Company: **EFG Hermes Holding SAE**

Conference Title: **Jazeera Airways Q3 2018 Call**

Moderator: **Hatem Alaa**

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Operator: Good day, and welcome to the Jazeera Airways' Third Quarter 2018 Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Hatem Alaa. Please go ahead sir.

Hatem Alaa: Hello everyone. This is Hatem Alaa from EFG Hermes. And welcome to Jazeera Airways 3Q 2018 Results Conference Call. I'm pleased to have on the call today, Rohit Ramachandran, the Company's CEO; and Krishnan Balakrishnan, the Company's VP for Finance. I'll now hand over the call to the management for a quick presentation on the results. That will be followed by Q&A session. Gentlemen, please go ahead.

Rohit Ramachandran: Thank you, Hatem, and good afternoon, everyone. It gives me great pleasure to welcome you all to Jazeera Airways webcast for the third quarter and the first nine months of 2018. Today, we are slightly changing the format of the call compared to earlier webcasts. I would like to thank EFG Hermes for hosting this call. I hope most of you have had a chance to review the earnings presentation that was uploaded a little earlier. In case, you haven't, I would like to direct you to the Investor Relations section of our website and quickly download it. We can go along the presentation together slide-by-slide, and, thereafter, would be happy to take your questions.

The third quarter is generally the busiest for airlines within the region. And this year was characterised by the April summer rush falling within this period. The steady and substantial increase in fuel prices during the period placed an extra burden on airlines compared to last year.

An aggressive, and in case – in some cases, irrational competition by some carriers also played a role in dampening yields.

You will see, also, as we go along through today's presentation, the latest update regarding Jazeera Terminal, which has shown a steady improvement in operational statistics, as well as customer experience during this period.

Let's move on to slide #4. The airline posted a significant improvement in seat factor, which is a percentage of occupied seats, which reached 80% for the quarter, an improvement of 4.2% over the same period last year. We carried a total of 615,000 passengers during the quarter, which was 37.2% more than Q3 in the previous year, demonstrating that we increased our market share on most key routes.

Yield, which is a function of the average fare paid per passenger, saw a decline at KWD 47.5 compared to almost KWD 49 in the previous year. The increase in utilisation from 13.5 hours per aircraft per day last year to almost 15 hours in Q3 of 2018 ensured far better utilisation of the aircraft asset than in earlier years, and improving the efficiency to industry-leading standards.

Let's move to slide 5. The airline posted as strong revenue result of KWD 29.2 million for the third quarter, which was 33.5% higher than the same period last year. Jazeera also posted an operating profit of KWD 7.6 million, which was a reduction of 8.4% compared to the same period last year.

Similarly, the net profit of the company was at KWD 7.1 million, which was 14% lower than last year. There are three main reasons for the profit in Q3 to be slightly lower than expected. First, the steady and significant increase in oil prices rise through the year, which went from $58 a barrel in Q3 of last year to $83 per barrel in Q3 of this year, meant that we had to take an additional hit in operating costs of KWD 1.6 million on oil prices alone.

Second, as mentioned briefly during my last webcast three months ago, we faced some operational and engineering-related disruptions in July and August, were hit with a one-off costs of KWD 727,000 as a result. And third, we took on some additional start-up costs associated with the operationalisation of the Jazeera Terminal, which are nonrecurring in nature and this resulted in an operating loss for this division of KWD 123,000.

Considering just the last two points alone, and without including the impact of fuel, the adjusted operating profit moves up to KWD 8.5 million and the net profit moves up to KWD 8.1 million, and these numbers are in line with last year.

Let’s move to slide 6. For the first nine months, the picture is better. The airline posted a strong revenue result of KWD 63.6 million, which was 38.4% higher than the same period last year. The airline posted an operating profit of KWD 8.9 million, a decrease of 5% compared to last year. Similarly, the net profit of the company was KWD 8.5 million, which was a decline of 11% compared to last year.

As I mentioned in the last slide, considering the impact of the operational disruptions and the terminal start-up costs alone, without including the impact of fuel, the adjusted operating profit moves up to almost KWD 10 million, which is 3.2% better than last year.

One word on competition. The first nine months of this year was characterised by several new competitors on key routes that try to eat into Jazeera’s market share. These included Wataniya Air Arabia Egypt and Indigo from India. We adopted a very aggressive approach to these attacks and decided to get into whatever necessary fare war in markets that we wanted to protect in order to take care of our turf.

While this resulted in a temporary hit on our yields, as seen earlier, we managed to knock several competitors from key routes to Egypt and the GCC, and the summer also saw the suspension of the other Kuwaiti private airlines. We are now better placed to raise yields and are already seeing positive results in October and beyond. Keeping the impact of fuel, yields, terminal expenses and competition in mind, I am pleased to announce these results.

Let's move onto slide 7. Two key components of our revenue also showed a significant improvement this quarter. E-commerce revenue and ancillary salary are very important for any low-cost carrier and its revenue mix. For the first nine months, e-commerce and Internet sales grew by almost 40%. Ancillary revenue grew by 42%. Both these elements will continue to be a big focus for the company in the months ahead.

Let's now move on to slide 8. Some other key highlights during the quarter that you might be interested in have been reflected on this slide. Effective next week, we will begin rolling out Jazeera Screens. This is a Wi-Fi-based in-flight entertainment system which will enable passengers to stream a wide variety of movies, TV shows, music, flight information and surveys to their own phones and tablets. We also have monetised the service by selling advertising.

The Indian monsoon season saw Kochi Airport, one of our lucrative Indian routes, submerged and non-operational for two weeks. This had a modest impact on our revenue performance. Another point I would like to highlight is that one of our flights into Hyderabad in July experienced an engine issue, which was coincidently a brand-new engine, which required an unplanned engine change in Hyderabad. Unfortunately, during this process, the maintenance organisation there damaged certain flight surfaces of our aircraft, which put the aircraft out of action for three weeks during the busiest time of the year. All this had some impact on our revenue performance during the quarter.

Let's move on to slide 9. I thought it would be interesting to share some network highlights with you all this afternoon. This slide shows all our destinations that we operate to. However, I have highlighted the new routes launched in the last one year and how we have moved into a dominant position in terms of market share. Also, all these routes are outperforming their business plans and are operationally profitable. Before the end of this year, we will also be adding four services a week into New Delhi in India.

Let's move to slide 10. To update you about our fleet, this year we added, as you know, two aircraft to our fleet. This includes the first A320 neo aircraft in the region, thus bringing our fleet to nine aircraft. While on the subject to neos, we have completed an analysis on our first neo to see if it is really delivering the fuel savings as advertised by the manufacturer. I am happy to note that our neo is delivering a fuel saving of 18% to the average of the rest of the fleet. We have also signed agreements with lessors for three additional neos to be delivered in the second half of next year. Barring any delays from Airbus, we should get the benefit of these airplanes in time for our summer peak of 2019.

Let's move to slide 11. The Jazeera Terminal, officially called T5, has served 900,000 passengers until the end of September, and all Jazeera passengers departed and arrived into our terminal in Q3. The duty-free opened two weeks ago and received very favourable reviews from our passengers. Additional F&B outlets and retailers such as Costa, Starbucks, Slim Chickens, Café Supreme, Al Rifai Nuts, and Swatch have signed up and are working on completing their outlets. Modern and functional business class lounge for Jazeera passengers is also under construction and should open in the next four weeks. Most interestingly, both immigration and security formalities take less than three minutes per passenger on average, and this is well received by our customers.

That concludes my part of the presentation. I now hand you over to our newly appointed VP, Finance, Mr Krishnan Balakrishnan to review the financials in detail. Over to you, Krishnan.

Krishnan Balakrishnan: Thank you, Rohit. Good afternoon to everybody, and thank you for joining us on this call. Quite happy to be part of this call for the first time and look forward to working with all of you in the future as well.

Let me quickly take you to the quarter three results. The highlights have already been covered by Rohit. So, I will not dwell on those. But in terms of the capacity, we increased the fleet from seven to nine, as mentioned earlier, about 29% increase.

We started flying to 25 destinations as compared to 18 in the same quarter last year. Our seat capacity increased by 36.5% year-over-year. The passengers increased by 37.2%, that's primarily because we did very well on the seat factor despite adding a lot of new flights in this network.

In terms of block hours[?], we did 43% more than last year. Now this has been possible because of the additional aircraft and also the utilisation, which has increased year-over-year. So, not only have we enhanced the capacity by better using our aircraft. We have also managed to fill every flight better, thereby optimising, or at least, reaching high level of utilisation of the aircraft.

So, the operating revenues for the quarter were about 33.4% more than the previous year. The expenses, operating, were about 58.8% more. However, if you were to take out the impact of the fuel price increase, which was beyond our control, and the one-time disruptions – the cost related to the disruptions, which Rohit spoke about a little earlier, of about KWD 0.8 million, and the losses of the terminal being the first full quarter of operation of about KWD 100,000 for the quarter alone. If you remove all of that, the increase of cost over previous year would have been only 40.1%, which is lower than our increased operations in terms of block hours of 43%. The net profit of course was lower, which already Rohit has covered, because of the reason beyond our control.

Let me take you to the nine monthly results, which you can see on the slide 13. So, our operating revenues were higher by 38.4%. The expenses were higher by 49.9%. Profit was lower by 5.9% and the net profit even lower by 11.2%.

Now, the revenues we have already covered that. The yield could have been better. The seat factor, of course, was better in this year. It was 1.7% better than the previous year. We also had higher utilisation for the YTD of almost 23.6% because in the earlier part of the year in 2017, it was much lower, and it has increased towards the end. So, if you see the nine months results, the utilisation was higher by 23.6% on a per day basis per aircraft.

So, if you remove the impact of all the exceptional items, which is primarily the fuel-price increase impact of about 3.4% for the nine months, the one-time disruption cost of almost KWD 1 million for the nine months' period and the terminal losses of about KWD 300,000 for the first nine months, if you remove all of those, the cost is well within the increased capacity impact. So, if you look at the drivers, obviously, we have done better in terms of the cost. Revenues, except for yields, we have done much better, and overall, definitely, the results are better than what we did in the previous year.

If you look at the balance sheet, the current assets have gone down by 26%. That's primarily driven by the fact that we paid out dividend of about KWD 7 million earlier in 2018. And also, we have funded the entire terminal building construction from our internal resources. The non-current assets have increased by about KWD 10 million, because we capitalised the terminal building during 2018. And that was – the cost was just over KWD 10 million for that. The security deposits we have paid to aircraft lessors for the 2019 deliveries have also added to the increase in the non-current asset. The trade liabilities have increased by approximately KWD 4 million but mostly because of the level of operations having gone up. The debt and the equity remained at the same levels as 2017, a very marginal change because of the results movement. The debt remains at zero and we continue to have a strong balance sheet as we have had in the last few years.

With that, I conclude – I would just like to highlight one more point. If you see the trend of the fuel on slide 14, the fuel prices have been going up from 2016 beginning of '16 up to this latest quarter. However, if you look at the yield graph on slide number 13, we are not able to pass on the impact of the increase in fuel price to the passenger, thanks to the unhealthy competition, which Rohit adhered to[?] earlier.

So, if you look at, this is a unfortunate fact today, but things are looking up. We believe we will be able to improve this in future. So, with that, I will conclude my part of this presentation and we are happy to take any questions that you may have.

Operator: Thank you. If you would like to ask a question over the call today over the telephone, please signal now by pressing star one on your telephone keypad. That's star and one to ask a question. We will pause for one moment to allow everyone to signal. We can now take the question on the line from Angad Dugal from The National Investor. Please go ahead.

Angad Dugal: Good afternoon, and thank you for hosting this call. My first question is, I think, just the question that's on everyone's mind. What is your oil hedging strategy going forward? Are you going to implement any hedging? And my second question is, what percentage of the terminal is currently leased out to the tenants? Are they enjoying any concessions on the rent at the moment? Thank you.

Rohit Ramachandran: Sure. I'll answer both those questions in order. At the moment, Jazeera Airways does not hedge for fuel because of three main reasons. One, we consider this not to be a favourable environment for hedging as things stand right now. Most importantly, we get – we have a booking pattern which is very close to the day of departure, which means the vast majority of our bookings come in very close to the day of departure, which means we don't have too many bookings locked in well in advance, hence we have the ability to reprice and quote to the customer after taking into account any variations in fuel prices, except for the last week or two weeks before departure.

And lastly, with the number of fuel-efficient A320 neos joining our fleet, that in itself becomes a natural hedge. This has been our policy so far. However, next year with the fleet growing with some of the routes also increasing in length and more being at stake with regard to exposure to fuel price movements, we are studying the matter and it is possible that in the year ahead a part of the fuel uplift that we make outside of Kuwait, a percentage of that we may hedge.

To answer your second question, as we stand today, every single air side spot in the terminal has been leased, and some of the lessors for those spots, I mentioned during my speech a little bit earlier on. We still have some spaces available land side, which is before immigration and security. We're just waiting for some additional clearances from the municipality, and there are people waiting to take those lease spaces as well. Now I'll take the next question.

Angad Dugal: Thank you.

Operator: Next question comes from Rene Selouan from Jadwa Investments. Please go ahead.

Rene Selouan: Hello, thank you for the call. We'd like to ask about an update on the fuel subsidy in Kuwait. Is there any update in that regard?

Rohit Ramachandran: There is no fuel subsidy as such. We have a volume discount that is given to airlines operating above a certain threshold. At the moment, coincidently, just Kuwait Airways and [inaudible] managed to reach that volume discount, which is approximately 20% discount in fuel. That continues to this day and is likely to continue for the foreseeable future. Thank you.

Rene Selouan: Thank you.

Operator: We can now take our next question from Chadi Moubarak from BCM. Please go ahead.

Chadi Moubarak: Yes, hi. Thanks for taking the call. Three questions from my end. First, does the company have a rough target for next year's EBITDA from the terminal, and how much is visible or highly visible based on what you've already secured in terms of contracts?

Second, is that target the steady state or could it grow meaningfully and how?

And finally, when I look at publicly-listed few players for some terminals with exposure to passenger growth, like let's say Sydney Airport or Airport of Thailand, they trade above 30 times earnings. Given that you're known as an airline, there is a risk that the market doesn't give you full value for the terminal. If that happens, would you be open to any value unlock[?] exercise to make sure the value of the airport reflected in the share price?

Rohit Ramachandran: Thank you. I'm not sure I've heard your second question correctly, but I think my colleague is turning – taking notes and I will refer to that. Let me start with the first question. Whether it's for the terminal or for the airline, we don't, as a matter of policy, give forecasts. This has been our policy for many years. And while we try and give you as much visibility about our current performance and even some outlook regarding operational and strategic issues, we don't give financial forecast. In terms of the – I think your second question referred to the area that has been leased out already. Am I right?

Chadi Moubarak: Yeah, exactly.

Rohit Ramachandran: As I mentioned to the last analyst who posed a question, 100% of the area on the air side which is both immigration and customs have been leased out. And a large proportion on the land side has also already been leased out. There are still area available land side, but we are holding them back until we get the necessary municipality approvals. And then I see no issue. I'm very confident of them being leased out at rates that are very acceptable to us.

In terms of how we view the terminal and whether we get all the necessary value in terms of the pricing in of the terminal, currently we view the terminal as a separate business unit. And while this is more a question for the board and the shareholders if I were to make an educated guess on their behalf, we will do whatever is necessary, including at some stage, having this split as a separate company, if it means that we need to extract maximum value from the terminal. Thank you.

Chadi Moubarak: Thanks.

Operator: Again, if you would like to ask a question, please press star one. There are no further questions on the line at this time. I would now like to turn the call back to the host for any additional or closing remarks.

Rohit Ramachandran: Thank you for those who – from all of us at Jazeera, thank you for attending this call, and I look forward to speaking with all of you for the full year results, which will be announced most likely in the first week of February.

I also want to, once again, thank EFG Hermes for hosting this call. The presentation is now available on the website, as I mentioned earlier. And in case any of you have additional questions that occur to you on a deeper review of the presentation, you're most welcome to write in your questions to us at the two contacts mentioned at the end of the presentation. Thank you all, and have a good day.

Hatem Alaa: Thank you, gentlemen, very much. Have a good day everyone.

Operator: That concludes today's conference. Thank you for your participation. Ladies and gentlemen, you may now disconnect.