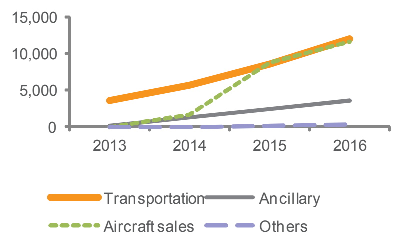


Source: VNDIRECT

BUSINESS ANALYSIS

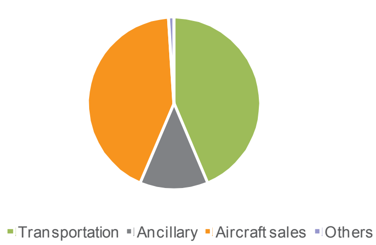
The fastest growing Vietnamese LCC…

VJC Revenue, VND bn



Source: VJC

VJC Revenue 2016



Source: VJC

VJC Fleet size

Model	2015	2013	2014	2015	2016
A320	5	10	19	30	30
A321				3	11

Source: VJC

Over the last 3 years, VJC has been growing at staggering rate of 94% on average. The growth mainly comes from 3 sources: 1) Transportation services; 2) Ancillary services; and 3) Aircraft sales.

Transportation services, the core operation of VJC, consist of scheduled flights and charter flights.

For scheduled flights, the company offers point-to-point services which carry passengers directly to their destination, rather going through central hubs. This strategy, used mostly by LCCs, helps to reduce travel time and fuel consumed per passenger. Currently, VJC has a network of 37 domestic routes and 26 international routes. Domestic routes are the main source of the revenue as they account for 91% of scheduled flight revenue and 70% of transportation revenue. The busiest routes connecting Hanoi – HCMC – Danang – Nha Trang make up around 40% of transportation revenue

Charter flight services involve operating an aircraft on specific routes which are not included in the company's scheduled network. Charter flights are tailored to meet specific needs, especially coming from tour companies. Over the last 2 years, revenue from charter flights grew rapidly at 153% annually on average. The service accounts for 22% of transportation revenue. The rapid growth is mainly associated to rising demand of Chinese tourists. Apart being another source of cash, charter flights help the company to: 1) Maximize aircraft utilization; 2) Discover potential scheduled routes.

Ancillary services, the byproduct of transportation services, strictly follow the growth of transportation services. Ancillary services include pre-flight seat selection, excess baggage, in-flight sales and cargo transportation. Pre-flight seat selection and excess baggage are the most important part of ancillary revenue as they claim up to 82% of the sum.

Aircraft sales, contributing around 43% total revenue, should be considered non-core operation as the revenue is generated only when VJC purchases new aircrafts through SLB transactions. SLB activities involve VJC, the manufacturer Airbus, and a finance company playing the role of buyer and lessor. Once a contract is signed, Airbus delivers VJC the aircraft which is customized to meet VJC's needs. The lessor will pay Airbus the agreed upon price which is usually lower compared to the market value of the aircraft. The difference between the market price and the discounted price is the gain that VJC receives from the lessor. SLB transactions are a common practice among LCCs as they help to alleviate finance burden created by huge upfront payments. For such contracts, VJC will pay a fixed amount every month until the lease term expires or the company decides to retire the plane and deliver it back to the lessor. The lessor will lease out or sell it to another carrier who is satisfied with second-hand aircrafts. Although VJC does not real purchasing costs, we expect the number could range from 50% to more than 55% of prices reported by Airbus. However, we believe gains from SLB activities are not free meals due to 2 reasons: 1) The gain usually come with other after-sales terms which could require VJC to use maintenance services of Airbus, or have their pilot trained by Airbus staff, or other terms that we have not come up with as most of these contracts are not disclosed; 2) Lease rates rise as SLB gains widen.

Vietnam fleet, 2016

Current fleet	VJC	HVN	JPA
A320	30		14
A321	11	57	
A330		7	
A350 XWB		7	
777		4	
787 Dreamliner		10	
Total	**41**	**85**	**14**
Average age	3.3	5.9	6.9

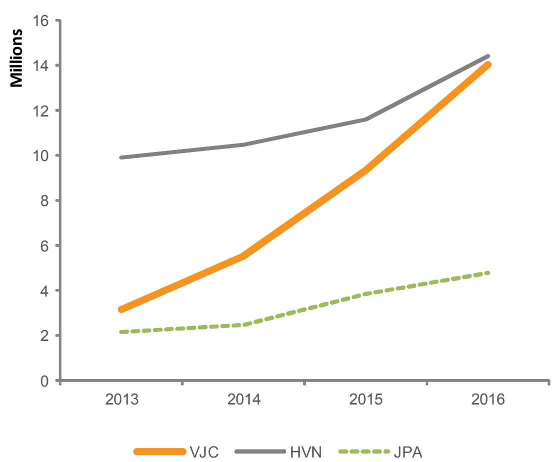
Source: planespotters.net, companies

VJC has the youngest fleet of 3.3 years among Vietnam carriers. It is very important for VJC because a younger fleet will has less down time for maintenance and burns less fuel which accounts as high as 50% of in-flight expenses. As a result, VJC is more flexible in deciding business tactics and could maximise its fleet's utilization. Therefore, the company will not likely to lose any revenue generating opportunity and will reduce unit fixed costs. However, not all advantage will last for decades. We expect HVN and JPA will rejuvenate their aircrafts in the next several years to catch up with VJC's fleet.

… to become the largest carrier in the domestic market

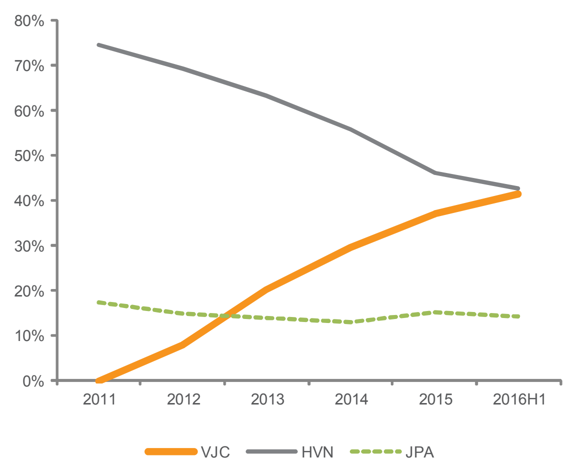
At the end of Jun 2016**,** VJC claims 43.1% domestic market share in term of passengers carried. Since establishment, VJC has rapidly taken over market share of other carriers including HVN and JPA as the company has grown faster than the industry. Over the last 3 years, the domestic market has been growing at CAGR of 30% while VJC reached a overwhelming rate of 65%. One of the most important growth engine is the unexploited MAC population. According to VJC, around one third of its clients in 2016 was first-time flyers. The proportion of first-time flyers could increase as VJC expands its business and reduces fares.

Domestic market, mn passengers



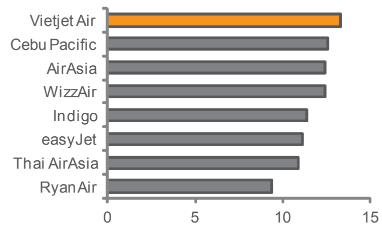
Source: VNDIRECT, VJC

Domestic market, market share



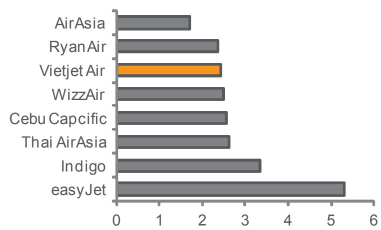
Source: VJC

Block hours/Aircraft per day, 2016



Source: VJC

Ex-fuel CASK, 2016



Source: VJC

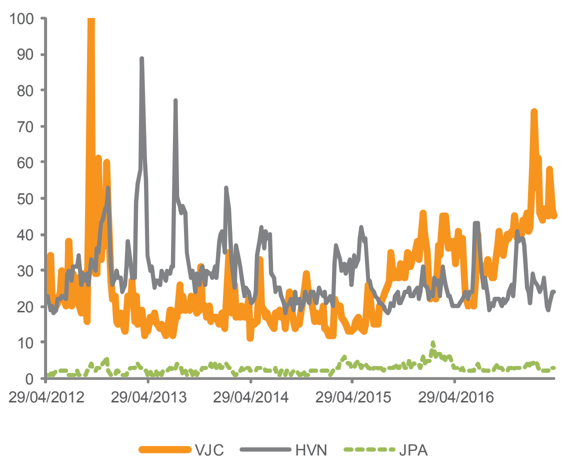
One of the most efficient LCCs in the world

VJC is one of the most efficient LCCs in the world in terms of fleet utilization (block hours/aircraft per day) and cost optimization (ex-fuel CASK). In term of utilization, VJC achieves 13.3 block hours/aircraft per day in 2016, 14% higher than the average level of peer companies of 11.7 block hours. VJC ranks above regional LCCs and some other European LCC such as WizzAir and RyanAir. In term of ex-fuel CASK, VJC ranks the third, right behind successful LCCs such as AirAsia and RyanAir.

Strong brand recognition rivaling domestic carriers

Although being the secondly-established Vietnam LCC, VJC has gained an important first-mover advantage that should have been entitled to JPA: brand recognition. The advantage may help VJC to fend off possible new competitors in the next few years. According to a survey by Axis Research dated July 2015, VJC had 96% brand awareness in Vietnam. The survey was limited to 13 largest cities and had a sample size of 1,136 participants. We believe VJC has successfully built its brand image associating with affordability and reliability. Data from Google Trend further support our conclusion: VJC's popularity is gradually overtaking Vietnam Airlines', the largest domestic FSA.

VJC's popularity 2017, Vietnam market



VJC's popularity by geography

Source: Google Trend

*Orange provinces have higher queries for "Vietjet Air"

The data is based on search queries including 3 keywords: "Vietjet Air", "Vietnam Airlines", and "Jetstar Pacific". Rather showing the number of search queries per day, the data represent the relative popularity over last 5 years. The data was computed as follows:

- Raw data of each day = Number of search query of a keywords at that day from Vietnam/Total number of search query from Vietnam at a day which has the highest number of search query over the last 5 years.
- Raw data of each day is scaled from 0 to 100.

The data from Google further reveals some other interesting facts on the domestic airline industry and VJC:

- Season peak for the industry is from the mid-Jun to September and from November to January.
- "Vietjet Air" appears to be the most popular among the three keywords in provinces excluding large cities. That could imply VJC's strategy to focus on MAC population
- "Jetstar Pacific" seems to be the most unpopular.
- Users searching for "Jetstar Pacific" have higher tendency to search for an alternative keyword "vietjet". By contrast, Users searching for "Vietjet Air" have lower tendency to search for "jetstar".
- Users searching for "Vietnam Airlines" prefer to stay with their choices of FSA.

OPERATING ANALYSIS

Performance metrics

Performance metrics

US cent	2013	2014	2015	2016
RASK	5.28	5.37	4.66	4.37
Transportation	4.96	4.44	3.59	3.32
Ancillary	0.30	0.94	1.04	0.97
CASK	5.20	5.03	4.26	4.01
Fuel	2.67	2.53	1.74	1.48
Aircraft lease	0.00	0.81	0.85	0.99
Crew	0.00	0.35	0.36	0.37
Maintenance	0.00	0.21	0.24	0.24
Support	0.00	0.33	0.32	0.31
Core EBIT ASK	0.07	0.34	0.40	0.36

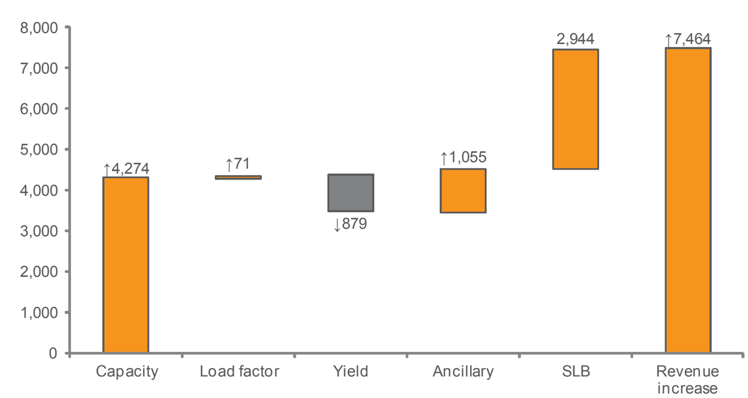
Source: VNDIRECT, VJC

Over the last 4 years, CASK has decreased continuously due to lower fuel prices. VJC has adjusted fares accordingly, leading to RASK decreased by 17% since the end of 2013. RASK decrease was mainly owning to transportation fares while ancillary revenue per ASK remained stable. Fuel cost per ASK has stumbled by 45% since 2013, reaching as low as 1.48 US cent. Aircraft lease expenses per ASK increased by 22% since 2014. Other operating costs per ASK appear to be relatively stable.

2016 Growth engines

VJC has a good financial year as the company has successfully deployed more than 9 new aircrafts while increasing the productivity of its fleet. 2016 revenue was VND27,532bn (+39% yoy) in which transportation services made up 58% of the growth and aircraft sales accounted for 40%. Transportation revenue growth came from 1) Increasing capacity by 52% (ASK 16,838mn), and 2) Improving load factor by 0.5pp. However, passenger yield continued to decrease as VJC launched more sales campaigns. Aircraft sales gains before tax were VND1,331bn, equivalent to a GP margin of 11.4%, an improve of 5.5pp compared to 2015.

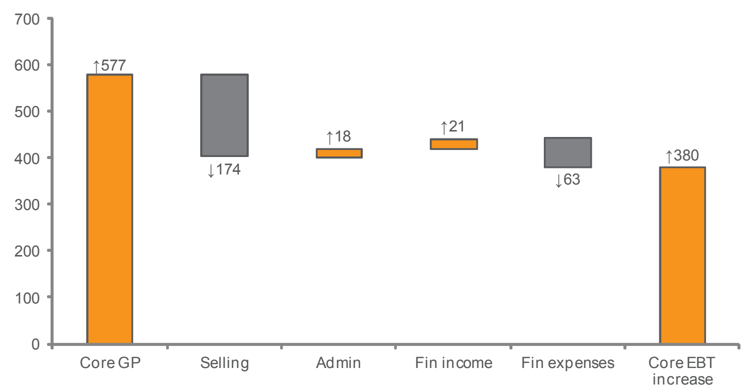
2016 Revenue drivers, VND bn



Source: VNDIRECT, VJC

NPAT achieved VND2,292bn (+96% yoy). After removing gains from aircraft sales, core NPAT was VND961bn (+47% yoy). Selling expenses are the most important component of core EBT, making up 52% 2016 core EBT. During 2016, VJC spent more on marketing and advertising, leading to 55% increase of selling expenses, equivalent to VND174bn decrease of core EBT. The company made a little improvement in administration activites, reducing related operating costs of VND18bn. Financial expenses increased by VND63bn (+11% yoy), mainly due to rising interest expenses of VND51bn (+40% yoy).

2016 Core EBT driver, VND bn

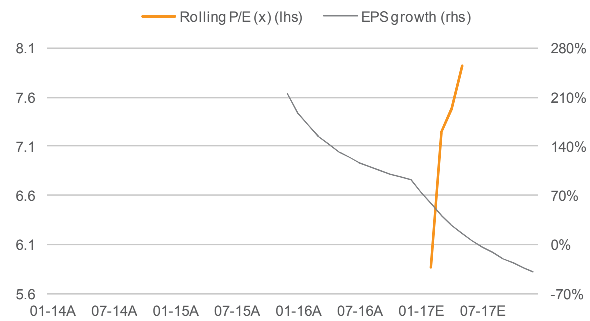


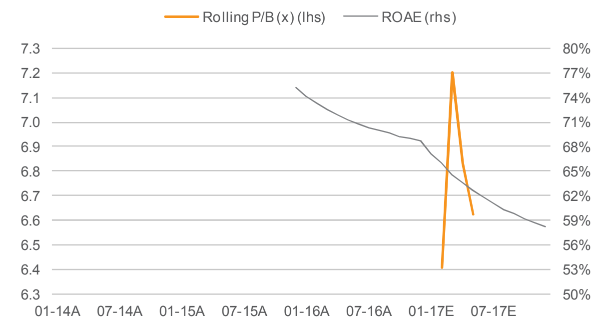
Source: VNDIRECT, VJC

1Q2017: Revenue plumbed as no aircraft sales were made

Revenue was VND5,107bn, decreasing by 23% yoy as VJC did not report any aircraft sales compared to 2016Q1. Transportation revenue grew at staggering rate of 44% to VND3,973bn. In 2016Q1, VJC reported VND3,033bn from aircraft sales at a GM margin of 6.5%. The core GP down by 2pp yoy to 15% possibly due to rising fuel cost. Domestic jet kerosene price went up by 46% yoy and the rally could further affect VJC in the next several months. Despite the unfavorable fuel price, VJC continued to cut ex-fuel CASK by 4.1% yoy to 2.34 cent and to raise RASK by 3.2% yoy to 4.5 cent. Due to rising fuel cost, RASK – CASH spread shrank by 12% yoy to 0.51 cent. The company, in cooperation with Airbus, will launch its own full flight simulation platform in 1Q2018. The system will be used to train pilots.

Valuation





Income statements

(VNDbn)	12-16A	12-17E	12-18E
Revenue	27,532	45,655	52,705
Cost of sales	(24,033)	(40,234)	(45,979)
Gen & admin expenses	(185)	(244)	(297)
Selling expenses	(492)	(657)	(801)
Operating profit	**2,822**	**4,519**	**5,628**
Operating EBITDA	2,822	4,519	5,628
Depreciation and amortisation	**0**	**0**	**0**
Operating EBIT	**2,822**	**4,519**	**5,628**
Interest income	175	207	287
Financial expense	(624)	(227)	(193)
Net other income	32	0	0
Income from associates & JVs	(9)	(9)	(9)
Pre-tax profit	**2,395**	**4,490**	**5,712**
Taxation	(105)	(903)	(1,147)
Minority interests	2	0	0
Net profit	**2,292**	**3,588**	**4,564**
Adj. net profit to ordinary	2,292	3,588	4,564
Ordinary dividends	0	(300)	(300)
Retained earnings	**2,292**	**3,288**	**4,264**

Balance sheets

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	2,740	3,748	5,251
Short term investments	0	0	0
Accounts receivables	7,638	8,576	9,367
Inventories	127	182	223
Other current assets	141	198	248
Total current assets	**10,645**	**12,704**	**15,088**
Fixed assets	1,221	2,092	2,906
Total investments	68	68	68
Other long-term assets	7,982	11,217	14,036
Total assets	**19,916**	**26,080**	**32,098**
Short-term debt	6,036	5,545	4,436
Accounts payable	407	584	716
Other current liabilities	4,608	6,491	8,106
Total current liabilities	**11,051**	**12,620**	**13,259**
Total long-term debt	761	618	468
Other liabilities	3,579	5,030	6,294
Shareholders' equity	**4,525**	**7,813**	**12,077**
Minority interests	(1)	(1)	(1)
Total liabilities & equity	**19,916**	**26,080**	**32,098**

Cash flow statement

(VNDbn)	12-16A	12-17E	12-18E
Pretax profit	**2,395**	**4,490**	**5,712**
Depreciation & amortisation	41	108	167
Other non cash gains/(losses)	0	0	0
Other non operating gains/(losses)	(197)	(197)	(277)
Tax paid	(40)	(903)	(1,147)
Other operating cash flow	(2,504)	0	0
Change in working capital	**964**	**1,009**	**866**
Cash flow from operations	**659**	**4,507**	**5,320**
Capex	(2,194)	(978)	(981)
Proceeds from assets sales	0	0	0
Others	2,685	197	277
Other non-current assets changes	(2,370)	(3,235)	(2,818)
Cash flow from investing activities	**(1,879)**	**(4,016)**	**(3,522)**
New share issuance	72	0	0
Shares buyback	0	0	0
Net borrowings	3,266	(634)	(1,259)
Other financing cash flow	(300)	1,451	1,264
Dividends paid	0	(300)	(300)
Cash flow from financing activities	**3,037**	**517**	**(295)**
Cash and equivalents at beginning of period	924	2,740	3,748
Total cash generated	**1,816**	**1,008**	**1,503**
Cash and equivalents at the end of period	2,740	3,748	5,251

Key ratios

	12-16A	12-17E	12-18E
Dupont			
Net profit margin	8.3%	7.9%	8.7%
Asset turnover	2	2	2
ROAA	14.3%	15.6%	15.7%
Avg assets/avg equity	5	4	3
ROAE	68.7%	58.2%	45.9%
Efficiency			
Days account receivable	23	20	22
Days inventory	2	2	2
Days creditor	6	5	6
Fixed asset turnover	40	28	21
ROIC	20.2%	25.7%	26.9%
Liquidity			
Current ratio	1	1	1
Quick ratio	1	1	1
Cash ratio	0	0	0
Cash cycle	19	16	18
Growth rate (yoy)			
Revenue growth	38.7%	65.8%	15.4%
Operating profit growth	77.6%	60.1%	24.5%
Net profit growth	95.8%	56.5%	27.2%
EPS growth	93.5%	(39.0%)	27.2%
Share value			
EPS (VND)	19,614	11,959	15,214
BVPS (VND)	15,085	26,043	40,257
DPS (VND)	0	1,000	1,000

Source: VNDIRECT

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