

Air Arabia

Doing Well in Tough Times



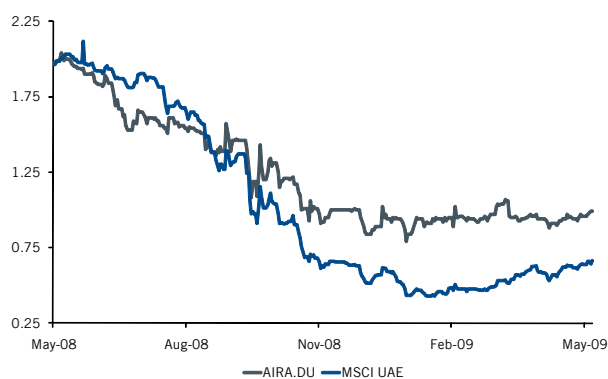
May 31, 2009

Key Data

Current Price*	Avg. Value Traded per Day
AED 0.99	AED 47.3 mln
52-Week High	Market Cap
AED 2.04	AED 4.6 bln
52-Week Low	Current Number of Shares
AED 0.79	4,666.7 mln
Reuters	Bloomberg
AIRA.DU	AIRARABI UH
Ownership Structure	
Privately Held: 45%	Public: 55%

* Price as of close on May 28, 2009. Sources: Reuters, Zawya, and NBK Capital

Rebased Performance



Sources: MSCI, Reuters, and NBK Capital

Key Ratios

	2008 a	2009 f	2010 f	2011 f	2012 f
P/E	9.1	9.7	10.0	9.2	11.1
EPS Growth	38%	-6%	-3%	8%	-17%
EV/ EBITDAR	6.2	5.4	4.7	4.0	3.7
EBITDAR Margin	25%	30%	28%	27%	27%
EBITDAR Growth	31%	16%	14%	18%	7%
Dividend Yield	10.1%	2.6%	2.5%	2.7%	2.2%
ROAE	10%	9%	8%	8%	7%

1Q2009 EBITDAR a	2Q2009 EBITDAR f
AED 118.5 mln	AED 138.6 mln
1Q2009 EBITDAR f	3Q2009 EBITDAR f
AED 125.0 mln	AED 201.9 mln

a = actual, f = forecast. Sources: Reuters and NBK Capital

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Highlights

12-Month Fair Value: AED 1.30

Recommendation: Buy-Risk Level: 4**

Reason for Report: 1Q2009 Update

- Air Arabia's total revenues reached AED 463.2 million in 1Q2009, which is an increase of 21% over the same period last year. This increase in revenue is due mostly to a 26% increase in passenger numbers during 1Q2009.
- Air Arabia achieved an EBITDAR of AED 118.5 million for 1Q2009, which is 34% higher than 1Q2008. This result was 5% lower than our forecast of AED 125 million for the quarter. Net income, on the other hand, increased by 32% year-on-year to reach AED 103.4 million. Included in net income is interest income of AED 45.3 in 1Q2009 (1Q2008 also had AED 45.3 million in interest income).
- We notice an improvement in Air Arabia's operating margins during the first quarter of 2009. The EBITDAR margin improved from 23% in 1Q2008 to 25.6% in 1Q2009 because of falling fuel costs per ASK, even though we are seeing a decline in yields. We expect this trend to continue in 2009.
- Air Arabia increased its output by around 40%, from 1.7 billion ASK in 1Q2008 to 2.4 billion ASK in 1Q2009. The 33% increase in RPK was slightly lower than the growth in ASK, which led to the drop in load factor from 85% in 1Q2008 to 81% in 1Q2009, a result that we consider to be healthy given the trading conditions that currently prevail.
- We have made some adjustments to our 2009 forecasts, we lowered revenue and EBITDAR by 9% and 3%, respectively. Our assumptions are that Air Arabia will achieve a load factor of 83.1% in 2009 (compared to 85% in 2008) and that yields will drop by around 15%. The decline in oil prices will reduce fuel costs per ASK, which will offset the decline in yields. Our new forecasts show that we expect Air Arabia to achieve an EBITDAR margin of 30% in 2009, compared to 25% in 2008.
- Our fair value estimate of the share price decreased from AED 1.41 to AED 1.30 because of a 24% decline in the fair value based on peer comparison. The fair value derived from our DCF valuation increased by 6%. Given the 31% upside potential from the last closing price, our new recommendation is "Buy."

** Please refer to page 7 for recommendations and risk ratings.

VALUATION

Air Arabia's 1Q2009 operating results came in slightly lower than our forecast, because actual EBITDAR was 5% lower than our estimate. The 1Q2009 pressure on yields was offset by falling fuel costs per ASK, leading to an improvement in margins. We expect this trend to continue throughout the year and result in a growth in EBITDAR of 16%. Load factor dropped slightly to 81% in 1Q2009, but remains at a very healthy level. We are forecasting that Air Arabia will achieve a load factor of 83% in 2009.

Our new 12-month fair value estimate of Air Arabia's share price has decreased by 7.9%. This change arises from a 24% decline in fair value based on peer comparison, as the fair value derived from our DCF valuation increased by 6%. Given that our fair value estimate is 31% above Air Arabia's latest market price, our recommendation is "Buy."

Figure 1 Fair Value per Share

Our 12-month fair value for Air Arabia is AED 1.30

Valuation Method	Old		New		Change
	Weight	Value	Weight	Value	
Discounted cash flow	70%	AED 1.27	70%	AED 1.35	6%
Peer comparison	30%	AED 1.74	30%	AED 1.33	-24%
Weighted average fair value	100%	AED 1.41	100%	AED 1.30	-8%

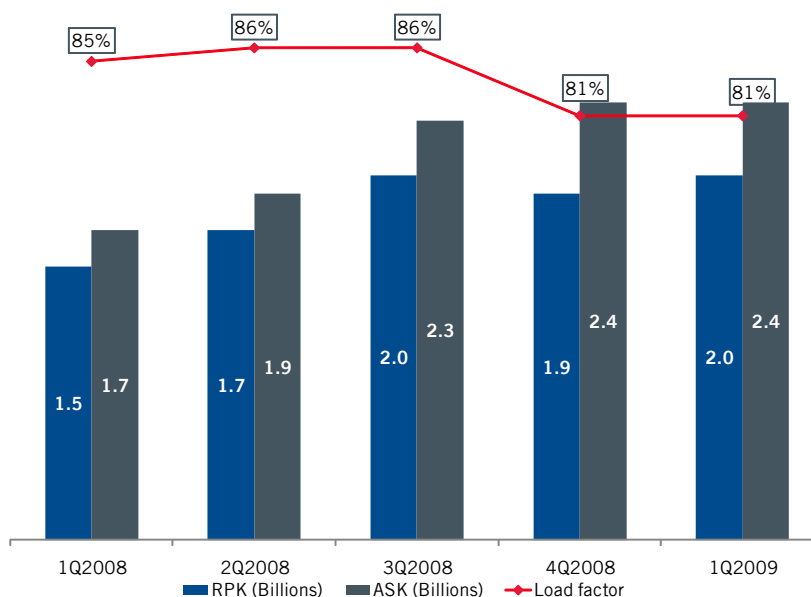
Source: NBK Capital

1Q2009 OPERATIONAL PERFORMANCE

- The number of passengers flying with Air Arabia grew by 26% year-on-year to 951,000 in 1Q2009. Load factor, on the other hand, dropped from 85% in 1Q2008 to 81% in 1Q2009, a result that we consider to be good given the trading conditions that currently prevail. According to management, inbound traffic was slightly lower than outbound traffic in 1Q2009.

Figure 2 Load Factor by Quarters

Load Factor has been falling recently but remains at a healthy level



Sources: Air Arabia and NBK Capital

- Air Arabia increased its output by around 40%, from 1.7 billion ASK in 1Q2008 to 2.4 billion ASK in 1Q2009. The 33% increase in RPK was slightly lower than the growth in ASK, which led to the drop in load factor that we witnessed.

1Q2009 FINANCIAL PERFORMANCE

- Air Arabia's total revenues reached AED 463.2 million in 1Q2009, which is an increase of 21% over the same period last year. This increase is due mostly to a 26% increase in passenger numbers during 1Q2009.
- Air Arabia's performance in 1Q2009 reflects a noticeable improvement in operating margins. The gross profit margin improved from 13.8% in 1Q2008 to 18.2% in 1Q2009, and the operating income margin increased from 8.3% in 1Q2008 to 12% in 1Q2009. This improvement resulted from reduced fuel costs, which we discuss in the next section of this report.
- Air Arabia achieved an EBITDAR of AED 118.5 million for 1Q2009, which is 34% higher than 1Q2008. This is 5% lower than our forecast of AED 125 million for the quarter. The EBITDAR margin improved from 23% in 1Q2008 to 25.6% in 1Q2009.
- Air Arabia's net income increased by 32% year-on-year in 1Q2009 to reach AED 103.4 million. Included in net income is interest income of AED 45.3 million in 1Q2009 (1Q2008 also had AED 45.3 million in interest income).
- Our major concern with the balance sheet remains the AED 1.5 billion in available-for-sale instruments, which represent 25% of total assets and 30% of equity. A loss of AED 0.3 million relating to these available-for-sale instruments was recognized directly in equity in 1Q2009, which is a much smaller amount than the AED 110 million loss that was recognized by the end of 2008. Management insists that this investment is in conservative, unquoted securities, and is not disclosing anything more.

Figure 3 Income Statements

Income Statement (AED Thousands)	First-Quarter Results			Common Size	
	2008	2009	Change	1Q2008	1Q2009
Total Revenue	383,233	463,234	21%	100.0%	100.0%
Cost of Revenue	330,409	379,083	15%	86.2%	81.8%
Gross Profit	52,823	84,151	59%	13.8%	18.2%
Selling and Marketing	8,388	12,027	43%	2.2%	2.6%
General and Administrative	12,521	16,670	33%	3.3%	3.6%
Operating Income	31,914	55,455	74%	8.3%	12.0%
Interest Income(Exp), Net Non-Operating	45,320	45,309	0%	11.8%	9.8%
Other, Net	1,077	2,605	142%	0.3%	0.6%
Net Income	78,311	103,368	32%	20.4%	22.3%
EBITDA	34,368	67,596	97%	9.0%	14.6%
Depreciation/Amortization	2,454	12,141	395%	0.6%	2.6%
EBITDAR	88,230	118,518	34%	23.0%	25.6%
Lease Rentals	53,862	50,922	-5%	14.1%	11.0%

*EBITDAR increased by 34%
in 1Q2009*

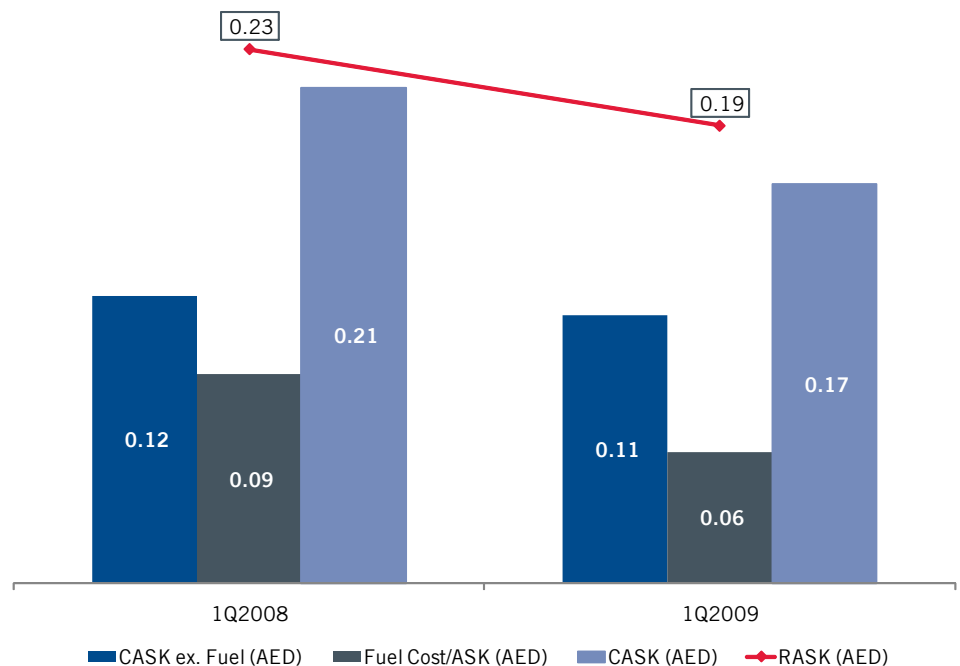
Sources: Air Arabia and NBK Capital

PER UNIT ANALYSIS

- Given that 1Q2009 has seen an improvement in margins, we believe that a per unit analysis of Air Arabia will clearly explain its performance during that quarter.
- Figure 4 shows the operating costs per ASK (CASK) for Air Arabia in 1Q2008 and 1Q2009. At first glance, we see a fall in CASK in 1Q2009 of around 20%, to AED 0.17 from AED 0.21 in 1Q2008. A close examination reveals that the majority of this reduction in CASK results from the drop in fuel costs, because fuel costs per ASK were cut almost by a third, from AED 0.09 to AED 0.06.
- The fact that CASK ex-fuel also had a minor dip indicates the airline’s ability to rein in other operating costs.
- Revenue per ASK (RASK) dropped by 14% in 1Q2009 compared to 1Q2008; however, this drop in RASK is less than the drop in CASK, which led to a widening spread between RASK and CASK. This improvement in the spread between RASK and CASK translates to improved operating margins. If Air Arabia can maintain this trend throughout the year, it will continue to see enhanced profitability to counter-balance pressure on yields.

Figure 4 1Q2009 CASK Comparisons

Fuel cost per ASK was cut almost in half from 1Q2009 to 1Q2008



Sources: Air Arabia and NBK Capital

OUTLOOK

Although the issue of rising fuel prices seems to have abated, at least temporarily, the weak economic conditions remain. In our opinion, this will pose a serious threat to the aviation industry because of the discretionary nature of the demand for travel services. However, we think that LCCs can turn this situation to their advantage by offering low prices that appeal to price-sensitive travelers. Accordingly, we believe that Air Arabia has what it takes to survive these tough times and expand its market share; although, ultimately, this will come at the expense of its yield. Air Arabia’s performance in 1Q2009 reflects the fact that lower yields are

being accompanied by a drop in operating costs per ASK, mostly because of a significantly low fuel cost per ASK. In our opinion, this will improve EBITDAR margins, which can translate to growth in operating profits.

Pressure on Air Arabia's yield is expected to increase when flydubai begins operating on June 1, 2009, because it will be starting with some special promotions. flydubai will serve four destinations (Beirut, Amman, Damascus and Alexandria) upon commencement of its service—all of which are part of Air Arabia's network. We expect flydubai's impact on Air Arabia in 2009 to be minimal, following Jazeera Airways' announcement that it will halt most of its direct services out of Dubai. Also, as we mentioned in our previous update, we expect flydubai to cannibalize on Emirates Airline's regional network, but this does not mean it will not be competing with Air Arabia.

We have made some adjustments to our 2009 forecasts to reflect declines in revenues and EBITDAR of 9% and 3%, respectively. Into our revenue assumptions for 2009 we have incorporated a load factor of 83.1% (compared to 85% in 2008) and a decline in yields of 15%, because we expect yields to fall because of the removal of fuel surcharges and a reduction in prices to stimulate travel and fend off new competition. The decline in oil prices will reduce fuel costs per ASK, which will improve the EBITDAR margin in 2009 even though we are expecting lower yields. We are forecasting that Air Arabia will achieve an EBITDAR margin of 30% in 2009, compared to 25% in 2008. The fact that Air Arabia has hedged around 60% of its fuel needs for 2009 at USD 52 per barrel of Brent oil makes us comfortable that these margins can be achieved even if we see a sudden rally in oil prices. Considering the AED 45 million in interest income that Air Arabia realized in 1Q2009, we have increased our estimate of interest income in 2009 to AED 143 million. Accordingly, this would result in a net income of AED 478 million in 2009, an increase of 5.5% year-on-year after excluding the AED 56.5 million in dividend income in 2008. We adjusted Air Arabia's fleet plan based on the latest guidance from management. Though no major changes were made to the fleet's projected size, the financing method for some aircraft changed following Air Arabia's decision to exercise its option with Airbus to purchase 10 additional aircraft. This increased capex payments but reduced lease payments over our forecast horizon.

We still have not incorporated Air Arabia Maroc in our forecasts because we are waiting to see how it performs in its first year. Even though it is unlikely that Air Arabia Maroc will be profitable in its first year of operation, we do not expect it to materially impact Air Arabia's performance in 2009 because it owns only 29% of this venture. Though some strong fundamentals favor Air Arabia Maroc (such as Morocco being the third most populous Arab country, the presence of the large Moroccan diaspora in Europe, Morocco being a tourist destination for Europeans and the open skies agreement between Morocco and the European Union), we still need to see how Air Arabia Maroc fares against competition. In Morocco, competition will come not only from Royal Air Maroc and Jet4you, another Moroccan LCC, but also from European airlines and LCCs, including some of the world's biggest LCCs such as Ryanair and easyJet, which serve several destinations in Morocco.

FINANCIAL STATEMENTS

Balance Sheet (AED Thousands)		Forecast					
Fiscal Year Ends December	2008	2009	2010	2011	2012	2013	2014
ASSETS							
Cash and Short-Term Investments	1,767,125	1,461,309	1,375,755	580,323	1,289,301	491,446	379,927
Total Receivables, Net	241,799	203,274	227,537	274,608	296,292	355,567	468,939
Total Inventory	1,562	1,718	1,890	2,079	2,287	2,516	2,768
Total Current Assets	2,010,486	1,666,301	1,605,182	857,011	1,587,880	849,529	851,634
Property/Plant/Equipment, Total - Net	921,471	1,234,280	1,728,439	2,942,206	4,559,587	5,800,593	6,512,351
Goodwill and Intangibles	1,281,821	1,281,821	1,281,821	1,281,821	1,281,821	1,281,821	1,281,821
Long Term Investments	1,573,663	1,570,961	1,568,259	1,565,557	1,562,855	1,560,153	1,557,451
Other Long-Term Assets, Total	74,133	92,335	111,887	130,244	135,618	142,615	162,970
TOTAL ASSETS	5,861,573	5,845,697	6,295,588	6,776,838	9,127,760	9,634,710	10,366,227
LIABILITIES & EQUITY							
Accounts Payable	330,923	306,415	377,941	448,641	472,577	555,241	720,749
Other Current Liabilities, Total	132,803	129,284	159,188	192,130	207,298	248,781	328,129
Total Current Liabilities	463,726	435,699	537,130	640,770	679,876	804,021	1,048,878
Long-Term Debt	-	-	-	-	2,000,000	2,000,000	2,000,000
Other Liabilities, Total	14,241	14,953	15,701	16,486	17,310	18,176	19,085
Total Liabilities	477,968	450,653	552,831	657,256	2,697,186	2,822,197	3,067,962
Total Equity	5,383,605	5,395,044	5,742,757	6,119,582	6,430,574	6,812,513	7,298,264
TOTAL LIABILITIES AND EQUITY	5,861,573	5,845,697	6,295,588	6,776,838	9,127,760	9,634,710	10,366,227

Income Statement (AED Thousands)		Forecast					
Fiscal Year Ends December	2008	2009	2010	2011	2012	2013	2014
Total Revenue	2,065,786	2,003,875	2,458,719	2,957,113	3,189,101	3,805,798	4,978,956
Operating expenses	1,739,062	1,624,290	2,014,621	2,398,500	2,524,426	2,956,261	3,841,023
Depreciation/Amortization	36,497	50,238	67,739	111,903	163,032	250,450	374,378
Operating Income	290,227	329,347	376,360	446,710	501,643	599,087	763,554
Interest Income (Exp), Net Non-Operating	163,900	143,423	81,765	50,069	(92,811)	(95,838)	(122,077)
Other, Net	55,598	5,338	5,492	5,654	5,825	6,003	6,191
Net Income	509,725	478,109	463,617	502,433	414,656	509,252	647,669

Cash Flow (AED Thousands)		Forecast					
Fiscal Year Ends December	2008	2009	2010	2011	2012	2013	2014
Cash from Operating Activities	388,591	389,926	521,094	614,992	681,889	914,178	1,269,166
Cash from Investing Activities	(1,602,959)	(229,073)	(490,744)	(1,284,816)	(1,729,247)	(1,444,720)	(1,078,767)
Cash from Financing Activities	11,587	(466,670)	(115,904)	(125,608)	1,756,336	(267,313)	(301,917)
Net Change in Cash	(1,202,780)	(305,816)	(85,554)	(795,432)	708,978	(797,855)	(111,518)

Sources: Company financials and NBK Capital

RISK AND RECOMMENDATION GUIDE

Recommendation	Upside (Downside) Potential
Buy	more than 20%
Accumulate	between 10% and 20%
Hold	between -5% and 10%
Reduce	between -10% and -5%
Sell	less then -10%

RISK LEVEL				
Low Risk			High Risk	
1	2	3	4	5

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