Vietjet Aviation JSC (HSX: VJC)

Growth speed to watch closely

Particulars (VND B)	Q2-FY18	Q1-FY18	+/-qoq	Q2-FY17	+/-yoy
Net revenue	8,662	12,560	-31%	11,317	-23%
PAT	633	1,366	-54%	1,420	-55%
EBIT	970	1,583	-39%	1,571	-38%
EBIT margin	11.2%	12.6%	-1%	13.9%	-3%

Source: VJC, RongViet Securities

1H 2018 performance: maintains impressive growth

- Core revenue and net profit grow by 53% and 23%, respectively.
- High efficiency and improved ancillary revenue are key elements to counter rising fuel price.
- Increasingly dependent on international flights is something to monitor closely.

2018-2019: golden time for the fleet

The number of passengers will likely grow well in 2018 and 2019, ensuring high frequency for VJC flights. In addition, operating A321 aircrafts (220-230 seats) in place of the A320s (180 seats only) will improve VJC's efficiency. We believe 2018-2019 is the time where VJC's fleet can operate at its highest efficiency. This, coupled with an improvement in ancillary revenues, should help the firm partially counter the effect of higher fuel prices. In a scenario where oil prices fall from this level, VJC would greatly benefit.

Valuation and recommendation:

VJC is a rare growth stock in the market. Having a core business growing at over 40%/year in the past five years is not common. As a result, the stock is trading at a P/E 2018F of 26x (EPS adjusted for sale and leaseback earnings). However, we are concerned that passenger growth from 2020 onward may slow down, while performance efficiency may decline due to the aggressive expansion of the fleet, higher oil prices or currency fluctuations.

*Accordingly, we only apply a target P/E of 18x for VJC in 2019. Combined with the EV/EBITDAR of 8x, our target price for VJC is **VND 170,000**. We recommend to **ACCUMULATE** the stock with a total upside of **19%**.*

The target price is revised up from our previous report (after adjusting for stock dividends) to reflect the projected result of 2019 instead of 2018 as in the previous report.

ACCUMULATE +19%

CMP (VND)	145,000
Target price (VND)	170,000
Cash dividend (VND)*	3,000

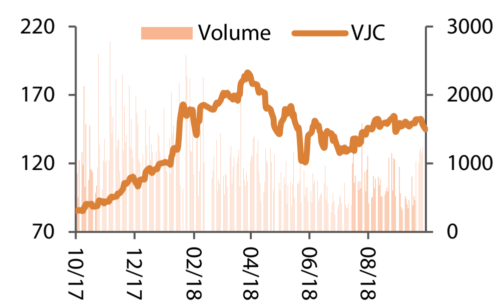
** Expected in the next 12 months*

Stock info

Sector	Cons Service
Market Cap (VND bn)	78,642
Current Shares O/S	541,612,000
Beta	1.1
Free float (%)	53.2
52 weeks High	186,466
52 weeks Low	85,345
Avg. Daily Volume (in 20 sessions)	703,335

	FY2017	FY2018E
EPS	9,367	10,631
Adjusted EPS	4,100	5,876
EPS growth (%)	83.8	43.3
P/E	29.8	25.9
P/B	6.3	5.8
EV/EBITDA	11.5	12.2
Cash dividend	4,000	4,000
ROE (%)	49.0	40.9

Price performance



Major Shareholders (%)

Huong Duong Sunny	28.6
Nguyen Thi Phuong Thao (CEO)	8.8
Sovico	7.6
Remaining Foreign room (%)	5.4

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Exhibit 1: Q2 2018 results

Particulars (VND B)	Q2-FY18	Q1-FY18	+/-(QoQ)	Q2-FY17	+/-(YoY)	1H-FY18	+/-(YoY)
Net revenue	8,662	12,560	-31.0%	11,317	-23.5%	21,222	29%
Gross profit	1,188	1,810	-34.3%	1,749	-32.0%	2,999	19%
SG&A	218	227	-4.0%	177	23.1%	445	20%
Operating income	970	1,583	-38.7%	1,571	-38.2%	2,553	14%
EBITDA	1,008	1,615	-37.6%	1,592	-36.7%	2,623	20%
EBIT	970	1,583	-38.7%	1,571	-38.2%	2,553	19%
Financial expenses	294	199	47.9%	81	262.0%	494	91%
- Interest Expenses	56	56	-1.2%	58	-3.5%	112	-5%
Dep. and amortization	38	32	16.4%	21	77.7%	70	87%
Non-recurring items (*)							
Extraordinary items (*)	0	752		823		752	
PBT	678	1,481	-54.2%	1,489	-54.4%	2,159	11%
PAT	633	1,366	-53.7%	1,420	-55.4%	1,999	13%
(*) Adjusted PAT	633	613	3.2%	597	6.0%	1,246	

Source: VJC, RongViet Securities

Exhibit 2: Q2 2018 performance analysis

Particulars	Q2-FY18	Q1-FY18	+/-(QoQ)	Q2-FY17	+/-(YoY)
Profitability ratios (%)					
Gross margin	13.7%	14.4%	-0.7%	15.5%	-1.7%
EBITDA margin	11.6%	12.9%	-1.2%	14.1%	-2.4%
EBIT margin	11.2%	12.6%	-1.4%	13.9%	-2.7%
Net margin	7.3%	10.9%	-3.6%	12.5%	-5.2%
Adjusted net margin	7.3%	4.9%	2.4%	5.3%	2.0%
Turnover *(x)					
-Inventories	90.6	149.8	-59.2	230.6	-140.0
-Receivables	3.0	4.6	-1.3	5.3	-2.3
-Payables	5.1	7.3	-2.2	9.1	-4.0
Leverage (%)					
Total debt/ equity	121.1%	113.2%	8.0%	162.8%	-41.7%

Source: VJC, (*) Annualized turnover

Exhibit 3: 2018-2019 performance forecast

Particulars (VND B)	Q3-FY18	+/-(QoQ)	+/-(YoY)
Revenue	54,152	28%	67,312
Gross profit	7,754	18%	9,881
EBIT	6,701	17%	8,405
NPAT	5,426	14%	6,222

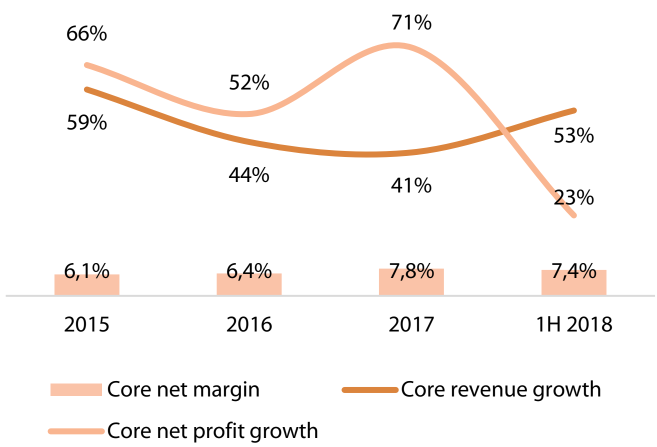
Source: VJC, RongViet Securities.

Update

Maintaining high-speed growth. Core revenue increased 53% in 1H 2018, reaching VND 16.5 trillion. Not many listed companies can sustain such impressive growth (Figure 1). Main reasons are:

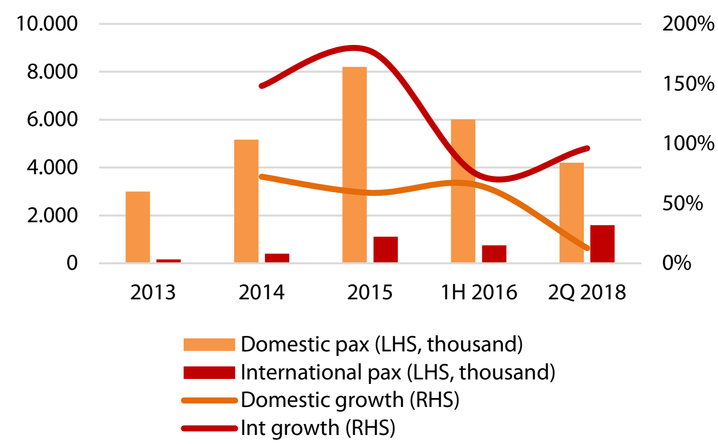
- **Number of passengers** in 1H 2018 was over 11 million, up 34% YoY. This result is on the back of high growth of international passengers. Domestic passenger's growth has shown signs of slowing down (Figure 2 and 3).
- **Ancillary revenue/pax** continued to improve, reaching USD 15. The figure, on average, has grown about 13% per year. We believe there is still room for further improvement (Figure 4 and appendix 1). A small rise can contribute significantly to VJC's growth, as is what happened in 2017.

Figure 1: VJC maintained impressive growth



Source: VJC

Figure 2: Domestic passengers: growth slowing down

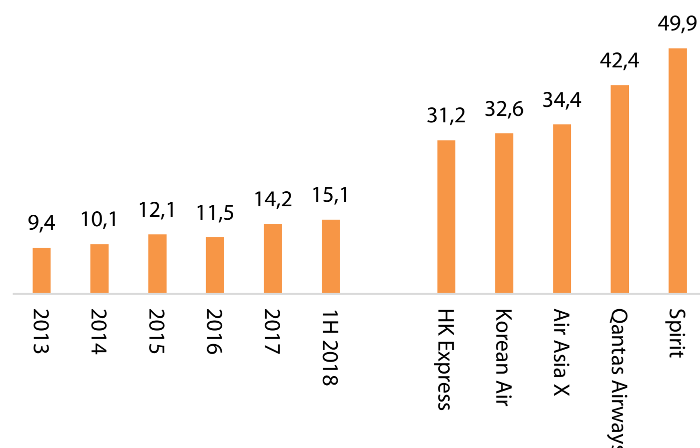


Source: VJC

Figure 3: Growth of Northeast Asia passengers to Vietnam (%)

Source: vietnamtourism

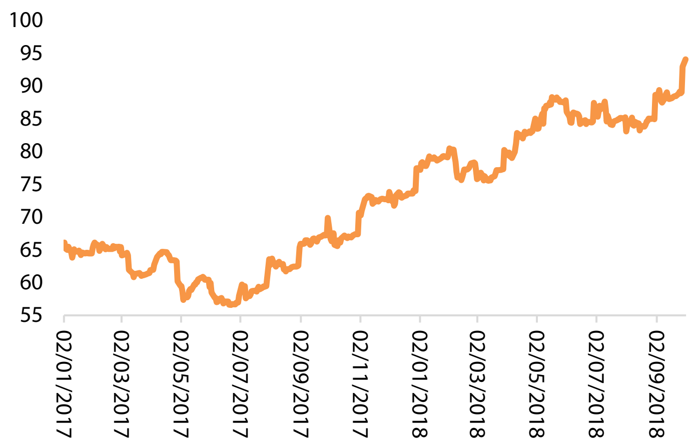
Figure 4: Ancillary revenue/pax (USD) of VJC vs top 5 (in 2016)



Source: VJC, RongViet Securities

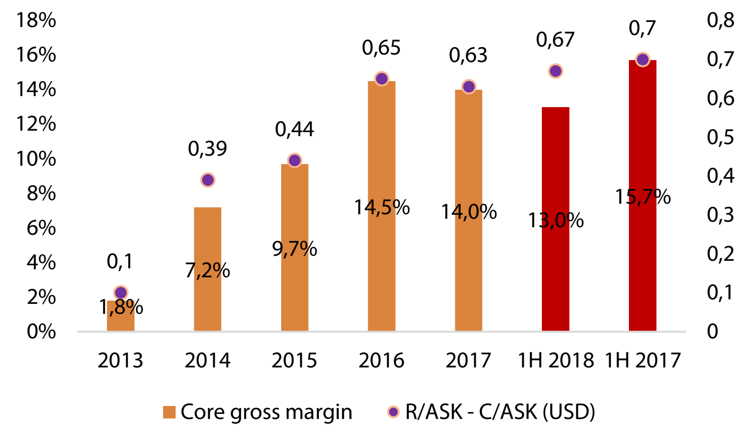
Higher oil prices have affected margins. Fuel prices increased by 25% within a year (Figure 5). However, higher air fare (due to price adjustments and more international flights-figure 7), and improved efficiency/flight (Figures 8) helped counter some of the Impact for VJC's margin (Figure 6).

Figure 5: Jet kerosene, Singapore price movement



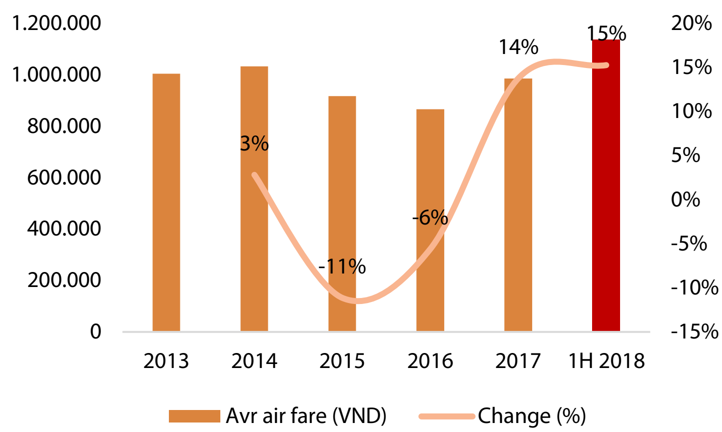
Source: Bloomberg

Figure 6: Core gross margin and R/ASK-C/ASK spread 1H 2018 declined YoY



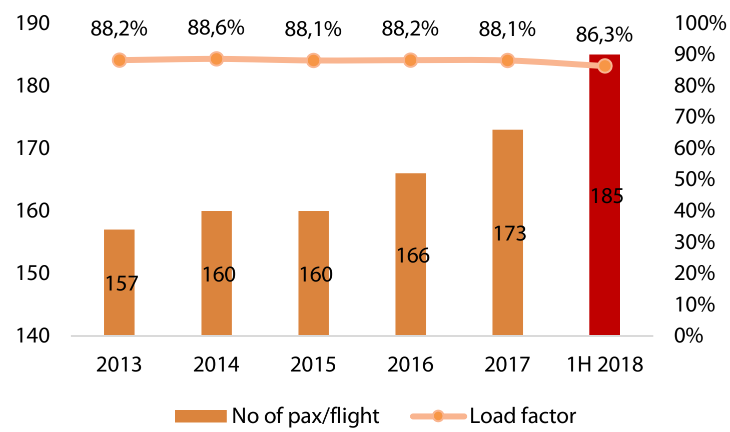
Source: VJC, RongViet Securities

Figure 7: Average air fare/pax



Source: VJC, RongViet Securities

Figure 8: No of passengers/flight and load factor of VJC



Source: VJC, RongViet Securities

Competition from Bamboo Airline (FLC Group), if any, is not worrisome.

According to published information, Bamboo Airline will likely operate a "point to point" model instead of a "hub and spoke" model. Bamboo Airline will directly connect Tier 2 cities in Vietnam, and international destinations in the region (before expanding to Europe and the US) to FLC's resort areas. This means the company has chosen a niche market, and will not compete directly with the main routes of VJC's connecting centers such as Hanoi, Ho Chi Minh, and Da Nang.

The exploitation of a niche market cannot ensure the flow of passengers proportionally with the size of the fleet that Bamboo plans to deploy. The company has ordered 20 Boeing 787-9s (valued at USD 5.6 billion, to be delivered in 2020-2021) and 24 A321-Neo (USD 3 billion, delivered in 2022-2025). It seems very risky for a new airline to exploit a large number of long-distance aircraft in its early years. The rush of Bamboo gives us the impression that it has not had the necessary preparation and could hardly become a counterweight for the market.

However, the appearance of Bamboo Airline also shows that there is possibility for new players with greater financial power and experience to enter the market, making the competition more intense.

2018-2019 Outlook:

VJC's growth will increasingly depend on international routes

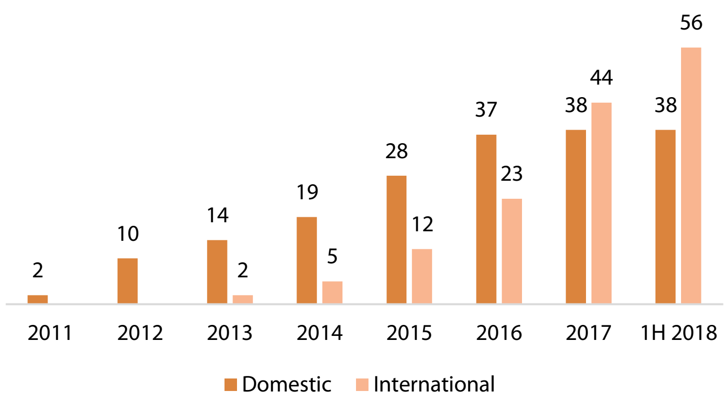
The tailwind is that the sharp increase of international visitors to Vietnam is likely to be maintained in the upcoming years. However, this trend needs to be monitored closely because it can completely be reversed by unexpected factors. The room for new international routes may be limited as VJC has opened many in recent years (Figure 9). VJC needs to increase the frequency of existing routes.

Revenue and profit from the sale and leaseback will be expanded for some time

2019 onward, VJC will receive 100 Boeing 737 Max 200 aircrafts (4 aircrafts in 2019 and 24 aircrafts/each year in the next 4 years). VJC's fleet is estimated to grow from 55 aircrafts in Q2/2018 to nearly 200 in 2022. Meanwhile, VJC estimates it will only use about 120 aircrafts for the Vietnam market by 2022. The rest will be operated in other markets in the region (like Thai Vietjet) or sub lease to other airlines (as in the case with Pakistan National Airline this year). **However, this requires a huge upside demand from other markets.**

With this move, VJC will continue its sale and leaseback activities, and in turn will continue to record revenue and profit from this activity. Recently, VJC has ordered 150 aircrafts at the Farnborough exhibition. For 2H 2018, VJC will receive 13 aircrafts in accordance with the original plan.

Figure 9: VJC's routes over the years



Source: VJC, RongViet Securities

Table 1: VJC 's contracts/MoU for aircraft

Contract/MoU	Year	No	Value	Delivery
Airbus A320 & A321	2013	100	9.1 Bn USD	2014-2022
B737 Max 200	2016	100	11.3 Bn USD	2019-2023
Airbus A321	2016	20	2.4 Bn USD	2017-2020
B737 Max	2018	100	12.7 Bn USD	2022-2025
Airbus A321 Neo	2018	50	6.5 Bn USD	2022-2025

Source: RongViet Securities

We believe VJC's fleet will reach its highest efficiency in 2018-2019. This will help the airline counter the effect of rising fuel price. However, from 2020 onward, we have some worries about the potential slowdown of passenger's growth while VJC expands the fleet too aggressively (Appendix 3). Interest rate, currency risk and political tension also make long-term prospect more uncertain.

We maintain our view that the difference VJC received from sale and leaseback activities should not be recorded as a one-time profit. Hence, we distribute the amount through the time of the leasing contracts (12 years). EPS is adjusted accordingly (see last page)

Main assumptions for 2018 and 2019 are as follows:

Criteria	2017	2018F	2019F
No of passengers (Mn)	**17.1**	**23.2**	**29.4**
Transportation revenue (Bn VND)	16,854	25,636	33,360
Ancillary revenue (Bn VND)	5,477	8,108	11,165
Ancillary revenue/pax (USD)	*14.2*	*15.1*	*16.0*
Revenue from selling aircraft (Bn VND)	19,972	20,408	22,786
Revenue (Bn VND)	**42,302**	**51,153**	**67,312**
Core gross margin	14.0%	12.9%	13.7%
Core net profit (Bn VND)	**1,752**	**2,433 (+39%)**	**3,254 (+34%)**
Core net margin	7.8%	7.2%	7.3%

VJC is planning to issue USD 300 Mn of convertible bonds. Shares will be diluted by 5% in case this deal happen and investors choose to convert. We have not included the effect of that in our model yet.

Appendix 1: Main ancillary fee of VJC compared with some LCCs having higher ancillary revenue/pax

	VJC		Spirit (US)	Air Asia X		easyJet (EU)
Ancillary rev/pax 2017	**$14**		**$51**	**$22**		**$16**
Luggage fee						
Carry-on bag	Free		$35-100	Free		Free
Checked baggage	Dom	Int		Dom	Int	
Purchase in advance	$6-18	$12-60	1st bag: $30-100 2nd bag: $40-100	$8-29	$25-46	$10-39
Purchase at airport	$13/15 kg	$30/20 kg		$9-34	$29-53	$43-54
Excess weight	$2/kg	$14/kg	$30-100/ bag	$9/kg	$12/kg	$12/kg
Assigned seats						
Standard seat	$1.3	$2.1	$1-50	$2-3.3	$10-13	$2-9
Special seat	$4	$6.5	$12-150	$8-11	$37-48	$10-29
Cancellation						
Within 24h purchase	$11	$25	Free	$26	$35	$31-36
Beyond 24h purchase			$90-$100			No refund
On-board service						
Hot meal	$5			$5-5.5		$5-7
Snacks	$0.5-3.5		$2.5-6.5	$1.5-2		$1.5-4.5
Soft/hot drink	$2-2.5		$2-3	$1-2		$3-3.5
Beer, wine, cocktail	Not available		$7-8	$4-7		$8-9

Source: RongViet Research complied

There are three main factors to determine the level of ancillary revenues:

1. **Fee**

Airlines operating in financially wealthier regions tend to charge higher fees for their ancillary services. The table shows that VJC fees are lower that its peers. The airline could increase its fees. However, we think there is not much room as the increase need to be suitable with the income and cost of living in Vietnam.

2. **The number of customers using the services**

For example, some LCCs like Spirit and Frontier charge the customer for all their carry-on and checked baggage, while other airlines usually allow one free carry-on bag. This explains the very high ancillary revenue/pax of those carriers

Americans and European airlines also have Frequent Flyer Programs (FFP) to encourage customers to use their services. Passengers accumulate miles by using master/credit card to book flights. With every miles passengers earn, the airline receives money from the card issuers or banks.

Air Asia's FFP is a bit different. Its passengers earn points based on the amount of money they spend. The more point they have, the more benefits they receive. Meanwhile, VJC does not yet have a FFP

3. **The diversity of ancillary services**

Depending on their own culture and strategy, airlines will offer other services such as unaccompanied minors or pet transportation. VJC's service is similar to others

In conclusion, we believe that most of the improvement of VJC ancillary revenue will come from the increase of international flights. Ancillary fees on international flights are much higher than on domestic ones. **We do not expect a huge jump but a stable and steady improvement over the years.**

Appendix 2: Peer group comparison

Airline	Country	Marcap (Bn VND)	Fleet size	Net margin	CAGR Revenue 2013-2017	CAGR Net profit 2013-2017	P/E trailing	PV of lease expense (Bn VND)	Adjust EV/EBITDAR
VietJet Air	**Vietnam**	**82,379**		**7.8%***	**56%***	**172%***		**49,682**	
Virgin Australia	Australia	33,631		-0.5%	6%	-217%		51,909	10.4x
Cebu Air	Philippine	19,225		11.5%	14%	98%	6.4x	15,783	5.0x
SpiceJet	India	15,842		7.2%	2%	222%		9,982	4.5x
WizzAir	Hungary	100,731	102	14.0%	17%	66%	8.6x	66,958	
RyanAir	Ireland	426,569	444	20.6%	8%	23%	12.1x	4,219	7.1x
EasyJet	England	185,193		6.4%	4%	-6%	13.9x	10,720	8.3x
Jet Blue	US	137,709	247	8.2%	7%	62%	12.5x	27,069	4.1x
SouthwestAirline	US	814,216	730	10.0%	5%	47%	16.7x	31,134	6.5x
Spirit Airline	US	72,946	119	8.8%	13%	24%	13.9x	34,304	6.8x
Average							**12.0x**		**6.6x**

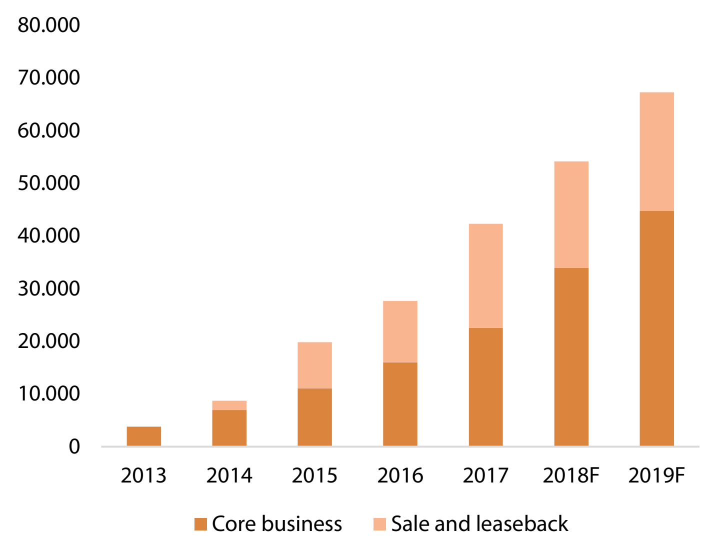
*Source: Bloomberg, RongViet Securities *calculate for core business only*

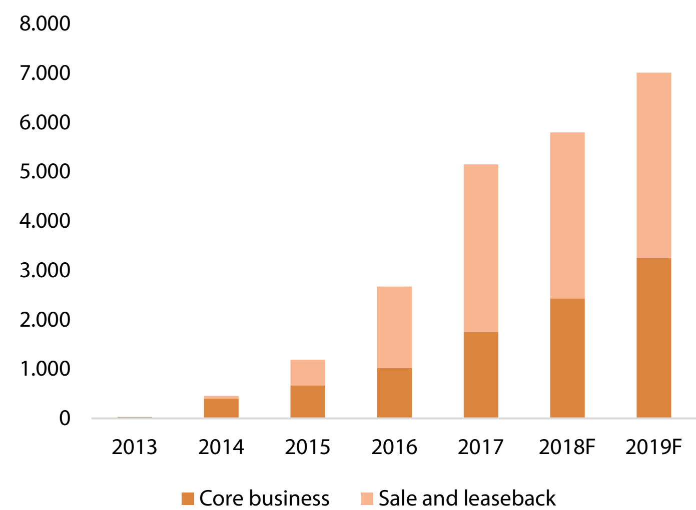
Appendix 3: Top 5 order books for airline groups in Southeast Asia as of Aug 1, 2018

Airline	Order book	Fleet size	Ratio
VietJet Air	**328**	**59**	**5.6:1**
Air Asia/Air AsiaX	494	243	2.0:1
Lion	449	304	1.5:1
Singapore Airlines	182	196	0.9:1
Garuda Indonesia	99	193	0.5:1

Source: CAPA Fleet Database

Appendix 4: Structure of VJC's revenue (left) and net profit (right) (in Bn VND)





Source: RongViet Securities

VND in billions

Income statement	FY2016	FY2017	FY2018E	FY2019F
Revenue	27,499	42,303	54,152	67,312
COGS	23,597	35,753	46,399	57,431
Gross profit	3,902	6,549	7,754	9,881
Selling expense	518	579	747	1,073
G&A expense	189	226	305	403
Finance income	145	119	231	231
Finance expense	654	521	868	823
Other profits	32	4	5	5
Gain/(loss) from JVs	-15	-44	-40	-40
PBT	2,703	5,303	6,029	7,778
Prov. of tax	207	229	270	814
Minority's interest	0	0	0	0
PAT to equity S/H	2,496	5,073	5,758	6,964
EBIT	3,195	5,745	6,702	8,405

%

Financial ratio	FY2015	FY2016	FY2017E	FY2018F
Growth (%)				
Revenue	38.6	53.8	28.0	24.3
Operating income	102.7	80.2	16.8	25.4
EBITDA	101.1	79.8	16.7	25.4
PAT	113.3	103.3	13.5	20.9
Total assets	66.6	57.8	14.1	21.6
Equity	120.5	118.6	36.2	37.9
Profitability (%)				
Gross margin	14.2	15.5	14.3	14.7
EBITDA margin	11.8	13.8	12.6	12.7
EBIT margin	11.6	13.6	12.4	12.5
Net margin	9.1	12.0	10.6	10.3
ROA	12.4	16.0	14.9	15.2
ROE	52.7	49.0	40.9	35.8
Efficiency (x)				
Receivable turnover	3.9	4.1	4.3	4.9
Inventory turnover	171.1	133.8	166.7	166.7
Payable turnover	5.3	5.1	5.0	4.9
Liquidity (x)				
Current	1.0	1.2	1.2	1.4
Solvency (%)				
Total debt/equity	143.6	72.7	57.8	34.2
Current debt/equity	128.9	66.7	53.8	31.6
Long-term Debt/equity	14.7	6.1	4.0	2.6

VND in billions

Balance sheet	FY2016	FY2017	FY2018E	FY2019F
Cash and cash equivalents	2,741	6,455	5,918	8,895
Short-term investments	1	1	1,249	1,327
Accounts receivable	7,129	10,223	12,464	13,654
Inventories	138	267	278	345
Other current assets	304	315	347	381
Property, plant & equipment	1,221	1,746	2,232	2,745
Acquired intangible assets	7	5	1	2
Long-term investments	68	68	68	68
Other non-current assets	7,951	12,170	15,024	18,462
Total assets	**20,063**	**31,658**	**38,607**	**45,881**
Accounts payable	4,468	7,014	9,190	11,609
Short-term borrowings	6,102	6,897	7,582	6,150
Long-term borrowings	695	627	562	496
Other non-current liabilities	4,064	6,526	7,178	8,190
Bonus and welfare fund	0	0	0	0
Technology-science, dev. fund	0	0	0	0
Total liabilities	**15,329**	**21,064**	**24,510**	**26,445**
Common stock and APIC	3,000	4,513	5,416	5,416
Treasury stock (enter as -)	0	0	0	0
Retained earnings	1,703	5,809	8,679	14,018
Other comprehensive income	30	24	0	0
Inv. and dev. fund	0	0	0	0
Total equity	**4,733**	**10,346**	**14,095**	**19,434**
Minority interest	**1**	**2**	**2**	**2**

Valuation ratio	FY2016	FY2017	FY2018E	FY2019E
Adjusted EPS (VND)	2,230	4,100	5,876	7,971
P/E (x)		29.8	25.9	19.1
BV (VND)	15,775	22,924	26,024	35,882
P/B (x)		6.3	5.8	4.2
DPS (VND/cp)		4,000	4,000	3,000
Dividend yield		2.7%	2.6%	1.9%

Valuation model	*Price*	*Weight*	*Average*
Adjusted EV/EBITDAR (8x)	196,650	50%	98,325
P/E adjusted (18x)	143,471	50%	71,736
Target price (VND)			**170,000**

Valuation history	*Price*	*Recommendation*	*Period*
06/03/2017	68,600	Neutral	1 year
06/02/2018	154,200	Neutral	1 year
03/10/2018	170,000	Accumulate	1 year

RESULTS UPDATE

This report is created for the purpose of providing investors with an insight into the discussed company that may assist them in the decision-making process. The report comprises analyses and projections that are based on the most up-to-date information with the objective that is to determine the reasonable value of the stock at the time such analyses are performed. Through this report, we strive to convey the complete assessment and opinions of the analyst relevant to the discussed company. To send us feedbacks and/or receive more information, investors may contact the assigned analyst or our client support department.

RATING GUIDANCE

Ratings	BUY	ACCUMULATE	REDUCE	SELL
Total Return including Dividends in 12-month horizon	>20%	5% to 20%	-20% to -5%	<-20%

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The **Analysis and Investment Advisory Department** of RongViet Securities provides research reports on the macro-economy, securities market and investment strategy along with industry and company reports and daily and weekly market reviews.

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