

## Jeju Air (089590)

BUY (Reinstate), TP W40,000

Stock price (Apr 19, KRW)	30,950
Market cap (USD mn)	714
Shares outstanding (mn)	26
52W High/Low (KRW)	37,200/24,300
6M avg. daily turnover (USD mn)	2.3
Free float (%)	23.7
Foreign ownership (%)	4.3
Major shareholders (%)	
AK Holdings Inc. and 9 others	64.7
Jeju Special Self-governing Province	7.6

Yr to	Sales	OP	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE	DY
Dec	(W bn)	(W bn)	(W bn)	(KRW)	(YoY)	(W bn)	(x)	(x)	(x)	(%)	(%)
2015A	608	51	47	1,812	24.6	61	22.1	13.0	4.5	30.2	1.0
2016A	748	59	53	2,045	12.8	73	12.3	4.6	2.4	21.1	2.0
2017F	931	78	69	2,609	27.6	97	11.9	4.8	2.5	23.0	1.9
2018F	1,100	96	83	3,143	20.5	124	9.8	3.3	2.1	23.1	1.9
2019F	1,275	116	99	3,747	19.2	153	8.3	2.2	1.7	22.7	1.9

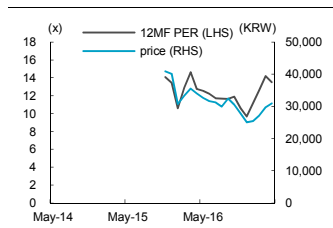
Note: NP in equity-method accounting

## Running in the sky

## Performance

	1M	6M	12M
Absolute (%)	10.1	0.8	(12.2)
Rel. to Kospi (%p)	11.4	(4.0)	(18.5)

## 12MF PE trend



**Recommend sector top pick:** We reinstate coverage of Jeju Air, a trendsetter in practical travel spending, with BUY and a TP of W40,000 (15.4x 2017F PE). We applied a 20% premium to the average multiple of Asian low-cost carrier rivals given the brisk passenger demand and its status as the leading domestic low-cost carrier. Jeju Air's EPS is forecast to achieve 22% CAGR through 2019 and our target PE is ~19% discounted to Chinese low-cost carriers with similar EPS growth.

**A low-cost carrier on the next level:** As a leading low-cost carrier, Jeju Air is stoking up consumer sentiment for overseas travel to create demand that outstrips the increase in supply. In 2017, the company's available seat kilometres (ASK) and revenue passenger kilometres (RPK) should grow 26.8% YoY and 28.4% YoY, respectively, driving up the passenger load factor by 1.1%p. Its passenger traffic (paying + transit passengers) should break the 10mn barrier, a first among low-cost carriers. In addition, the company should solidify its no. 1 position with passengers achieving 15% CAGR through 2019 (market 8%). Backed by an industry-leading passenger load factor, Jeju Air operates a single type of aircraft that helps increase operating efficiency. And with the addition of supplemental revenue, steady profit growth should continue. Despite higher oil prices in 2017, unit costs excluding fuel should shrink 6% YoY while OP jumps 33% YoY.

**A low-cost carrier with economies of scale:** As Jeju Air achieves economies of scale, it should continue to deliver better profitability compared to rivals. Jeju Air's international passenger traffic has achieved 40% CAGR over the past five years. The carrier introduced its 28<sup>th</sup> aircraft in March and plans to add four more in 2017. Unlike its rival Jin Air that has introduced larger aircraft, Jeju Air is sticking with a single type (B737-800) optimized for short-haul routes. As the company continues to bulk up, it would be able to cut unit costs. And regarding aircraft leases, it would gain a stronger bargaining power to help lighten the lease cost burden. There are also greater business opportunities that arise from the company's overall growth. In 2017, Jeju Air plans to fully launch Value Alliance, an airline alliance comprising only low-cost carriers, with Cebu Pacific, Nok Air and others. As such, the company should make a bigger impact in Southeast Asia as well as Oceania.

**Stable profit is worth noting:** Since its NP turned upward in 2011, the company has steadily earned a profit every year. And despite volatile external variables and the Middle East respiratory syndrome outbreak in 2015, it has been profitable for the past 10 straight quarters. Given its limited reliance on debt, the non-operating bottom line (interest cost or FX-translated loss) is less volatile. The OP per RPK should continue to rise. The company plans to stick with a single type aircraft going forward. This means as it continues add planes, the lease cost burden would

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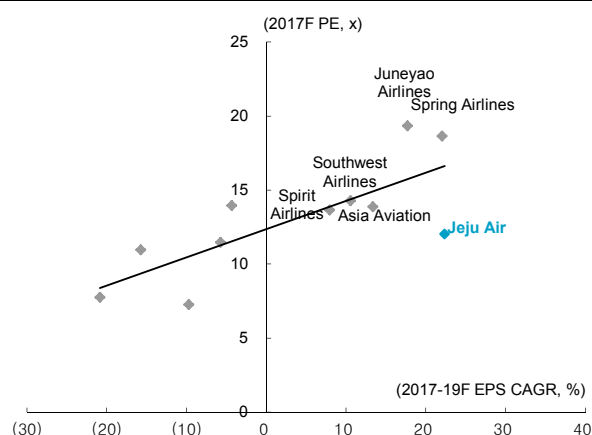
lighten. Moreover, the company is trying to address profit divergence during off-peak seasons by expanding additional revenue. Considering Korean Air has been spilling red ink for the past four years, the fact that Jeju Air's PE is even worth mentioning offers a valuation premium for the low-cost carrier.

**Table 8. TP W40,000**

(W bn, x, mn shares, KRW, %)

	Value	Note
2017F controlling-int. NP (A)	69	
<b>Target PE (B)</b>	<b>15.4</b>	<b>20% premium to global low-cost carrier peer avg. of 12.9x</b>
EV (C=A*B)	1,056	
Shares (D)	26.3	
<b>TP (C/D)</b>	<b>40,176</b>	
Current price	30,950	April 19 close
Upside	29.2%	

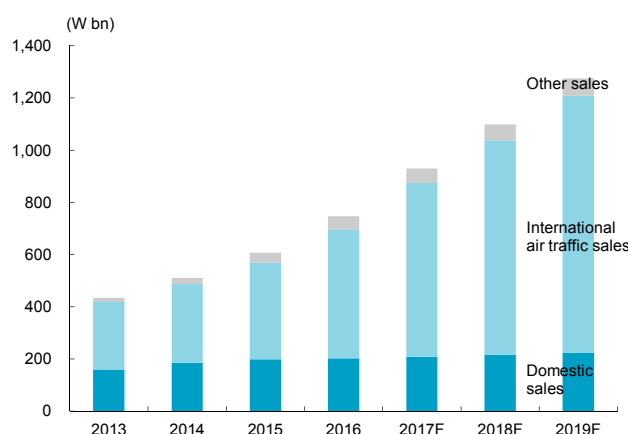
Source: Korea Investment &amp; Securities

**Figure 57. Target 15.4x PE reflects 19% discount to Chinese low-cost carriers**

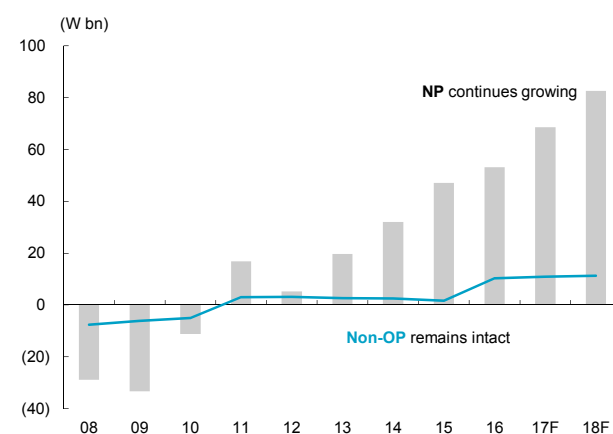
Source: Bloomberg, Korea Investment &amp; Securities

**Figure 58. PE band**

Source: Quantiwise, Korea Investment &amp; Securities

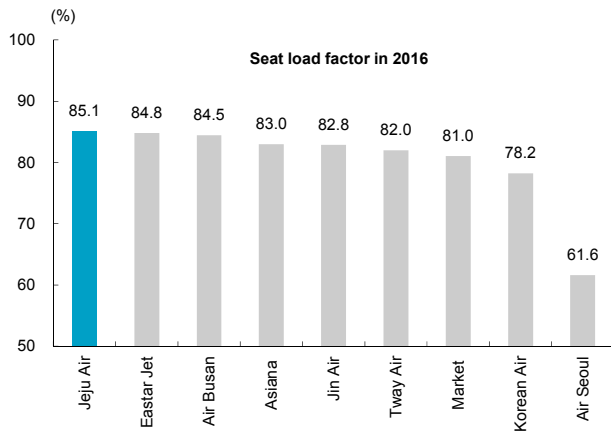
**Figure 59. Strongest top-line growth in domestic air transport industry**

Source: Company data, Korea Investment &amp; Securities

**Figure 60. Firm profitability protection compared to wild market volatility**

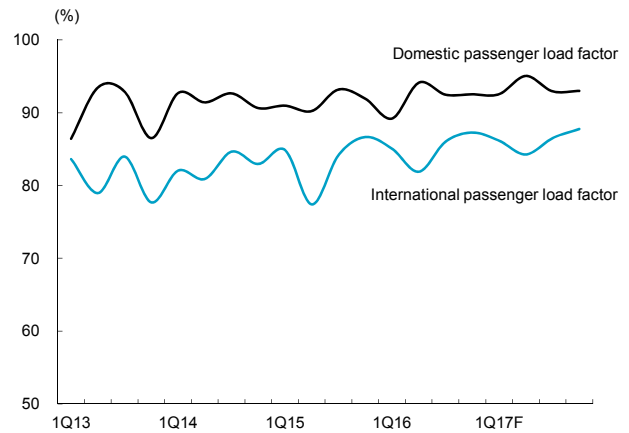
Source: Company data, Korea Investment &amp; Securities

**Figure 61. Industry-high passenger load factor**



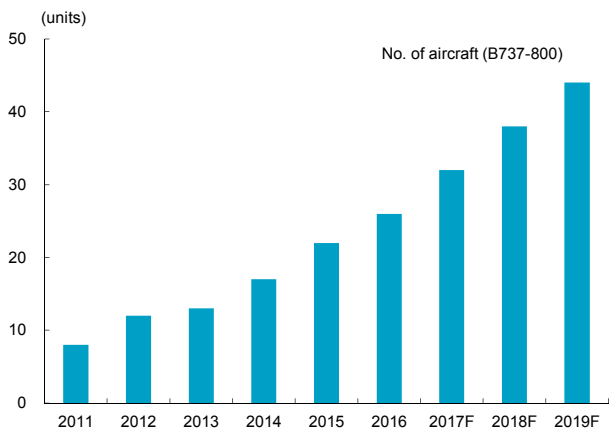
Source: Ministry of Land, Infrastructure & Transport (MOLIT), Korea Investment & Securities

**Figure 62. Regained cost control post-2016**



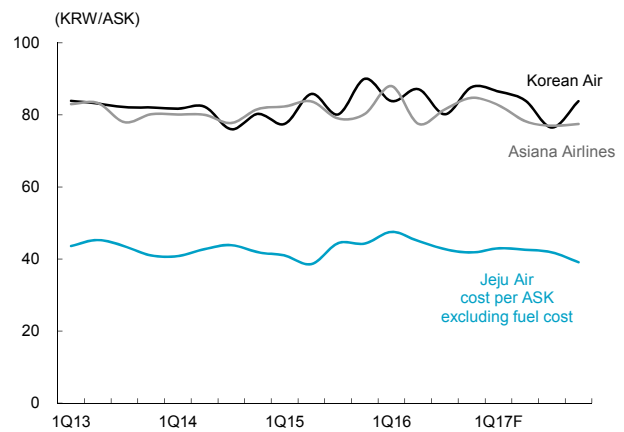
Source: Company data, Korea Investment & Securities

**Figure 63. Economies of scale via single type aircraft**



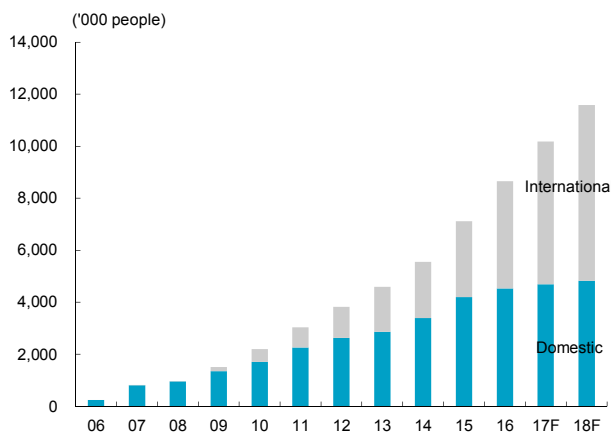
Source: Company data, Korea Investment & Securities

**Figure 64. Easing seasonality via more additional sales**



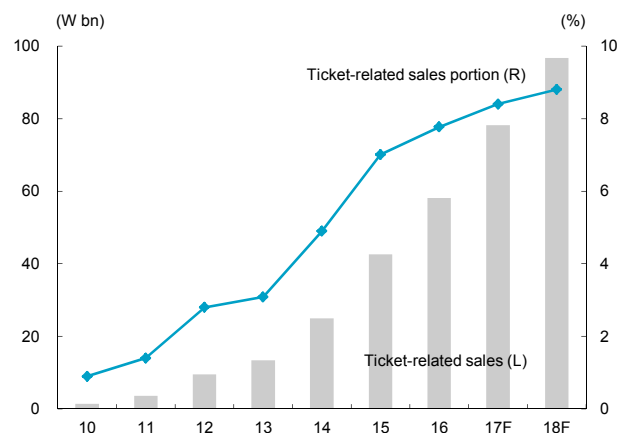
Note: Based on operating cost/ASK excluding fuel  
Source: Company data, Korea Investment & Securities

**Figure 65. Passenger traffic growth**



Source: Company data, KCA, IIAC, Korea Investment & Securities

**Figure 66. Additional sales continue to grow**



Source: Company data, Korea Investment & Securities

Table 9. Earnings outlook

(W bn, mn km, KRW, %, % YoY)

	2016				2017F				Full-year			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2015	2016	2017F	2018F
<b>Sales</b>	<b>173</b>	<b>162</b>	<b>222</b>	<b>191</b>	<b>229</b>	<b>198</b>	<b>270</b>	<b>234</b>	<b>608</b>	<b>748</b>	<b>931</b>	<b>1,100</b>
Domestic	42	53	62	46	41	56	65	48	199	203	209	217
ASK (mn)	551	578	635	584	514	599	654	608	2,186	2,365	2,374	2,443
RPK (mn)	492	544	588	541	475	572	614	565	2,003	2,182	2,226	2,286
Load factor (%)	89.2	94.1	92.5	92.5	92.5	95.5	93.8	93.0	91.6	92.2	93.8	93.9
Yield (KRW)	85.3	98.0	105.5	84.4	86.1	100.0	107.6	86.1	99.4	93.0	95.6	96.4
International	120	98	148	129	176	130	192	168	371	494	666	822
ASK (mn)	2,158	2,251	2,679	2,819	3,237	2,858	3,402	3,580	7,629	9,831	13,078	15,933
RPK (mn)	1,835	1,843	2,304	2,460	2,789	2,409	2,943	3,142	6,354	8,342	11,282	13,826
Load factor (%)	85.1	81.9	86.0	87.3	86.2	84.3	86.5	87.8	83.3	84.9	86.3	86.8
Yield (KRW)	65.6	53.0	64.1	52.3	63.3	53.9	65.1	53.4	58.4	59.8	59.0	59.5
Others	11	11	12	16	12	13	13	18	38	50	56	61
<b>Sales chg.</b>	<b>19.9</b>	<b>13.8</b>	<b>33.0</b>	<b>23.3</b>	<b>32.4</b>	<b>22.4</b>	<b>21.7</b>	<b>22.5</b>	<b>19.1</b>	<b>23.0</b>	<b>24.5</b>	<b>18.1</b>
Domestic	(1.3)	5.5	6.3	(4.6)	(2.3)	5.0	4.5	4.5	7.1	1.9	3.2	3.5
ASK (mn)	11.8	6.8	7.6	4.1	(6.8)	3.5	3.5	4.0	23.3	8.2	0.4	2.5
RPK (mn)	9.6	11.4	6.7	4.8	(3.3)	4.5	4.0	4.5	23.1	8.9	2.0	2.7
Load factor (%)	(1.8)	3.9	(0.7)	0.6	3.3	0.9	0.5	0.5	(0.1)	0.6	1.5	0.2
Yield (KRW)	(10.0)	(5.2)	(0.4)	(9.0)	1.0	2.0	2.0	2.0	(13.0)	(6.5)	2.8	0.8
International	28.9	18.1	49.6	33.5	46.5	32.9	29.8	30.4	22.9	33.2	34.6	23.5
ASK (mn)	26.0	16.6	38.0	37.8	50.0	27.0	27.0	27.0	34.6	28.9	33.0	21.8
RPK (mn)	26.3	23.4	41.0	38.8	52.0	30.7	27.7	27.7	35.6	31.3	35.2	22.5
Load factor (%)	0.2	4.5	1.8	0.6	1.1	2.4	0.5	0.5	0.6	1.6	1.4	0.5
Yield (KRW)	2.1	(4.3)	6.1	(3.8)	(3.6)	1.7	1.6	2.1	(9.4)	2.3	(1.3)	0.8
Others	27.4	20.8	24.3	57.0	10.0	12.9	10.1	10.8	66.6	33.2	10.9	8.8
<b>Operating costs</b>	<b>158</b>	<b>161</b>	<b>183</b>	<b>186</b>	<b>208</b>	<b>193</b>	<b>227</b>	<b>224</b>	<b>557</b>	<b>689</b>	<b>853</b>	<b>1,004</b>
Chg.	28.3	21.1	22.4	23.7	32.3	19.8	23.5	20.4	15.7	23.8	23.8	17.7
Fuel	29	34	42	44	47	46	57	61	143	149	211	261
Chg.	(11.2)	(9.6)	11.4	25.6	64.3	34.4	35.4	37.0	(13.8)	4.2	41.2	23.7
Labor	26	26	28	33	34	30	34	39	80	112	136	159
Rent	26	27	28	28	35	33	33	33	85	109	134	156
Maintenance	21	21	23	21	24	23	25	23	67	85	94	104
Others	55	53	63	61	68	61	78	70	181	233	277	325
<b>OP</b>	<b>16</b>	<b>1</b>	<b>38</b>	<b>4</b>	<b>21</b>	<b>5</b>	<b>43</b>	<b>9</b>	<b>51</b>	<b>59</b>	<b>78</b>	<b>96</b>
Chg.	(27.8)	(93.0)	127.4	7.7	32.9	679.5	12.9	118.4	74.2	14.1	33.1	22.8
OPM	9.0	0.4	17.2	2.2	9.0	2.5	16.0	4.0	8.5	7.8	8.4	8.7
EBT	15	6	38	10	21	5	48	15	53	69	89	107
Chg.	(26.9)	(59.0)	153.9	247.4	34.8	(8.0)	27.0	48.7	65.6	30.2	28.9	20.5
<b>Controlling-int. NP</b>	<b>12</b>	<b>5</b>	<b>28</b>	<b>8</b>	<b>16</b>	<b>4</b>	<b>37</b>	<b>11</b>	<b>47</b>	<b>53</b>	<b>69</b>	<b>83</b>
Chg.	(43.0)	(59.0)	126.9	254.4	33.3	(10.6)	30.2	40.3	47.3	12.8	28.9	20.5

Source: Company data, Korea Investment &amp; Securities

### Company overview

Jeju Air is a low-cost carrier founded in 2005. The company has emerged as Korea's top low-cost carrier that accounts for 6% of the international routes market based on passengers and 15% of domestic as of 2016. The company started its first Jeju-Gimpo route in 2006 and built experience in domestic flights to make inroads to the international arena with its Jeju-Hiroshima route in 2008. Compared to Korea's two national carriers, Jeju Air features a more flexible and simple business structure, which enables the company to adopt diverse marketing strategies. The company continues to improve profitability via cost control efforts.

- Revenue passenger kilometres (RPK): The airline industry's method to measure passenger volume, calculated by multiplying the number of paying passengers by the distance traveled
- Available seat kilometres (ASK): The airline industry's method to measure carrying capacity, calculated by multiplying the number of available seats by the distance traveled
- Load factor (L/F): Occupancy rate to supply, calculated by dividing RPK/FTK by ASK/AFTK

**Balance sheet**

FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
Current assets	355	437	490	578	671
Cash & cash equivalents	126	167	208	246	285
Accounts & other receivables	31	29	38	45	52
Inventory	6	8	10	11	13
Non-current assets	122	164	226	265	313
Investment assets	1	9	12	14	16
Tangible assets	41	59	96	111	135
Intangible assets	12	12	15	18	20
Total assets	478	600	716	843	984
Current liabilities	200	261	307	352	395
Accounts & other payables	65	90	112	133	154
ST debt & bonds	20	20	26	37	41
Current portion of LT debt	0	0	0	0	0
Non-current liabilities	46	67	84	99	115
Debentures	0	0	0	0	0
LT debt & financial liabilities	0	0	0	0	0
Total liabilities	246	328	391	451	510
Paid-in capital	130	131	131	131	131
Capital surplus	88	89	89	89	89
Other reserves	1	0	0	0	0
Retained earnings	14	51	104	171	254
Shareholders' equity	232	272	325	392	475

**Income statement**

FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
Sales	608	748	931	1,100	1,275
COGS	486	602	745	877	1,013
Gross profit	122	146	186	223	262
SG&A expenses	71	87	108	127	146
Operating profit	51	59	78	96	116
Financial income	4	11	12	12	12
Interest income	2	2	3	3	4
Financial expenses	6	2	2	2	2
Interest expenses	0	0	0	1	1
Other non-operating profit	4	1	1	1	1
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	53	69	89	107	128
Income taxes	6	16	20	25	29
Net profit	47	53	69	83	99
Other comprehensive profit	(4)	(5)	0	0	0
Total comprehensive profit	43	48	69	83	99
EBITDA	61	73	97	124	153

**Cash flow**

FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
C/F from operations	72	117	100	120	148
Net profit	47	53	69	83	99
Depreciation	7	11	14	23	31
Amortization	2	4	4	5	6
Net incr. in W/C	5	39	(4)	(5)	(3)
Others	11	10	17	14	15
C/F from investing	(152)	(69)	(49)	(77)	(97)
Capex	(41)	(30)	(51)	(38)	(55)
Decr. in fixed assets	17	0	0	0	0
Incr. in investment	(121)	(38)	(2)	(2)	(2)
Net incr. in intangible assets	(0)	(1)	(7)	(8)	(9)
Others	(7)	0	11	(29)	(31)
C/F from financing	127	(7)	(10)	(5)	(12)
Incr. in equity	108	3	0	0	0
Incr. in debt	19	0	6	11	4
Dividends	0	(10)	(13)	(16)	(16)
Others	0	0	(3)	0	0
C/F from others	1	1	0	0	0
Increase in cash	48	42	41	38	39

Note: K-IFRS (non-consolidated)

**Key financial data**

FY-ending Dec.	2015A	2016A	2017F	2018F	2019F
Per-share data (KRW)					
EPS	1,812	2,045	2,609	3,143	3,747
BPS	8,948	10,351	12,359	14,902	18,049
DPS	400	500	600	600	600
Growth (%)					
Sales growth	19.1	23.0	24.5	18.1	16.0
OP growth	74.2	14.1	33.1	22.8	20.9
NP growth	47.3	12.8	28.9	20.5	19.2
EPS growth	24.6	12.8	27.6	20.5	19.2
EBITDA growth	61.3	18.9	33.4	27.7	23.8
Profitability (%)					
OP margin	8.5	7.8	8.4	8.7	9.1
NP margin	7.8	7.1	7.4	7.5	7.7
EBITDA margin	10.1	9.7	10.4	11.3	12.0
ROA	12.7	9.9	10.4	10.6	10.8
ROE	30.2	21.1	23.0	23.1	22.7
Dividend yield	1.0	2.0	1.9	1.9	1.9
Dividend payout ratio	22.0	24.7	23.0	19.1	16.0
Stability					
Net debt (W bn)	(248)	(325)	(349)	(405)	(472)
Debt/equity ratio (%)	10.5	7.5	8.1	9.5	8.7
Valuation (x)					
PE	22.1	12.3	11.9	9.8	8.3
PB	4.5	2.4	2.5	2.1	1.7
EV/EBITDA	13.0	4.6	4.8	3.3	2.2

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BUY	Hold	Underweight (Sell)
77.4%	21.7%	0.9%

Note: % of companies under coverage with this rating

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