

High Grade - SAS 6% 2008 (EUR)

Sector: Airline
Recommendation: BUY

International Bonds - 10 October 2001

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Buy SAS 6% 2008 at a very attractive price!

SAS` situation after the terrorist attack on WTC

Expansion in a falling market is difficult and dangerous

SAS had just embarked on the largest expansion in the company's history when the entire aviation industry was hit by the terrorist attack on WTC. Aircraft worth an aggregate USD 1,650m will be delivered in 2001 and 2002, which is not a happy circumstance, given the present market conditions with declining passenger traffic. However, SAS has started a cost-cutting programme to reduce capacity by 12% and the workforce by 1100. In addition, SAS plans to close down five destinations, to ground 16 aircraft, and to raise ticket prices by 5% from 1 October. The capacity reductions are expected to improve the 2002 result by SEK 500m-600m.

SAS was hit particularly hard by the fall in Business Class passengers

Traditionally SAS has a large share of the market for Business Class passengers, and the slowdown in the global economy and the terrorist attack on WTC prompted a significant fall in the travel activities of those passengers. Passenger traffic for September showed a fall of 4.2% in comparison with September 2000. The number of passengers fell by 3.2%. Business Class traffic was down by 16%, and Economy Class traffic up by 1.5%. In view of the economic situation at present in SAS's main markets and the anxiety about new terrorist attacks, there are no prospects of an immediate turnaround.

A lucrative home market and membership of the STAR alliance buoys up SAS

SAS has a very profitable home market, and although the Scandinavian market is comparatively small, it is one of the European regions where earnings per passenger are highest. Also, SAS has a de-facto monopoly in Scandinavia, which also strengthens earnings. Membership of the STAR alliance led by Lufthansa provides a firm bottom under earnings. The North Atlantic routes, which were hit hardest by the terrorist attack on WTC, account for only 6%-7% of passenger traffic revenue, which is much lower than the comparable figures of companies such as British Airways and KLM.

A strong cash position and large net worth will keep SAS out of financial problems

Basically, we find that SAS's financial position will put the company in a good position for weathering the current crisis. SAS has strong holdings of liquid assets which will suffice to cover the liquidity drain generated by the adverse market conditions and the investment in new aircraft. Moreover, SAS has a net worth of about SEK 20bn. This robust basis means that SAS will have good possibilities of taking on more debt without increasing its debt ratio to a critical level in comparison with other European carriers. The table below sets out some figures about SAS's financial situation:

Liquid funds (SEKbn)	EBITDAR (earnings before interest, tax, depreciation, amortization and rent)	Net debt/net worth (%)
12.2	1.5	50.5

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SAS is well consolidated in comparison with the average of European air carriers

Altogether we expect SAS to be able to handle the present crisis. Further capacity reductions will be required if the traffic situation does not revert to normal in the coming months.

Recommendation **We recommend SAS 6% 2008 (EUR) at a very attractive price level**

Name	Coupon	Rating	Maturity	Issue	Yield	Price	Spread	Swap
SAS	6	A3	20/6/08	SEK500m	8.03	89.75	+368	+340

Reason for investing in SAS

The SAS 6% 2008 bond was launched in June at 107 bp above the underlying government bond and 84bp above the mid-swap rate. The present price of the bond corresponds to a rating of BB - which is 5 notches below the present rating. In our view, the present level does not reflect SAS's real financial situation. The following circumstances are in favour of investing in SAS at the present price level:

- large holding of liquid assets (SEK 12.2bn)
- low debt ratio (50.5%)
- membership of a strong alliance (the STAR alliance)
- large market share in a lucrative home market

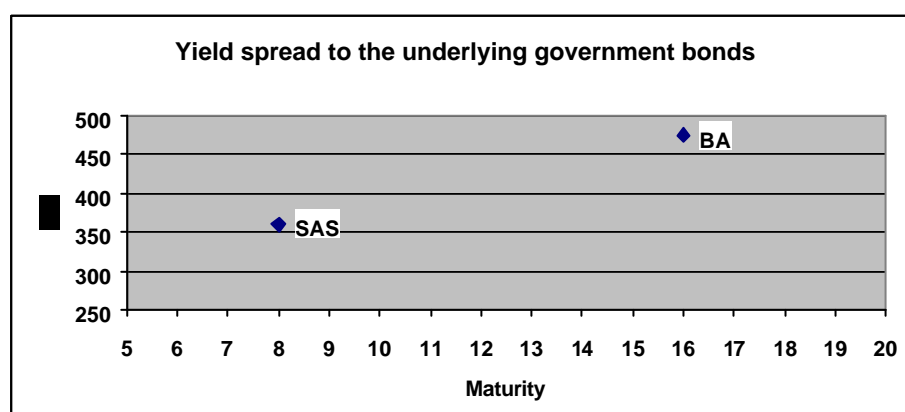
Risk involved in investing in SAS

The risk of investing in SAS at present is limited, in our opinion. The risk can be divided into two elements, credit risk and market risk.

The credit risk appears to be limited, since SAS has a very strong financial position and a low debt ratio. Moreover, its trans-Atlantic routes account for only 6%-7% of total passenger traffic revenue. SAS is also in a very strong position on the home market. The ongoing discussion about the Eurobonus programmes and the fall-out from the scandal of the secret pricing agreement with Maersk Air may have negative consequences for SAS.

Market development over the coming months will be fraught with uncertainty. The airline industry needs an early end to US action in Afghanistan and a turnaround of the global economy.

Yield spread to the underlying government bonds



BA = British Airways, rating BBB+/A3 - on watch for downgrade - this is a 7.25 2016 bond denominated in GBP with coupon step-up/-down of 25 bp triggered by upgrade or downgrade.