

# Interglobe Aviation



## Aiming for higher altitudes

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## InterGlobe Aviation: Aiming for higher altitudes

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### Key terms used throughout the report

#### **ASK: Available Seat Kilometer - The Basic Measure of Capacity**

One seat (empty or filled) flying one kilometer is an ASK

A 180-seat A320 flying 100 kilometers creates 18,000 ASKs

#### **RPK: Revenue Passenger Kilometer - The Basic Measure of Production**

A paying passenger flying one kilometer creates an RPK

150 passengers flying 100 kilometers generate 15,000 RPKs

#### **Load Factor: Production Compared to Capacity**

To calculate the load factor, divide RPKs by ASKs

For an individual flight, 15,000 RPKs divided by 18,000 ASKs, or 83%

Higher load factors are desirable but how much each passenger pays is also important

**Investors are advised to refer through important disclosures made at the last page of the Research Report.**

Motilal Oswal research is available on [www.motilaloswal.com/Institutional-Equities](http://www.motilaloswal.com/Institutional-Equities), Bloomberg, Thomson Reuters, Factset and S&P Capital.

# InterGlobe Aviation

BSE Sensex  
25,252S&P CNX  
7,683

CMP: INR998

TP: INR1,478 (+48%)

Buy



## Stock Info

Bloomberg	INDIGO IN
Equity Shares (m)	360.3
4-Week Range (INR)	1,169/848
1, 6, 12 Rel. Per (%)	34/-/-
M.Cap.(INR b)/(USD b)	359.7/5.4
Avg Val ( INR m)	7,159
Free float (%)	100.0

## Financial Snapshot (INR Billion)

Y/E MAR	2016E	2017E	2018E
Sales	163.1	203.1	244.4
EBITDA	38.0	45.3	54.4
NP	25.9	31.3	38.5
EPS (INR)	71.9	86.9	106.9
EPS Gr. (%)	100.1	20.9	23.0
BV/Sh. (INR)	58.9	93.8	136.8
RoE (%)	203.6	113.9	92.7
RoCE (%)	76.0	77.5	76.7
P/E (x)	13.9	11.5	9.3
P/BV (x)	17.0	10.6	7.3
D.Yield (%)	5.0	4.4	5.4

## Shareholding pattern (%)

As On	Sep-15
Promoter	86.2
DII	5.9
FII	0.0
Others	7.9

FII Includes depository receipts


[Please click here for Video Link](#)

## Aiming for higher altitudes

Unique strategy + leadership credentials = sustainable cash machine

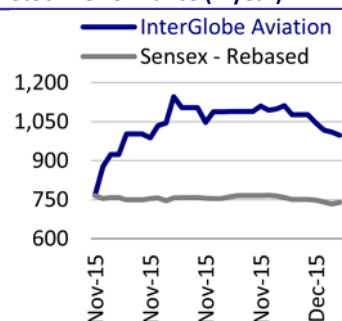
- InterGlobe Aviation-operating the 'IndiGo' brand, the market leader by a distance in domestic aviation, with 34% share-is set to comfortably ride the domestic passenger CAGR of 12% over the next decade, potentially making India the 3rd largest aviation market in the world.
- IndiGo is the only airline in India to be profitable for the last seven years and we believe this sustainable advantage is due to its unique fleet strategy, which significantly reduces its aircraft ownership cost and makes it the lowest-cost operator.
- We estimate EBITDA/PAT CAGR of ~44% over FY15-18 (EBITDA margin expansion of ~900bp), led by (a) continued fleet addition (94 to 154) and (b) passenger CAGR of 21% (load factor at >80%).
- Expect dividend payout to remain high, led by management focus on profitability, negative working capital and unique fleet strategy leading to higher distributable free cash flow.
- Despite our 44% earnings CAGR through FY18, we assign lower FY17E target P/E multiple of 17x (10% premium to comparable global LCC player RyanAir)-owing to high earnings sensitivity to oil prices-to arrive at a fair value of INR1,478 (an upside of 48%).
- On FY17E, the stock currently trades at 11.5x EPS and adj. EV/EBITDAR of 7.4x with an implied dividend yield of >4%. We initiate coverage with a Buy rating.

## Huge growth potential, India one of the most underpenetrated markets

- Despite double-digit passenger CAGR of 12% over the last two decades, the Indian aviation sector is significantly underpenetrated-per capita seats at 0.08 v/s 2.6/1.6 in the US/Canada and average of 0.5 in Brazil, Thailand, Indonesia and China.
- However, India is set to become the 3rd largest aviation market by 2030, driven by (a) value migration from rail to air, (b) increasing per capita GDP and disposable income, (c) growing tourism and (d) favorable aviation policy.
- Compared with the passenger growth estimate of 13% CAGR through FY20, YTD growth has been very robust at 20% (v/s last 5-/10-year CAGR of 9%/13%)-supported by lower ticket prices owing to benign oil prices.

## Indigo, the best aviation franchise, expected to remain market leader by a distance

- IndiGo, a low-cost carrier (LCC) with 94 planes (FY15, 24% fleet share of the Indian market) and operating primarily on domestic routes, has steadily improved its market share from 18% in FY11 to 34% in FY15 and 37% in YTD FY16 through fleet expansions and load factor of >80%.
- Management focus on (a) network depth v/s breadth and (b) on-time and reliable customer experience to bring in repeat customer has resulted in sharp market share gains culminating in leadership position for Indigo, in our view.

**Stock Performance (1-year)**

- We expect Indigo to maintain its leadership position, given the benign competition and planned fleet expansion from 94 to 154 by FY18.

**Unique fleet addition strategy imparts competitive advantage...**

- We believe Indigo's fleet strategy delivers savings on opex and capex and, in turn, acts as its "*secret sauce*" for industry-leading profitability.
- IndiGo's unique fleet strategy to (a) use single-type aircraft (reduces maintenance and training costs) and (b) keep the average fleet age low (3.2 years v/s Jet@5.9, SpiceJet@4.1) improves reliability and lowers fuel costs—thereby giving it a significant advantage over peers. We believe it is difficult for the competitors to replicate the strategy in the short-medium term.
- The company's strategy to place bulk purchase orders significantly reduces its ownership costs as it gets discounts on price; we expect the benefit to continue over the long term—given its fleet expansion plans.

**...which coupled with operating cost leadership, drives industry-leading profitability**

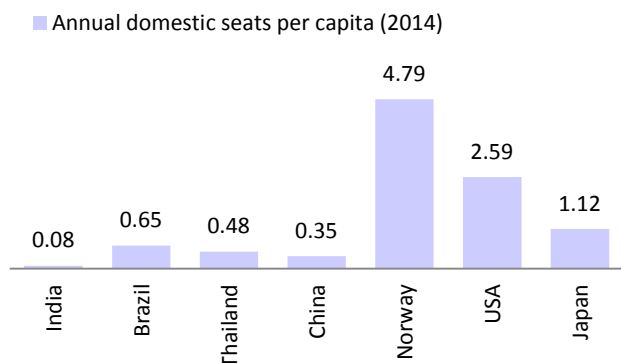
- We expect Indigo's fuel cost leadership over competitors to widen as it gets deliveries of 15% more fuel-efficient A320 neo aircrafts, which are expected to form 33% of Indigo's fleet by FY18.
- Focus on a) high-density routes, (b) consistently high load factor and c) improving aircraft utilization will help it remain the most profitable airline, in our view.
- We estimate EBITDA/PAT CAGR of ~44% over FY15-18, led by revenue passenger kilometer (RPK) CAGR of 21% (v/s 28% in the last four years) and expansion in EBITDA margin from 13.4% in FY15 to 22.3% FY18.

**Valuation and view**

- **Key assumptions:** In our estimates through FY18, we model (a) fleet size growth from 94 in FY15 to 154 in FY18 and (b) load factor (seat utilization) moving from 80% in FY15 to 84% in FY18.
- **Upside to payout assumptions:** Our dividend payout assumption of 60% has an upside risk as the last three years average payout was 91%. Nevertheless, we note that even on our reduced payout ratio assumption, the dividend yield is attractive at >4%.
- **BUY for a ~48% upside:** Despite our 44% earnings CAGR through FY18, we assign lower FY17E target P/E multiple of 17x (10% premium to comparable global LCC player RyanAir) owing to high earnings sensitivity to oil prices to arrive at a fair value of INR1,478 (an upside of 48%). At our target price, implied FY17E EV/EBITDAR stands at 9.7x (v/s 9.6x for RyanAir).
- On FY17E, the stock currently trades at 11.5x EPS and adj. EV/EBITDAR of 7.4x with an implied dividend yield of >4%. Initiate coverage with a Buy.
- **Key risks:** A sharp slowdown in the Indian economy, sudden jump in oil prices, high cash burn strategy by competitors and any adverse regulatory move.

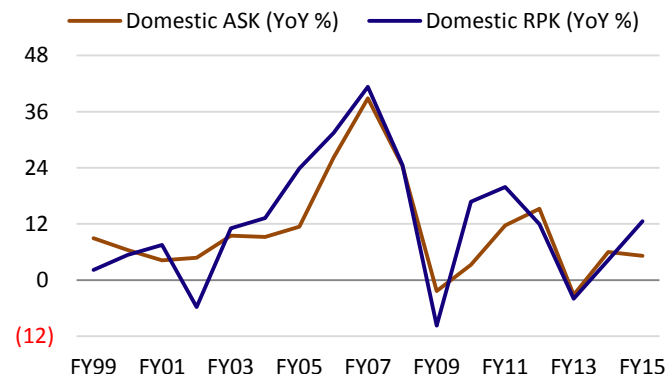
## Story in charts

**Exhibit 1: India aviation underpenetrated despite the last decade domestic passenger CAGR of 12%**



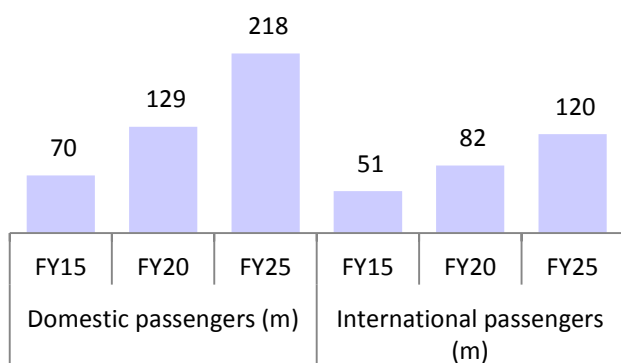
Source: CAPA, Company, MOSL

**Exhibit 2: Domestic aviation: Demand follows supply; RPK growth at 2.3x real GDP growth**



Source: DGCA, MOSL

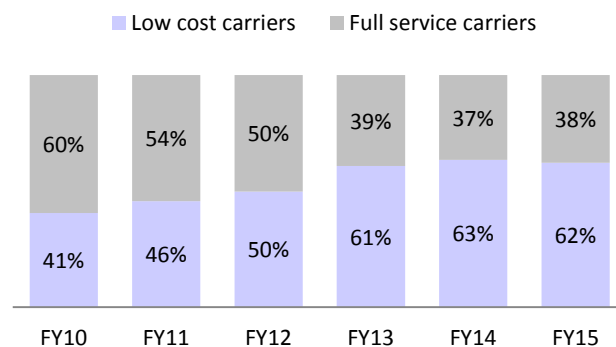
**Exhibit 3: India to be the 3rd largest aviation market by FY25**



Share on basis of future fleet

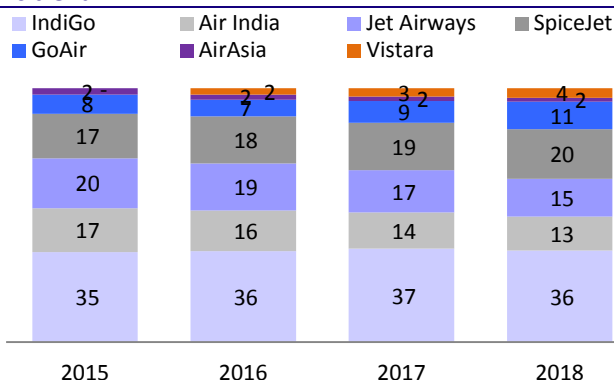
Source: Industry, Company, MOSL

**Exhibit 4: Like globally, value migrating to LCCs even in India**



Source: DGCA, CAPA, Company MOSL

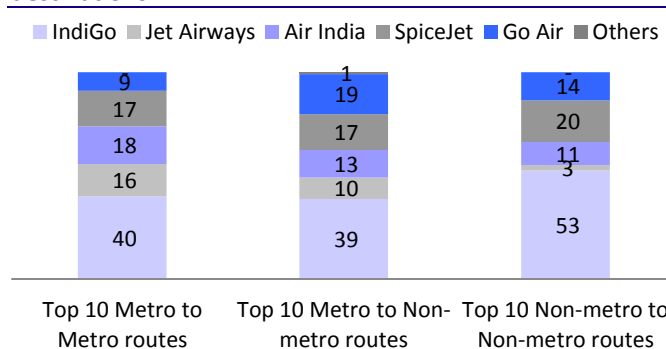
**Exhibit 5: IndiGo, the market leader to benefit most from this trend**



Share on basis of future fleet

Source: Industry, Company, MOSL

**Exhibit 6: Indigo has >50% market share in non-metro destinations**



Source: DGCA, CAPA, Company, MOSL



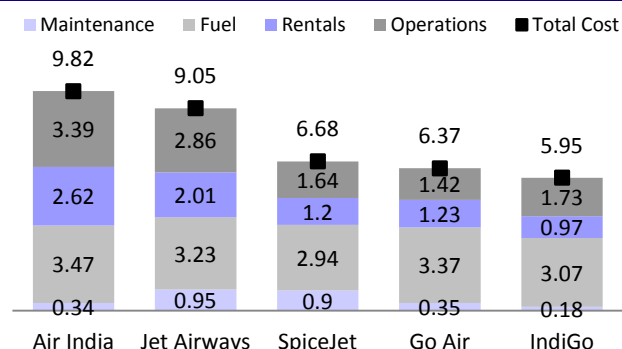
## Story in charts

**Exhibit 7: Continued profitability indicates focus on cost controls**

	FY09	FY10	FY11	FY12	FY13	FY14	FY15
<b>IndiGo</b>	Yes	Yes	Yes	Yes	Yes	Yes	Yes
SpiceJet	No	Yes	Yes	No	No	No	No
Jet Airways	No	No	No	No	No	No	No
GoAir	No	No	Yes	No	Yes	Yes	Yes
Air India	No	No	No	No	No	No	No
Kingfisher	No	No	No	No	Ceased Operations		

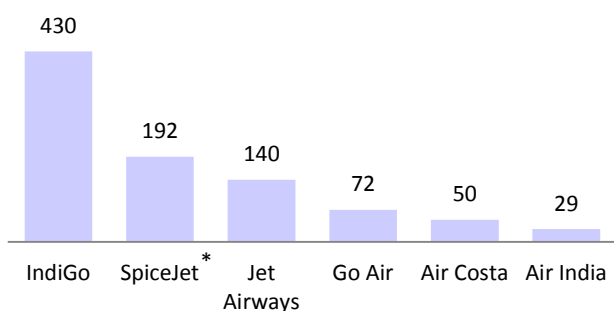
Source: SAP, Company, MOSL

**Exhibit 8: Lowest-cost proposition makes it the most profitable Indian airline**



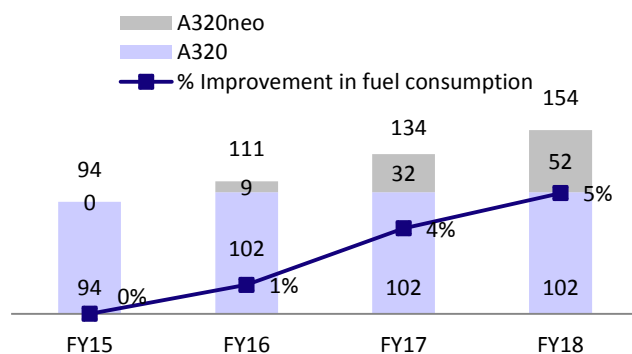
Source: SAP, Company, MOSL

**Exhibit 9: Strong fleet orderbook to ensure higher market share**



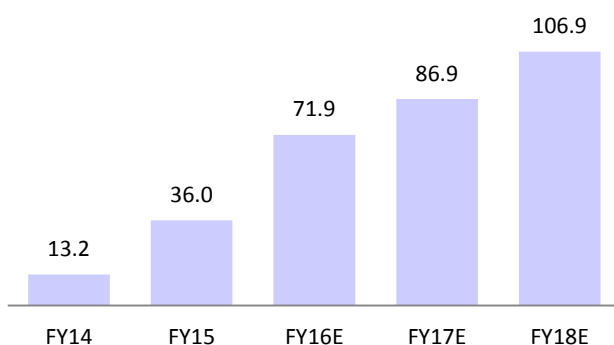
\*Based on media reports Source: Industry, CAPA, DGCA, Company

**Exhibit 10: 15% more fuel efficient A320neo aircraft to form 33% of FY18 fleet, giving significant competitive advantage**



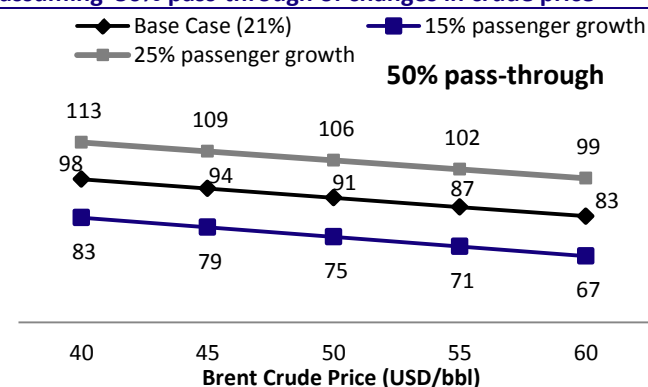
Source: Company, MOSL

**Exhibit 11: FY15-18 EPS (INR) to grow at 44% CAGR**



Source: Company, MOSL

**Exhibit 12: Sensitivity of FY17 EPS (INR) to passenger growth assuming 50% pass-through of changes in crude price**



Source: MOSL

## Indian aviation market set to become 3rd largest

Owing to factors such as rise in per capita GDP and disposable income

- Indian aviation sector is significantly underpenetrated, with per capita seats at 0.08 v/s 2.6/1.6 in the US/Canada and average of 0.5 in Brazil, Thailand, Indonesia and China.
- India is expected to become the 3rd largest aviation market by 2030 and LCC's (low cost carriers) are rightly placed to benefit the most, in our view. Key drivers include (a) value migration from rail, (b) increasing per capita GDP and disposable income, (c) growing tourism and (d) favorable aviation policy.
- Compared with passenger growth estimate of ~13% CAGR through FY20, YTD growth has been robust at 20% (v/s last 5/10 yr CAGR of 9%/13%)—supported by lower ticket prices owing to benign oil prices.

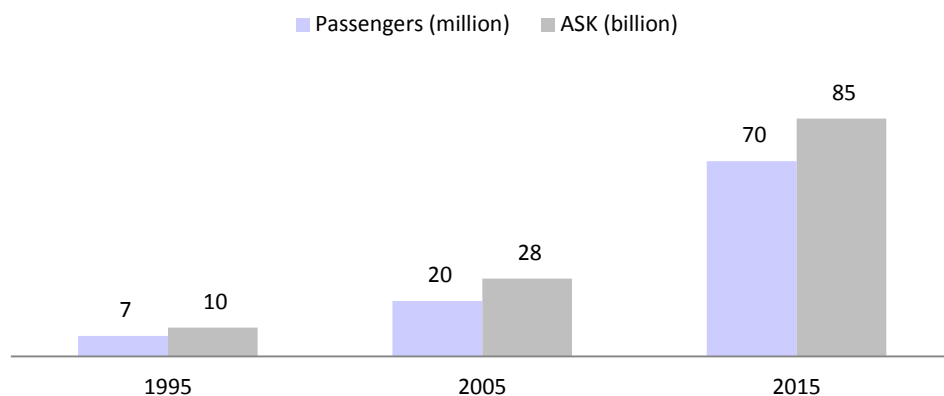
### Indian aviation market significantly underpenetrated

Indian aviation sector  
despite ranked sixth in the  
world....

...however remains  
significantly  
underpenetrated

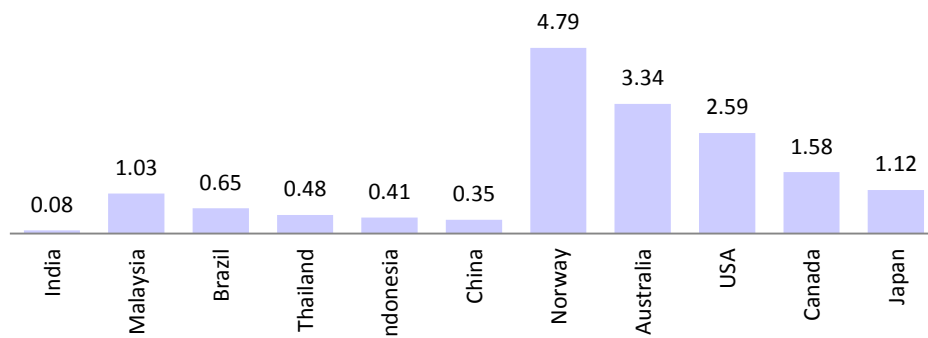
- **Indian aviation market global ranking respectable...:** India's air travel market is the sixth largest globally in terms of total domestic seats and ninth largest in the world by total domestic and international seats.
  - **...however, still the most underpenetrated:** Indian aviation sector while being in the existence since decades still remains significantly underpenetrated due to relative high costs and commercial airline services being limited to metros.
  - India, despite boasting of favorable factors such as (a) being the second most populous country, (b) seventh largest in terms of area, (c) among the top 10 in terms of GDP and more importantly (d) the last two-decade air passenger CAGR of 12% (70m passengers in FY15), still remains the most underpenetrated aviation market in the world.
  - India's annual domestic seats per capita (as defined by CAPA) stand 0.08—significantly lower than other developing countries like Brazil and China, where penetration rates are between 0.65 and 0.35.

### Exhibit 13: Indian aviation sector recorded a two-decade CAGR of 12-13%



Source: DGCA, MOSL

**Exhibit 14: India's per capita airline seat penetration (2014) is 1/7<sup>th</sup> of developing countries and 1/30<sup>th</sup> of developed countries**



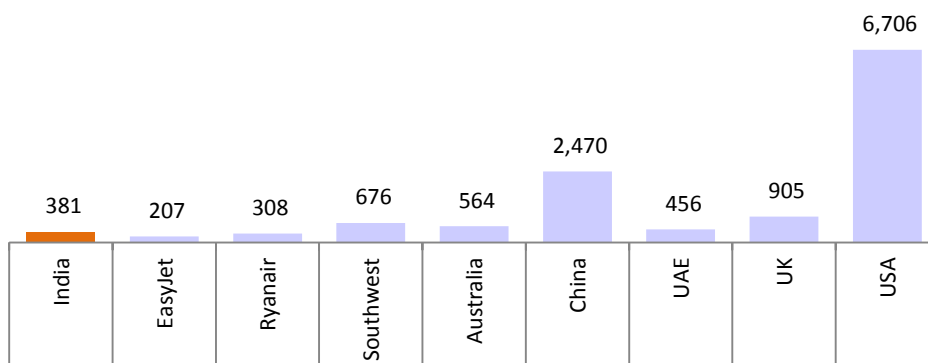
\*based on annual domestic seats per capita

Source: CAPA, Company, MOSL

- **India's overall fleet size smaller than even some individual airlines:** Total fleet size of Indian aviation market is similar to individual airlines like Ryan Air (an Irish low-cost airline) or half the size of South West Airlines (world's largest low-cost carrier).

**Exhibit 15: India's total fleet size is significantly smaller than even some of the airlines (number of aircraft)**

India's combined (all airlines) fleet size is very small compared to even some individual airlines



Source: CAPA, Industry, MOSL

### Historical growth supported by business travellers and tourism

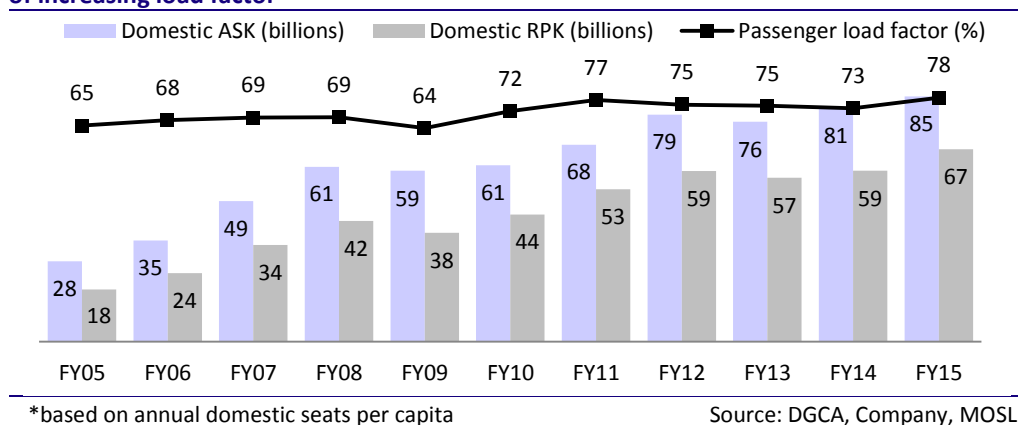
Over the last decade, situation is changing rapidly with the emergence of LCC's as well as change in the travel patterns (emergence of time pressed business travellers post liberalization, increasing tourism with improving disposable Income) and emergence of LCC's (low cost carriers) who score high on economics versus traditional FSCs (full service carriers).

- As per DGCA, Indian domestic passenger volumes have grown at a CAGR of 13% between FY05 to FY15 and at a CAGR of 9% between FY10 to FY15.
- While, domestic carrier capacity (as measured in available seat kilometers, or ASKs) grew at a CAGR of 12% between FY05 to FY15 and at 7% between FY10 to FY15. And, the domestic passenger traffic (as measured by RPKs) grew at a CAGR of 14% between FY05 to FY15 and at 9% between FY10 to FY15.
- **Demand drivers in place; India has an additional, non-traditional driver:** A CAPA report attributed the growth to increased tourism and business-related travel, as well as the stimulation of new traffic demand through low fares offered by LCCs.



- We believe India has one more driver for air travel growth, social/cultural travel:
  - Each Indian state has a unique culture (in terms of religion, language, etc.) and, in turn, unique festivals. Given the migration for jobs to urban areas, people travel to their native places during festive seasons.
  - Regional festivals are almost evenly spaced throughout the year and we believe this also helps to sustain the travel momentum.
  - Some regional festivals/holidays fall on Friday/Monday, thus increasing the number of passengers taking advantages of these “extended weekends”.

**Exhibit 16: Over the last decade, domestic ASK/PK grew at CAGR of 12%/14% with a trend of increasing load factor**



### India to become the 3<sup>rd</sup> largest aviation market by 2030

- According to new IATA Passenger Forecast 2014, India will become the 6<sup>th</sup> largest air passenger market over the next five years, and break into the top 3 in the 2030s.
- On the current base of 400 aircraft, even a 10% growth would imply demand of 40 additional from India and coupled with replacement demand of 40, annual demand will be 80 aircraft. As the base increases, India is set to become one of the most important countries in the aviation sector.
- India, currently the 9<sup>th</sup> largest market by annual passengers (domestic + international), will see 367 million passengers annually by 2034 (256 million passengers more annually than in 2014). It will overtake the UK to become the 3<sup>rd</sup> largest market around 2030.

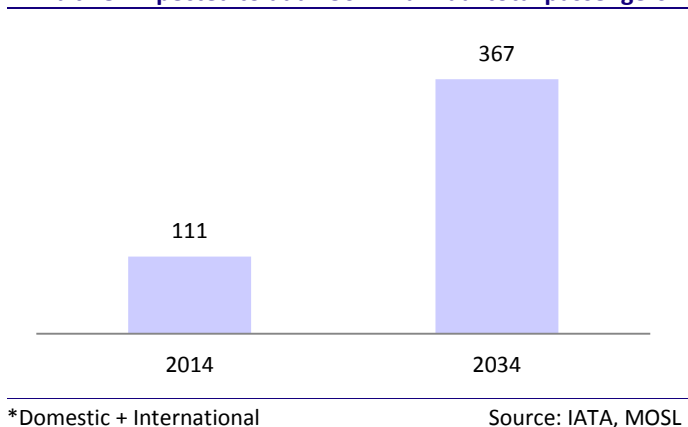
**Exhibit 17: India to become the 3rd largest market**

Rank	2015	2020	2025	2030
1	US	US	US	US
2	China	China	China	China
3	UK	UK	UK	India
4	Japan	Japan	India	UK
5	Spain	Spain	Japan	Brazil
6	Germany	India	Spain	Japan
7	Italy	Germany	Germany	Indonesia
8	France	France	Brazil	Spain
9	India	Italy	France	Germany
10	Brazil	Brazil	Indonesia	France

\*CAPA estimates India to reach 3<sup>rd</sup> position by 2025

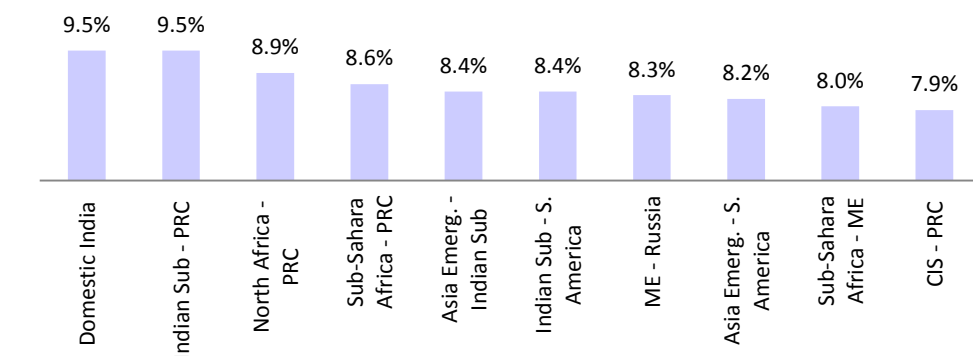
Source: IATA, MOSL

**Exhibit 18: Expected to add 256 mn annual total passengers**



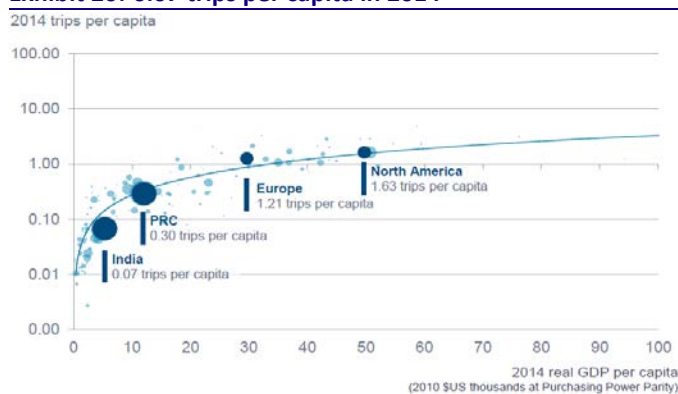
- According to Airbus Report, the domestic Indian aviation market is forecast to be the world's fastest growing—with revenue passenger kilometers (RPKs) growing at a CAGR of 9.5% between 2013 and 2033.
- India's trips per capita are forecast to increase from 0.07 in 2014 to 0.3 in 2034.

**Exhibit 19: Indian market to be the fastest growing Origin-and-Destination routes in RPK CAGR (2013-2033)**



Source: Airbus 2014 GMF, Company

**Exhibit 20: 0.07 trips per capita in 2014**



Source: Sabre, IHS Economics, Airbus GMF2015

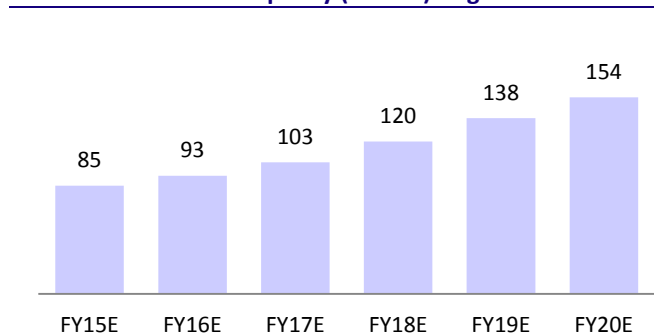
**Exhibit 21: By 2034, India will reach the current China levels**



Source: Sabre, IHS Economics, Airbus GMF2015

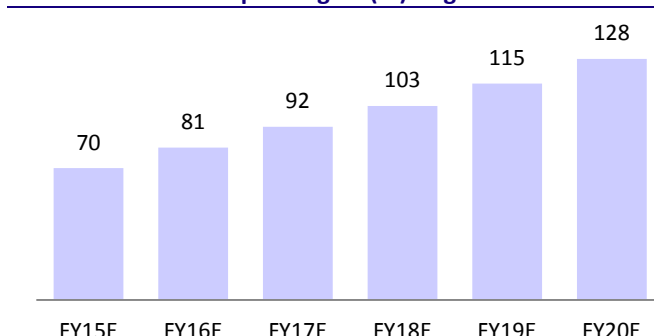
- Going forward, the Indian air travel market is expected to enter a period of accelerated growth. According to a CAPA Report, domestic ASKs are forecast to grow at a CAGR of 12.7% between FY15 and FY20, while domestic passenger volume is forecast to grow at a CAGR of 12.8%.

**Exhibit 22: Domestic capacity (ASKs b) to grow at 12.7% CAGR**



Source: CAPA, Company

**Exhibit 23: Domestic passengers (m) to grow at 12.8% CAGR**

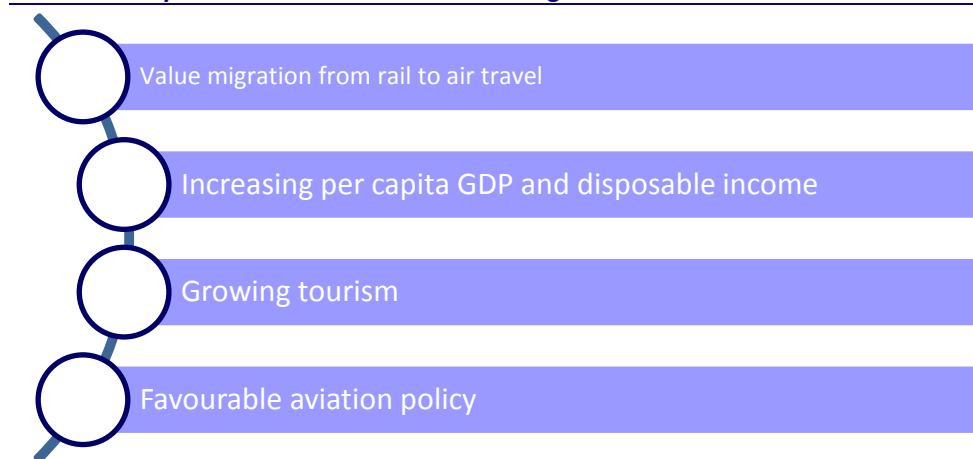


Source: CAPA, Company

### Key drivers for Indian Aviation sector growth

The substantial gap between aircraft penetration rates in India and larger aviation markets suggests significant opportunity for growth. We believe that the investments in airport infrastructure and airlines going to newer towns will help the sector grow multifold. We believe the growth for Indian aviation sector will be supported by (a) value migration from rail, (b) increasing per capita disposable income, (c) growing tourism and (d) favorable aviation policy

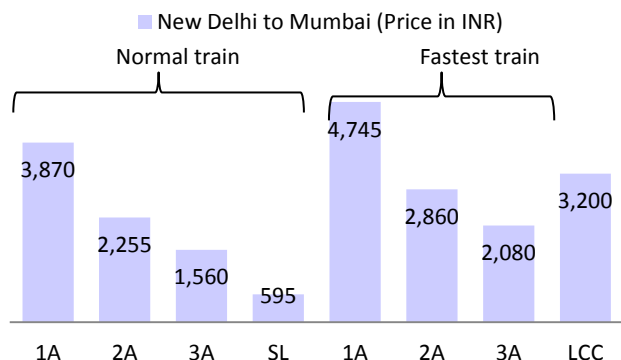
**Exhibit 24: Key drivers for Indian aviation sector growth**



Source: Airbus 2014 GMF, Company

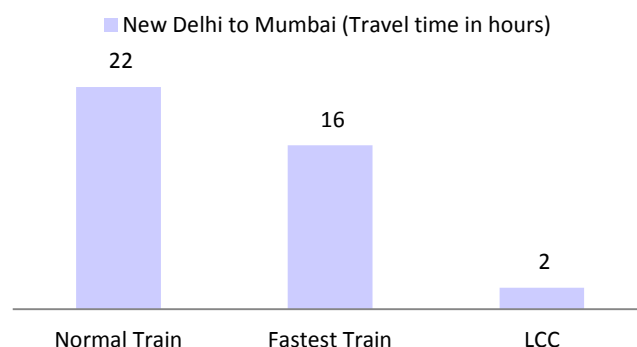
#### A. Value migration from rail to air travel

- Alternative modes of transport (road and rail) do not offer speed and comfort from long distance journeys and with increasing per capita GDP, we expect demand to come from tier 2/3 cities.
- India's domestic air travel market of ~70m passengers in FY15 is comparable with the AC coach passenger count (~95m) of railways, but represents a very small percentage (~2% of ex-suburban rail passengers) of total rail passengers.
- Capacity constraints of Indian rail (required to book tickets atleast 2-3 months in advance to get confirmed seat) and comparable ticket prices of AC (Air conditioned) coach seats to airline ticket prices are driving the shift from rail travel to air travel.
- The price differentials between air and rail AC II tier ticket price becomes very low during the off-season travel months of July to September and widens during peak travel season of April to June and October to December.
- With rising income levels, air travel is expected to become the preferred mode of travel (over rail and road) for the Indian middle class because of its convenience, shorter duration and competitive pricing.

**Exhibit 25: LCCs' ticket prices comparable to train tickets**

Source: Industry, Railways, MOSL

\*Prices are taken for one month advanced booking

**Exhibit 26: Air travel saves time significantly**

Source: Industry, MOSL

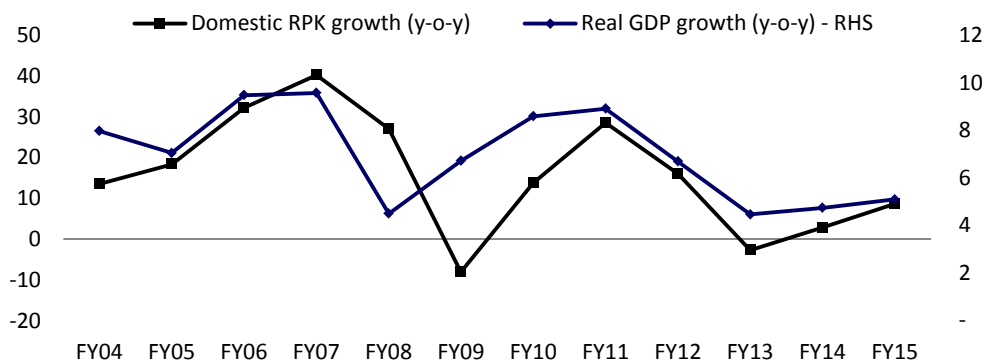
**B. Aviation growth closely related to GDP**

- Air travel is generally costlier than other modes of travel and, hence, is the preferred mode in countries with high per capita GDP and disposal income.
- Though India lags behind on these parameters, we believe it has reached an inflexion point. With expected GDP growth of >7% and population growth of 1.3%, per capita GDP is set to increase (which in turn will result in more people opting for air travel).

India RPK growth  
@2.3x of GDP

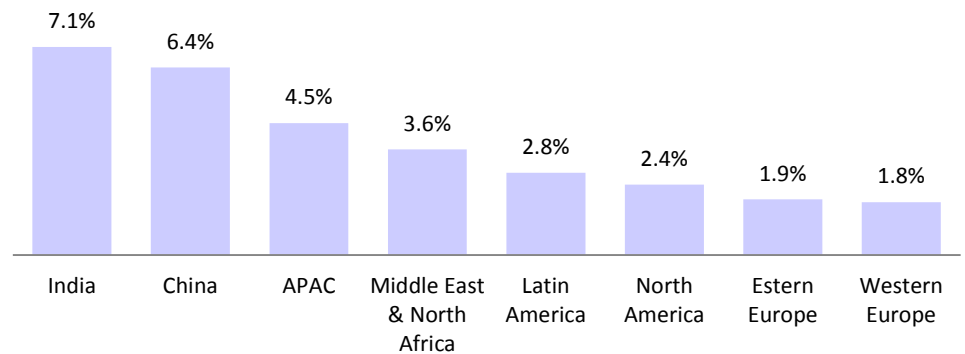
With expected India GDP  
growth of >7-8%

aviation passenger CAGR  
can be >14-15% in the  
medium term  
(YTD FY16 growth higher  
though at ~20%)

**Exhibit 27: Average RPK growth at 2.3x real GDP growth**

Source: DGCA, EIU, Company

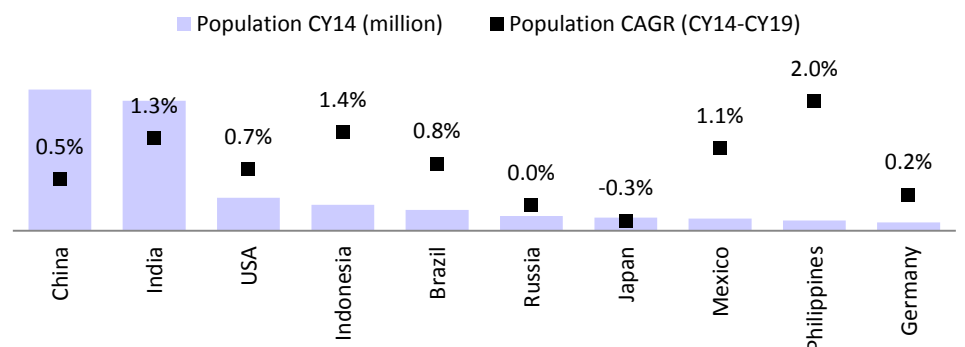
- RPK growth was, on average, 2.3x real GDP growth during FY04-FY15. RPK growth was negative in FY09—mainly due to an increase in oil prices (Brent crude price crossing USD140/bbl v/s current price of USD42/bbl), which resulted in very high fares.
- Domestic RPK growth was negative in FY2013—mainly due to Kingfisher's closure, which resulted in a temporary decline in passenger traffic, also corroborating our view of demand following supply in Indian aviation.

**Exhibit 28: Indian economy to be one of the fastest growing major economies**

Source: Figures for 2014 are estimates by the EIU, IMF, Company

**Population growth estimated at 1.3%**

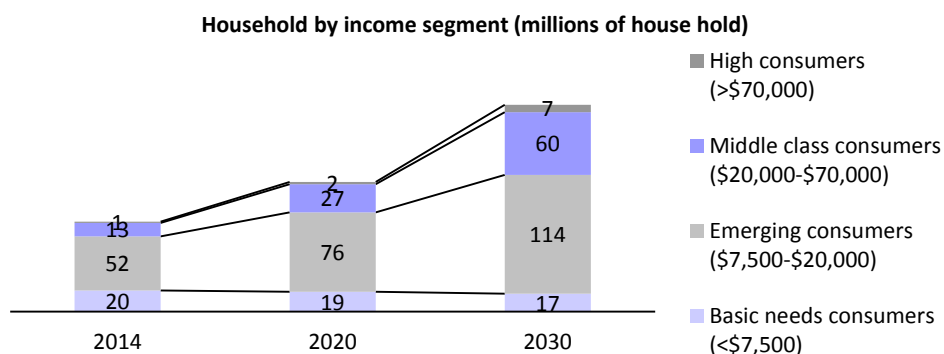
- India is the 2<sup>nd</sup> most populous country with 1.26 billion people. The population is expected to reach 1.34 billion (1.3% CAGR) by the end of CY19, according to IMF.
- The expected growth in India's population is higher than the average growth of top 20 domestic air markets globally.

**Exhibit 29: India to grow at 1.3% CAGR from 2014 to 2019**

Source: IMF, Company

**Disposable Income + Consumption = Air Travel**

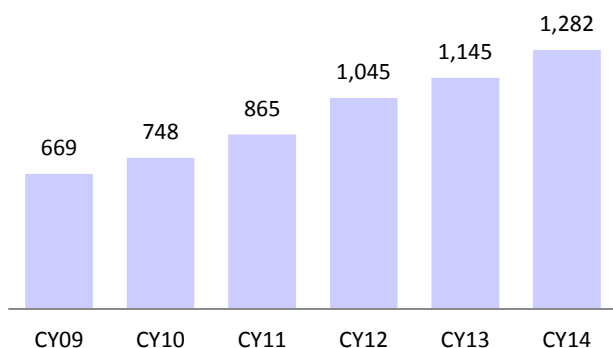
- **India disposable income doubled:** Spending power of Indians has increased rapidly in the past two decades on the back of accelerated economic growth. According to Oxford Economics, real average household disposable income has more than doubled since 1980 and will continue to grow.
- **Significant rise in middle class category:** As the size of the middle class grows, so will the demand for air travel. The Airbus GMF forecasts passenger traffic to/from India to grow fivefold in the next 20 years.
- With rising income, household consumption will increase as will the number of Indian middle class. The number of households with discretionary income above USD7,500 per annum is estimated at 66 million households today and will treble to 180 million by 2030.
- Households with disposable income above USD20,000 per year will grow to 67 million, which will be larger than the population of France.

**Exhibit 30: Indian middle income households to grow to 60 million**

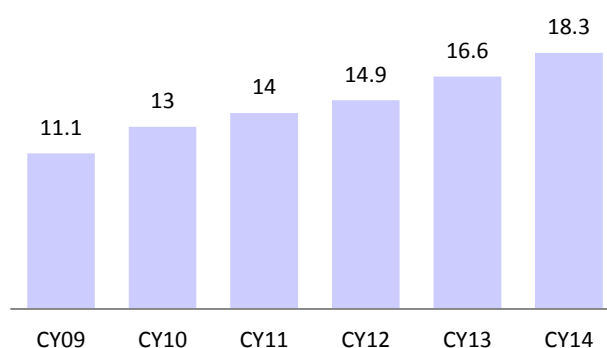
Source: Oxford economics, Airbus

**C. Growing tourism to drive passenger volume growth**

- The tourism industry accounted for INR7.6t or 6.7% of GDP in 2014 and is forecast to rise by 7.3% per annum to INR16.6t (7.6% of GDP) by 2025, according to the World Travel and Tourism Council.
- During 2014, the number of domestic tourist visitors by all modes of transport was 1,282 million—grown at a CAGR of 13.9% from 2009 to 2014. During the same period, the number of Indian tourists going abroad increased at a CAGR of 10.6% to reach 18.3 million in 2014, according to the Ministry of Tourism of India.

**Exhibit 31: Domestic visits by Indians see 13.9% CAGR...**

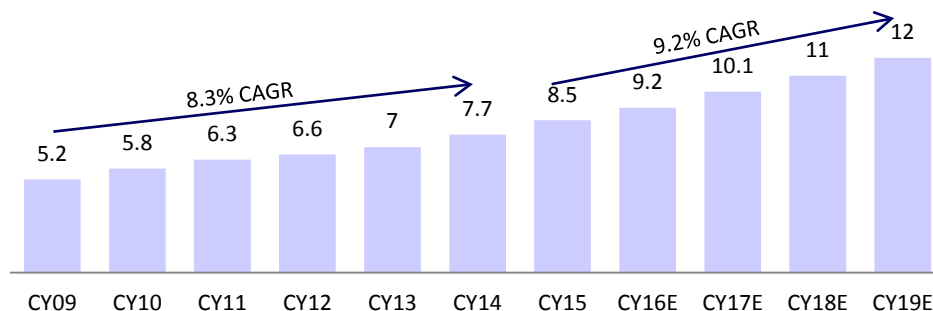
Source: India Tourism Statistics, Ministry of Tourism, Company

**Exhibit 32: ...while foreign visits (passengers m) up 10.6%.**

Source: India Tourism Statistics, Ministry of Tourism, Company

- In CY14, 7.7 million foreign tourists visited India; the arrivals have witnessed a CAGR of 8.3% during CY09-CY14, according to the Ministry of Tourism of India.
- Recent government initiatives to promote India as a tourist destination, such as successful implementation of the e-Tourist Visa program for passport holders of 113 countries and plan to make electronic visas available to visitors from over 150 countries, will boost tourism in India.
- According to EIU, the number of foreign tourists is expected to increase at a CAGR of 9.2% during CY15-CY19 to reach 12.0 million in CY19.



**Exhibit 33: Foreign tourist arrivals (millions) to grow at 9.2% CAGR**

Source: India Tourism Statistics, Ministry of Tourism, EIU, Company

#### **D. New civil aviation policy to spur growth and reduce costs**

Indian government is in process of finalizing new civil aviation policy and the recommendations appear encouraging for the sector to add new locations and to also boost ancillary revenues.

The draft regulation clearly spells out the government desire to take the airlines to the masses and we believe this augurs well for low cost carriers like Indigo. The government's targeting 4-5x passenger growth by 2022 to boost the Indian aviation market.

Further, its plans to develop a domestic MRO (Maintenance, repair and overhaul) industry will reduce the maintenance costs for the airlines and in turn increase profitability.

## Indigo to remain market leader by a distance

Fleet size to increase by 64% to 154 by FY18

- IndiGo, a low-cost carrier (LCC) with 94 planes (FY15, 24% fleet share of the Indian market) and operating primarily on domestic routes, has steadily improved its market share from 18% in FY11 to 34% in FY15 and 37% in YTD FY16 through fleet expansions and load factor of >80%.
- Management focus on (a) network depth v/s breadth and (b) on-time and reliable customer experience to bring in repeat customer has resulted in sharp market share gains culminating in leadership position for Indigo, in our view.
- We expect Indigo to maintain its leadership position, given the benign competition and planned fleet expansion from 94 to 154 by FY18.

### India aviation demand is supply driven, in our view

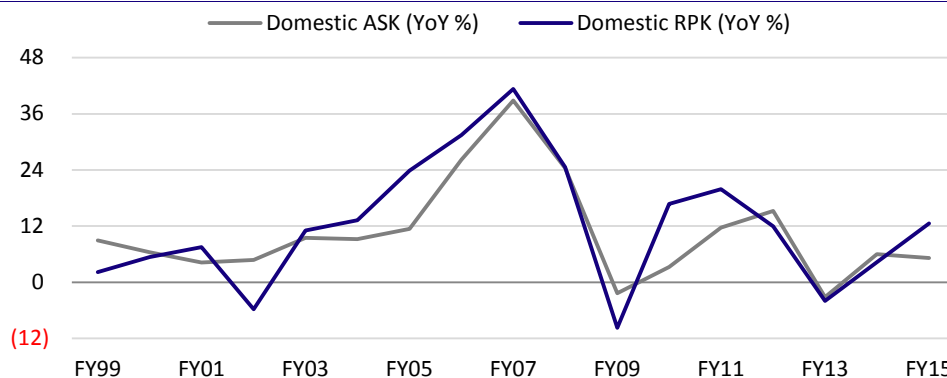
- **Indian aviation market capacity constrained:** An analysis of the last 15 years analysis shows that all the incremental capacity continued to operate at higher utilization levels, thereby implying that demand will follow supply in Indian aviation market till the penetration reaches a respectable level.
- More importantly capacity constraints on the alternate long distance travel option i.e. railways and lower ticket price difference with AC Tier I/II drove the demand for airlines.

India domestic RPK growth tracking ASK...

...implying demand largely following supply

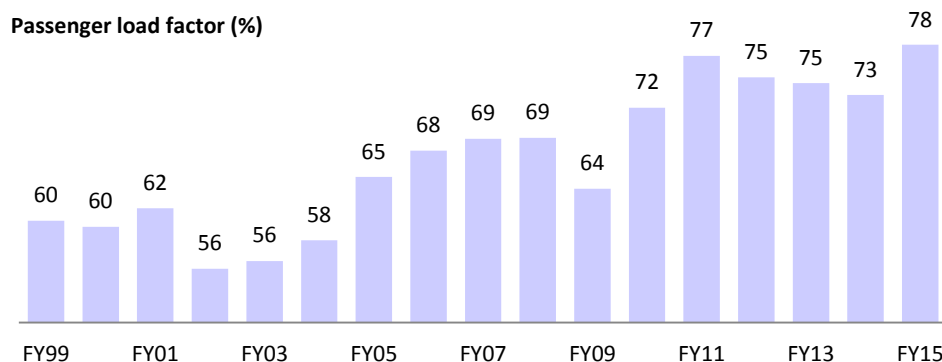
Expect the same to continue till respectable penetration

### Exhibit 34: Domestic RPK, ASK highly correlated—implying demand follows supply in India



Source: DGCA, MOSL

### Exhibit 35: Domestic passenger load factor largely on an uptrend (%)

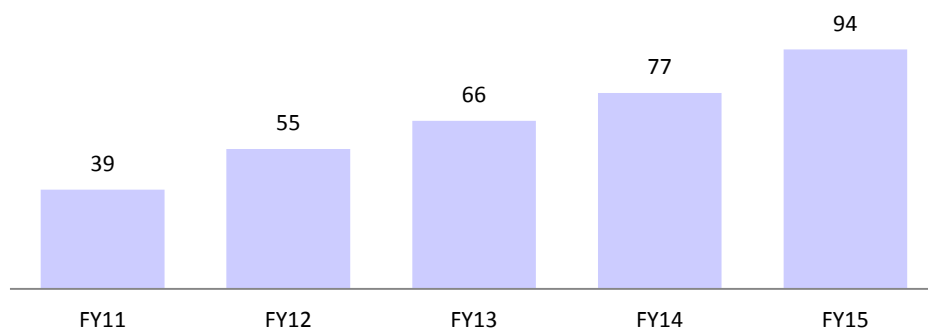


Source: DGCA, MOSL

### IndiGo consistently increased its market share, driven by fleet expansions

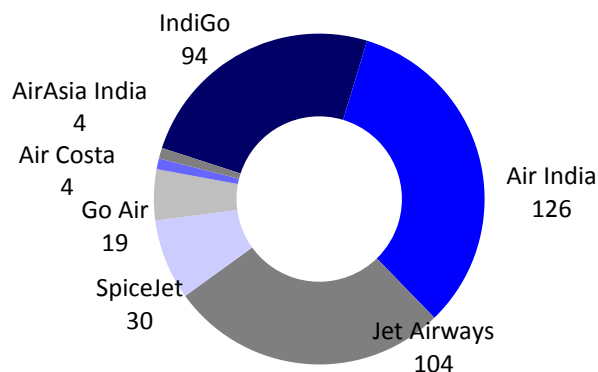
- **Market share tracks capacity share, largely:** India's aviation market is largely capacity constrained and hence, market share is largely dependent on an airline's fleet size; this is where IndiGo has scored over others.
- **IndiGo fleet expansion consistent and large:** IndiGo has been able to consistently increase its fleet, from 39 aircrafts in FY11 to 94 aircrafts in FY15 (~24% fleet share), and hence its market share by constant aircraft induction. While Jet Airways and Air India have larger fleets, they also served international routes—reducing their domestic fleet capacity; IndiGo was able to fill this capacity gap (furthered by fall of Kingfisher) due to fleet expansion.

**Exhibit 36: IndiGo fleet size increased ~2.5x during FY11-FY15**



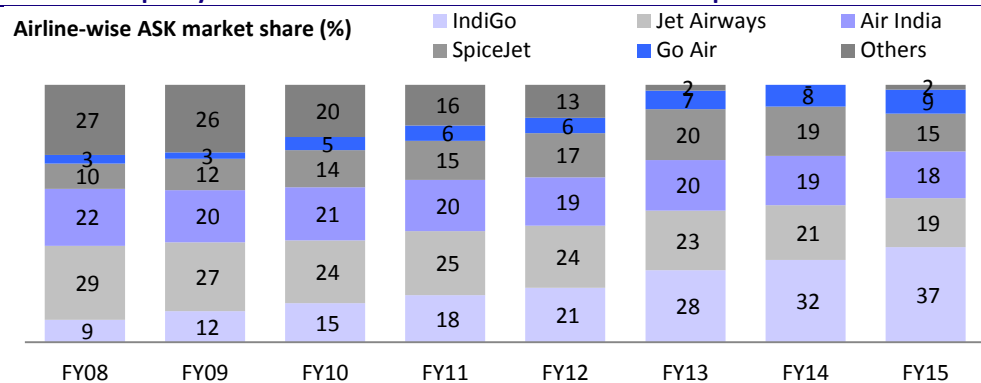
Source: Company, MOSL

**Exhibit 37: IndiGo has one of the largest fleets on domestic routes**



Source: CAPA, MOSL

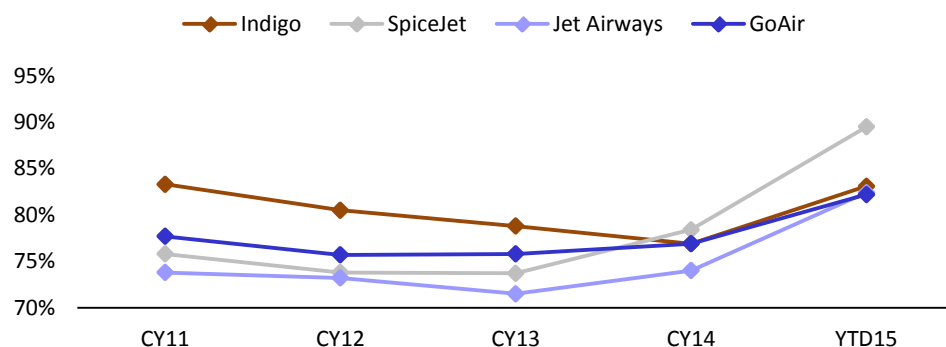
**Exhibit 38: Capacity market share increase on the back of fleet expansions**



Source: CAPA, DGCA, Company, MOSL

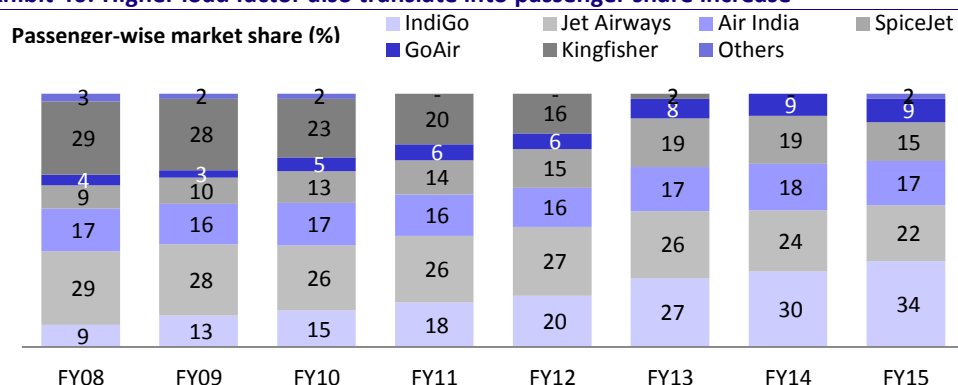
- IndiGo has been able to keep its load factor high despite fleet expansions due to (a) its recognition for operational reliability and (b) consistent expansion of its routes.

**Exhibit 39: Despite rapid fleet expansions, IndiGo managed to keep load factor high**



Source: DGCA, MOSL

**Exhibit 40: Higher load factor also translate into passenger share increase**



Source: DGCA, Company, MOSL

### Focus on delivering best-in-class operational performance

We believe, IndiGo has created a niche positioning for itself by delivering a consistent operational performance to its customers in terms of on-time flight departures/arrivals, consistency in customer service. Amongst the Indian carriers, IndiGo reported (a) highest on-schedule arrival and departures of flights and (b) lower cancellation rates.

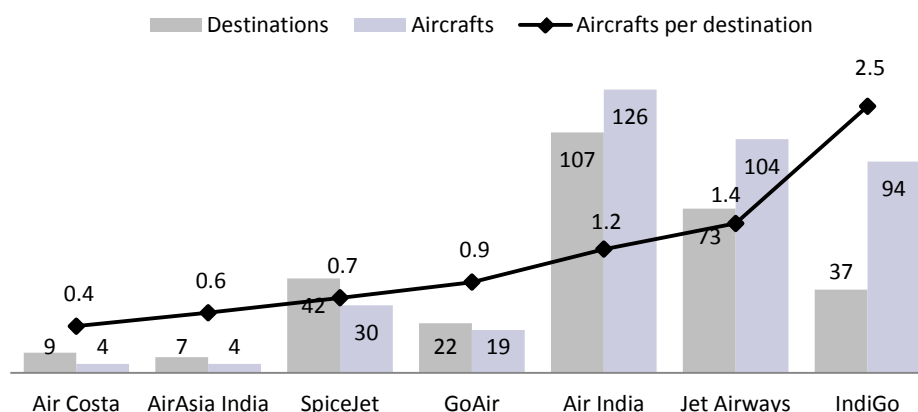
Key drivers for its superior operational performance, in our view include:

1. **Focus on network depth than breadth:** Economies of scale (leading to cost reduction and improvement in profitability) also apply to airline industry and hence IndiGo prefers to increase frequencies on fewer destinations than creating new ones. It currently operates only 37 destinations and plans to open only 2 new destinations per annum.
2. **No code sharing:** Unlike peers, IndiGo doesn't share codes with other airlines and doesn't interline —thus reducing the risk of delay in flights due to delay of a previous flight. These factors make IndiGo more reliable than others for frequent fliers and business passengers.
3. **Reliable experience to bring in repeat customer:** India has higher share of corporate travellers – who are time sensitive but relatively less price sensitive. IndiGo's strategy to operate on key corporate travel destinations

coupled with on-time performance helps it to get repeat business from corporate traveller.

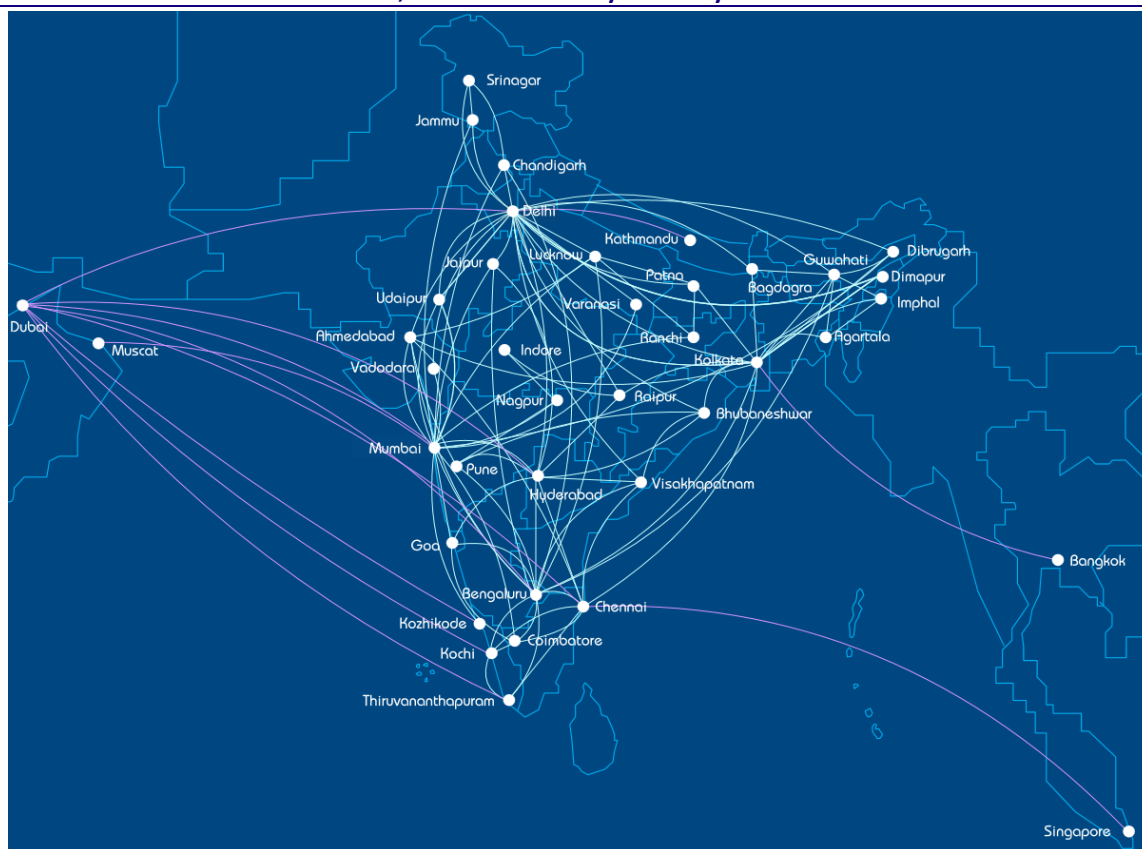
4. **Non-unionized employees:** Indigo has no employee unions and is also consistently ranked in the list of top companies to work for. We believe this is the reflection of employee morale, which in turn we believe plays an important role in customer service.

**Exhibit 41: IndiGo's route network per aircraft the most dense**

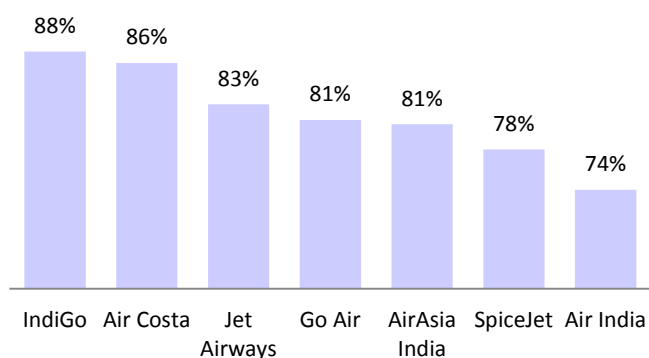


Source: DGCA, Company data, MOSL

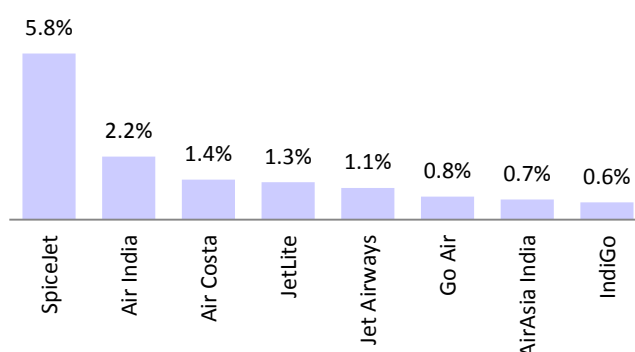
**Exhibit 42: IndiGo's route network extensive; offers connectivity to all key destinations**



Source: CAPA, Company, MOSL

**Exhibit 43: IndiGo's on-time performance was highest...**

Source: CAPA, Company

**Exhibit 44: ...while the cancellation rate was lowest in FY15**

Source: CAPA, Company

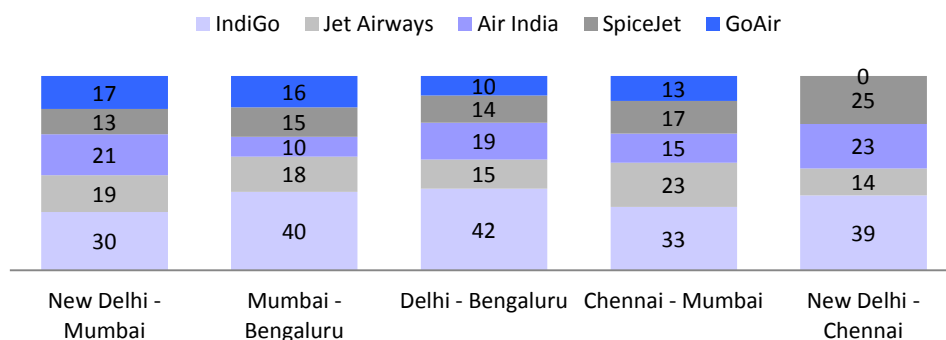
**Market leader on metro and non-metro routes**

- IndiGo has utilized its increased capacity to increase flight frequency on some of the top domestic routes in the country, resulting in almost 40% market share on the top 10 metro to metro routes.
- IndiGo is #1 in Top 5 routes (FY15) despite being the last airline to start and the entry barriers due to non-availability of prime slots in metros.
- Among the 3 segments (Metro to Metro, Metro to Non-metro, Non-metro to Non-metro), IndiGo's market share on the top 10 non-metro to non-metro routes is equal to all of its competitors combined at ~50%.
- We believe it could also have higher profitability given no constraints on the infrastructure unlike metro airports.

**Exhibit 45: IndiGo's frequency of flights on top domestic routes higher than competitors**

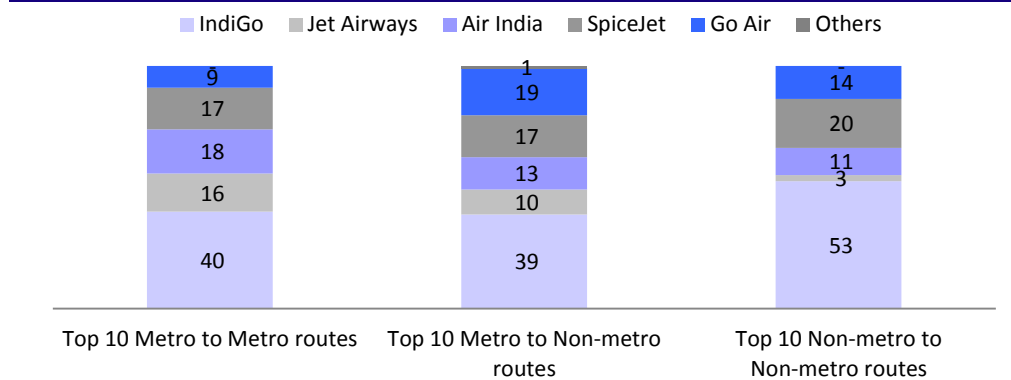
Routes and Airlines	Flight schedule as reported on March 31, 2015				
	IndiGo	Jet Airways	Air India	GoAir	SpiceJet
Mumbai - New Delhi	16	14	19	8	4
Mumbai - Chennai	6	8	3	2	1
New Delhi - Chennai	10	4	3	-	2
Bangalore - New Delhi	13	7	6	3	1
Bangalore - Mumbai	7	12	4	5	2
<b>Total</b>	<b>52</b>	<b>45</b>	<b>35</b>	<b>18</b>	<b>10</b>

Source: DGCA, MOSL

**Exhibit 46: IndiGo garners highest market share on top 5 routes in FY15...**

Source: DGCA, CAPA, Company, MOSL

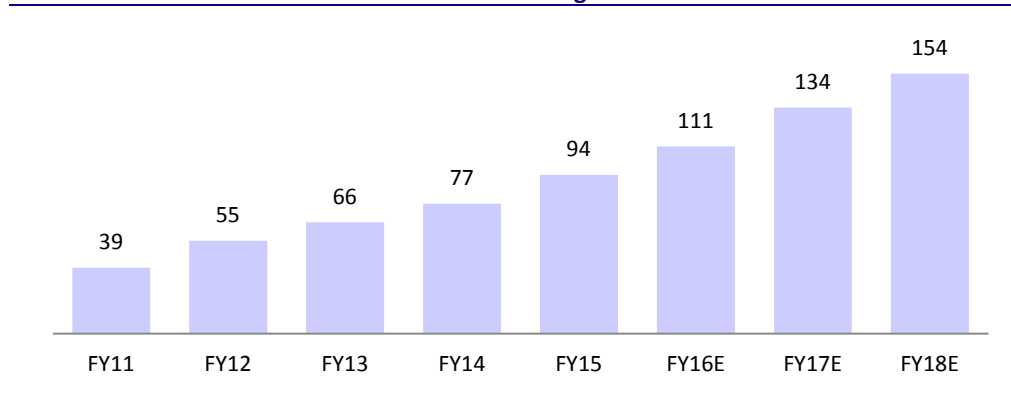


**Exhibit 47: ...market share at >50% on the top 10 non-metro routes**

Source: DGCA, CAPA, Company, MOSL

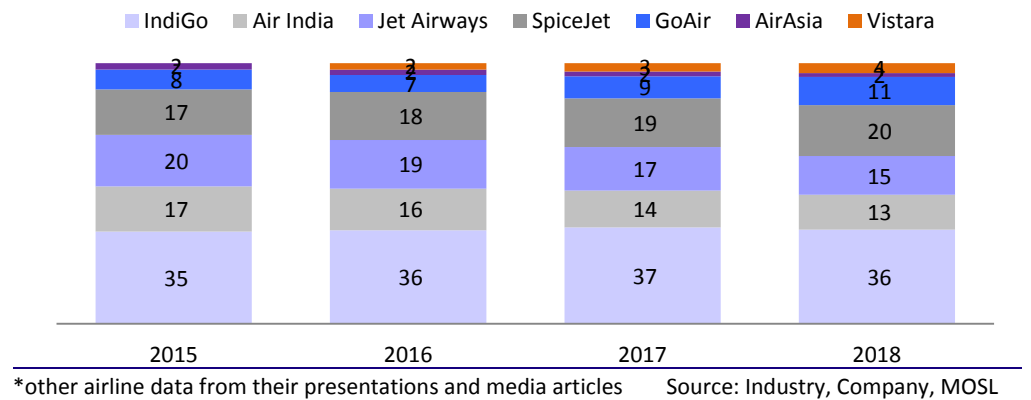
**Expect IndiGo's leadership position to remain intact**

- Historically, IndiGo has garnered market share with its fleet addition and to some extent benefitted from ceasing of Kingfisher's operations. In the near-medium term we expect IndiGo to maintain/strengthen its market share position as its new planes are inducted. With the current order book, IndiGo expects its fleet to increase to 154 aircraft by FY18.
- While in the last few years the competitive scenario was benign, led by financial losses in other airlines, recent low oil prices has given them some respite. Near-term capacity additions though remain benign for other airlines, with only SpiceJet and GoAir adding some meaningful capacities till FY18. We expect IndiGo's 60 new airplanes by FY18 to further strengthen its market share.
  - **SpiceJet:** SpiceJet has an order book of 42 airplanes and media articles also indicate that it could add 150 more.
  - **GoAir:** GoAir has a firm order book of 72 airplanes and its delivery is expected to commence from May 2016.
  - **Others:** Other airlines do not have any meaningful capacity additions through FY18.

**Exhibit 48: IndiGo's fleet size to increase 64% during FY15-FY18**

Source: Company, MOSL

**Exhibit 49: Expect IndiGo to maintain its market share – however any delays in fleet expansion by competitors will increase Indigo’s market share**



## Profitability way ahead of peers

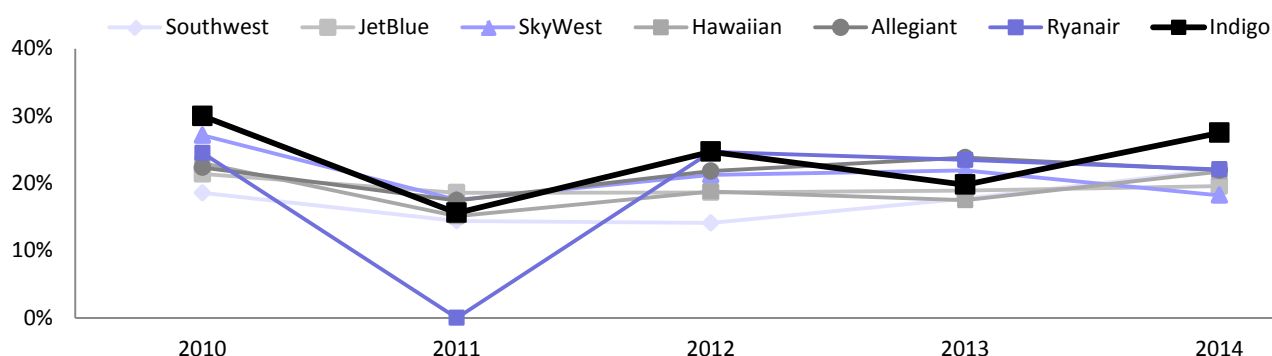
Unique fleet strategy + low opex = High cash generation

- IndiGo's fleet strategy to (a) use single type aircraft, (b) place bulk orders and (c) keep average age low gives it an operational and financial edge.
- Its ownership cost is 45% lower than competitors, while operating cost leadership will further improve as it gets A320neo aircraft (15% more fuel efficient delivery) from November 2015.
- IndiGo's fleet strategy coupled with (a) focus on high-density routes and (b) consistently high load factor and improving aircraft utilization will help it remain the most profitable airline, in our view.

### IndiGo fleet strategy – a secret sauce for high profitability

- IndiGo's unique fleet strategy to
  - (a) Use single type aircraft – keeps maintenance/training costs low,
  - (b) Place bulk orders – gets price discount,
  - (c) keep route concentration high to keep costs lower and
  - (d) Keep average age low – low maintenance cost;
 gives it an operational and financial edge in our view.
- Management confidence in the strategy can be seen from its initial order of 100 airplanes at one go (first in the airline industry!) in 2005. This not only helped it to bring down the aircraft acquisition costs, but also helped to negotiate better contract terms with aircraft related suppliers and also service providers.

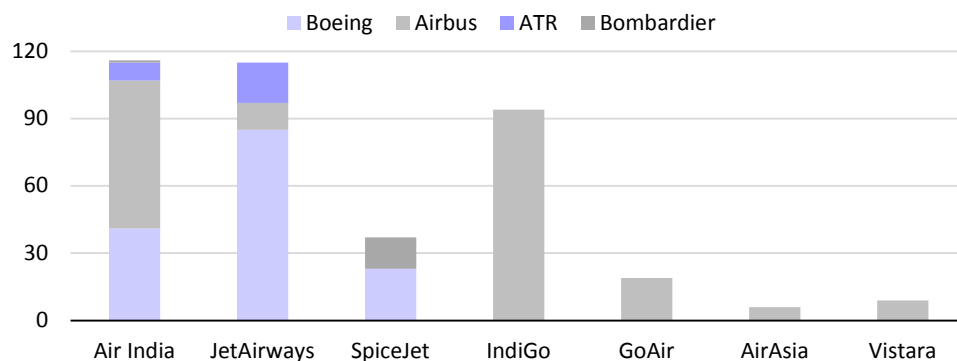
**Exhibit 50: IndiGo's EBITDAR margins one of the highest among global LCCs**



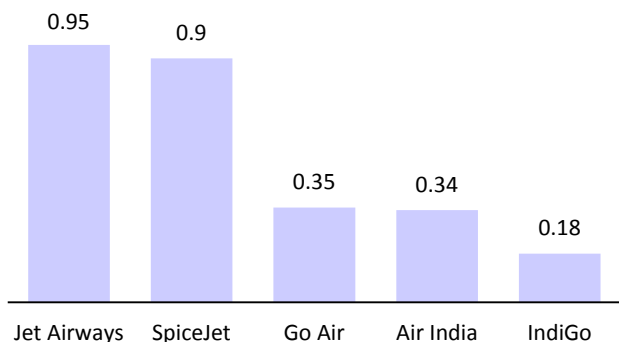
Source: CAPA, Company, MOSL

### A. Single type aircraft fleet reduces costs

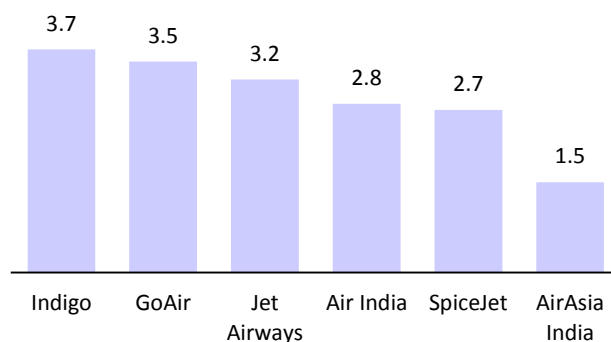
- IndiGo's fleet comprises solely of Airbus A320s, which lowers costs in maintenance, spare parts and training.
- Due to single type aircraft, spare parts can be used interchangeably and the company isn't required to maintain inventories for different aircraft types.
- Further, single type aircraft helps in reducing training costs of pilots and crew members and more effective management of crew rosters.
- IndiGo employed 115 employees per aircraft compared with Jet Airways's 130.

**Exhibit 51: Unique fleet strategy—Indigo uses single-type aircraft unlike comparable peers**

\*other airline data from their presentations and media articles Source: Industry, Company, MOSL

**Exhibit 52: IndiGo: Lowest maintenance cost per ASK (USD) in FY14**

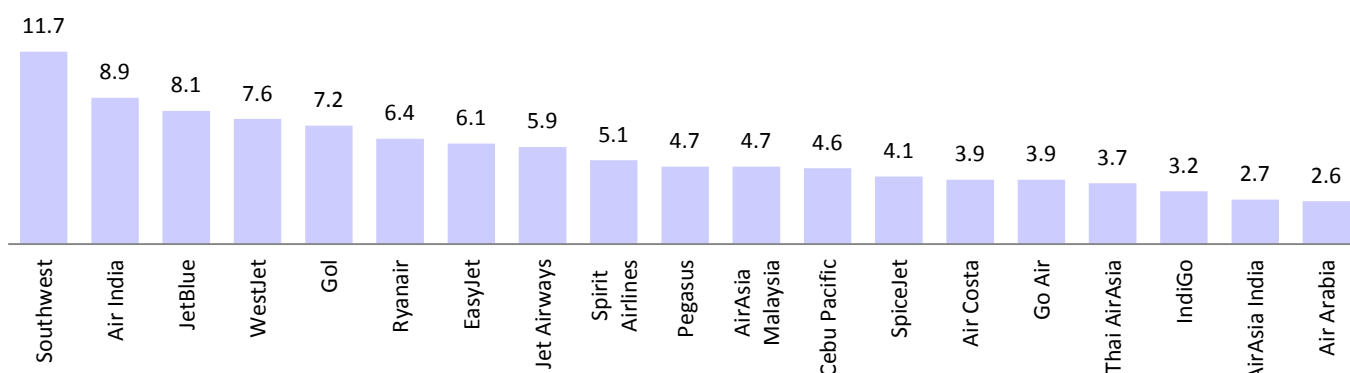
Source: SAP, Company

**Exhibit 53: IndiGo: Highest employee productivity in FY15 as measured by ASKs/employee (m)**

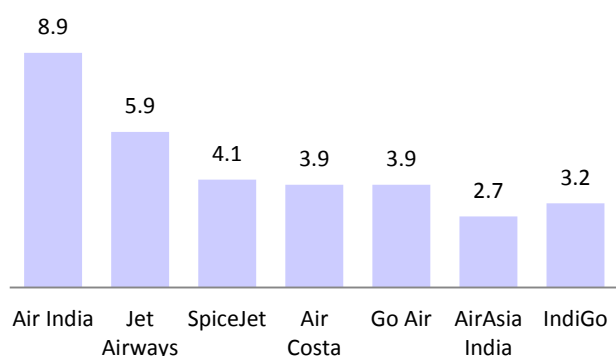
Source: CAPA, Company

## **B. A young and fuel efficient fleet the secret to low costs**

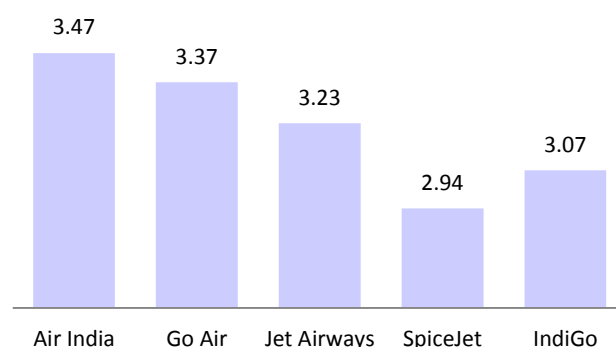
- By FY18, A320Neos will contribute to ~33% of its overall fleet and we expect this to give a significant advantage over competitors as overall fuel cost will reduce by 5% for IndiGo.
- A young fleet results in lower maintenance costs for an airline, while keeping the risks of technological obsolescence nil. IndiGo boasts of a very young fleet (average age 3.2 years), partly managed by constantly turning around older jets.
- IndiGo usually leases aircraft for an average of three to six years under the sales and leaseback model. On short-term leases, the carrier typically leases aircraft for four years. With deliveries of 180 new aircraft beginning from November 2015, IndiGo will benefit from the advantages associated with a younger fleet.

**Exhibit 54: IndiGo's fleet one of the youngest in the world; average age at 3.2 years**

Source: CAPA, Company, MOSL

**Exhibit 55: IndiGo's fleet one of the youngest; 3.2 years old on average**

Source: CAPA, Company, MOSL

**Exhibit 56: IndiGo: Second lowest fuel cost among Indian airlines (USD/ ASK) in FY14**

Source: CAPA, Company, MOSL

**C. Route concentration to keep costs lower**

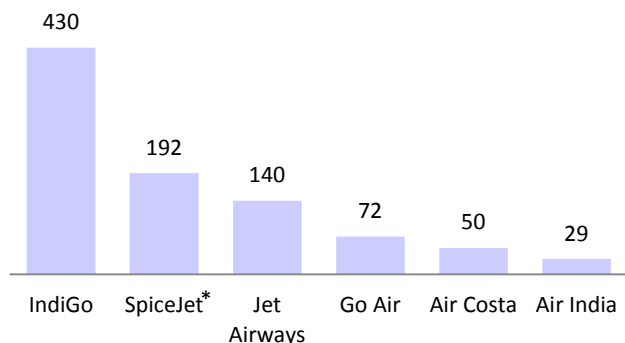
- We believe that IndiGo has one of the most dense route networks in India (2.5 destinations per aircraft), with 94 aircrafts servicing only 37 destinations in FY15.
- Also, as discussed earlier, IndiGo has highest market share in top 5 domestic destinations and has 50% market share in top 10 non-metro routes.
- The airline's A320 aircraft are primarily small-distance aircraft and the company has chosen to focus on domestic operations only, albeit on long domestic routes as it doesn't consider itself to be a regional player.
- Further, IndiGo has chosen international destinations with flight time of less than five hours. The move enables it to return the same day, thus saving the airline any international parking charges.

**D. Bulk aircraft ordering reduces ownership costs**

- IndiGo placed orders for 100 A320s in 2005, 180 A320neo (New Engine Option—NEO) in 2011 and 250 A320neo aircraft in August 2015. The orders were the largest in Airbus's history.
- By placing orders of these magnitude, IndiGo has been able to aggressively negotiate aircraft prices. Moreover, IndiGo was one of the anchor customers for A320Neos—which further helped it negotiate prices in its favor.
- IndiGo has also negotiated prices with engine and other parts suppliers, providing it a huge structural cost advantage over other players. According to a

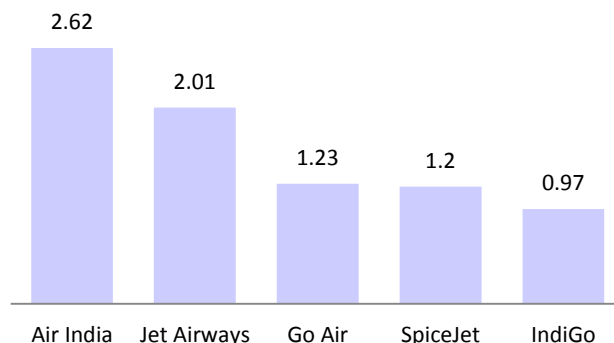
PWC report in 2013, it is not uncommon for airlines to be able to negotiate discounts above 40% on the list price of aircraft when placing orders in bulk.

**Exhibit 57: IndiGo's current order book bigger than the total Indian fleet of 400**



\*Based on media reports Source: Industry, CAPA, DGCA, Company

**Exhibit 58: IndiGo: Lowest ownership costs\* (USD/ASK) in FY14**



\*Includes rentals, D&A, insurance, interest Source: SAP, Company

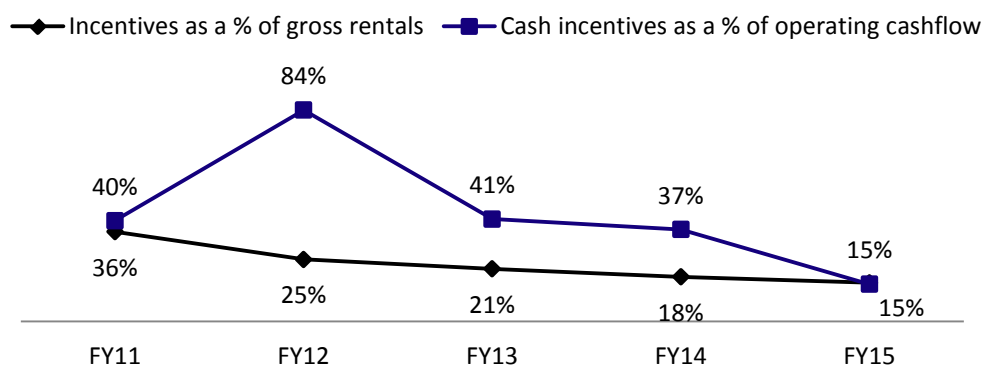
- **Cash incentives improve profitability:** IndiGo is able to pass on the risk of unutilized aircraft to the lessors through sales and leaseback, receiving cash upfront on the delivery of each aircraft.
- These discounts, carried as deferred incentives, are amortized on a straight-line basis over the lease duration of the aircraft, ensuring lesser volatility in the annual earnings. As on FY15, IndiGo had deferred incentives of INR18b.

**Exhibit 59: Aggressive negotiations on aircraft prices reduce overall ownership costs**

INR Billion	FY11	FY12	FY13	FY14	FY15
<b>Deferred incentives</b>					
Opening Balance	6	7	12	15	18
Additions (calc.)	3	8	7	6	4
Deductions (from P&L)	2	3	4	4	4
<b>Closing Balance</b>	<b>7</b>	<b>12</b>	<b>15</b>	<b>18</b>	<b>18</b>
Gross aircraft additions	13	16	13	7	3
Deferred Incentive per aircraft (USDm)	6	10	10	14	19

Source: DGCA, Company, MOSL

**Exhibit 60: Amortized incentives and cash incentives form 15% each of FY15 gross rentals and operating cash flow**



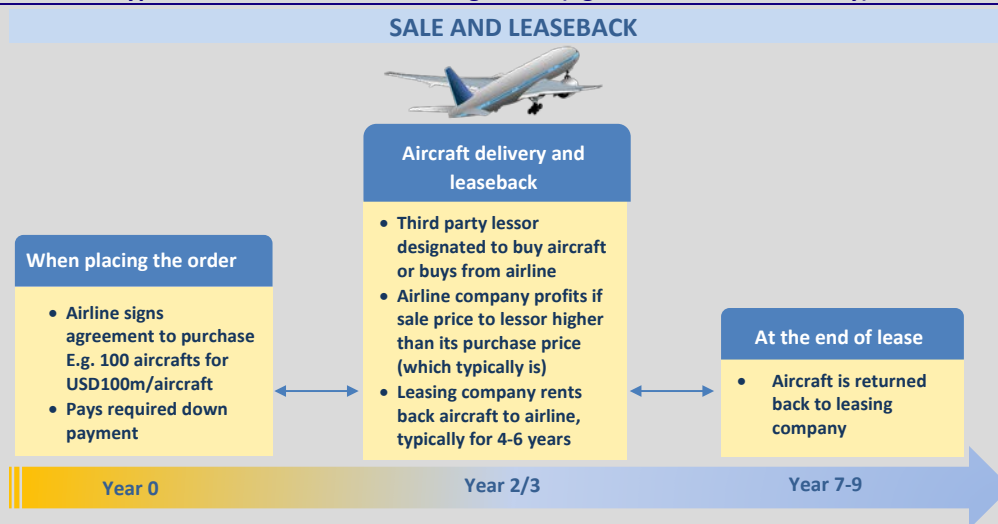
Source: Company, MOSL



### Operating lease v/s finance lease

- Airlines world over now use a mix of operating and financial lease and very low share of owned aircraft. Owing to high cost of aircraft, airlines typically lease aircrafts from aircraft lessors instead of outright acquisition.
- **How does an operating lease work?** The aircraft do not appear on the balance sheet of the airlines. Instead, the airline (called the lessor) pays rent to the aircraft lessee. The system is beneficial to airlines as deterioration in the market value of aircraft and/or aircraft becoming obsolete does not impact them. As a result, airlines across the world now prefer to lease aircrafts.
- **How does a finance lease work?** In a finance lease, the ownership and associated risks of aircraft are passed on to the airline. Further, since the aircraft is carried on the books of the airline, the latter's profitability ratios decline.
- **Which is the preferred mode of financing?** Operating lease helps the airline company to keep the average fleet age low as the typical duration of the operating lease (for IndiGo) is three - six years. While financial lease is preferred immediately after a major technology change. Currently, IndiGo has a lower portion of financial lease and we believe it will opt more for financial lease only after new A320/321Neos are inducted as typical technology change in the airline happens once in 12-15 years.
- **How does a sale leaseback arrangement work?**
  - Under a sale leaseback arrangement, an airline will typically acquire aircraft from the original manufacturer. The aircraft would then be sold to an aircraft leasing company, which will then lease the aircraft back to the airline.
  - The aircraft's price would be paid by the aircraft lessor to the manufacturer instead of the airline. The airline would only make a minimal pre-delivery payment. A profit will be recognized by the airline on the difference between the price paid by the lessor and the price negotiated by the airline.
  - An aircraft leasing company agrees to such an agreement because it gets a customer along with the aircraft, which drastically reduces its business risk. Further, due to prevailing order backlogs with Boeing and Airbus, lessors cannot expect quick deliveries of aircraft; if they order in advance, they might have to face risks of reduction in business activity in the time elapsed between placing an order and receiving the delivery.

**Exhibit 61: Illustration of a typical sale and leaseback arrangement (figures for illustration only)**



**Exhibit 62: Basic difference between an operating lease and a finance lease**

Line items	Operating Leases	Finance Leases
Income statement impact	Only incurs lease rentals	Incurs depreciation and interest expenses
Ownership	Not transferred	Transferred to lessor when lease ends
Balance Sheet impact	Aircraft is not carried on the balance sheet	Aircraft carried on balance sheet under tangible assets, associated lease liabilities are recognized on the liabilities side.

### Capitalization of operating leases will reduce reported profitability

- IASB (International Accounting Standards Board) is currently reviewing IFRS (International Financial Reporting Standards) accounting policies, including treatment of operating leases. Under the new policies, the leased aircraft will be accounted for as assets while the associated liabilities will be recognized under liabilities on the balance sheet.
- Further, as the operating lease proportion varies across airlines, we believe that return ratios are not comparable.
- Hence, we have analyzed the possible impact of capitalizing the operating leases. We have capitalized the future minimum lease payments stated by the company. Accordingly, we have adjusted EBIT for depreciation and lease rentals.

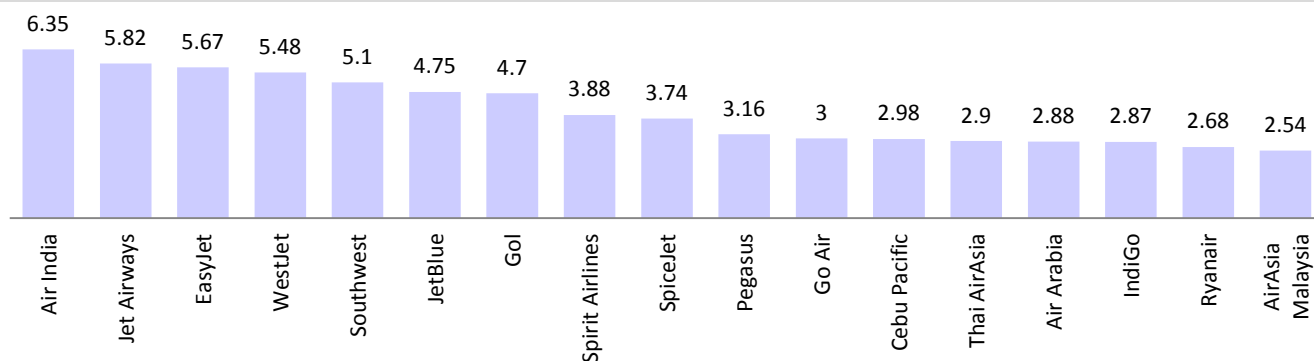
#### Exhibit 63: Reported RoCE will reduce if operating leases are capitalized

(INR Billion)	FY11	FY12	FY13	FY14	FY15
<b>Calculating reported RoCE</b>					
Reported Capital Employed	10	14	24	40	48
PBT	7	1	10	5	18
Interest	0	1	1	1	1
PBT + Interest	8	1	10	6	20
<b>Reported RoCE (%)</b>		<b>10%</b>	<b>55%</b>	<b>19%</b>	<b>45%</b>
<b>Calculating adjusted RoCE for operating lease treatment</b>					
Reported Capital Employed	10	14	24	40	48
Add: O/S amount of operating leases	21	35	43	60	61
<b>Adj. Capital Employed</b>	<b>31</b>	<b>49</b>	<b>67</b>	<b>100</b>	<b>109</b>
PBT + Interest	8	1	10	6	20
Less: Additional depreciation (@ 6%)	1	2	3	4	4
Add: Rentals	4	8	14	17	20
<b>Adj. PBT + Interest</b>		<b>7</b>	<b>21</b>	<b>19</b>	<b>35</b>
<b>Adj. RoCE (%)</b>		<b>18%</b>	<b>37%</b>	<b>23%</b>	<b>34%</b>

Source: Company, MOSL

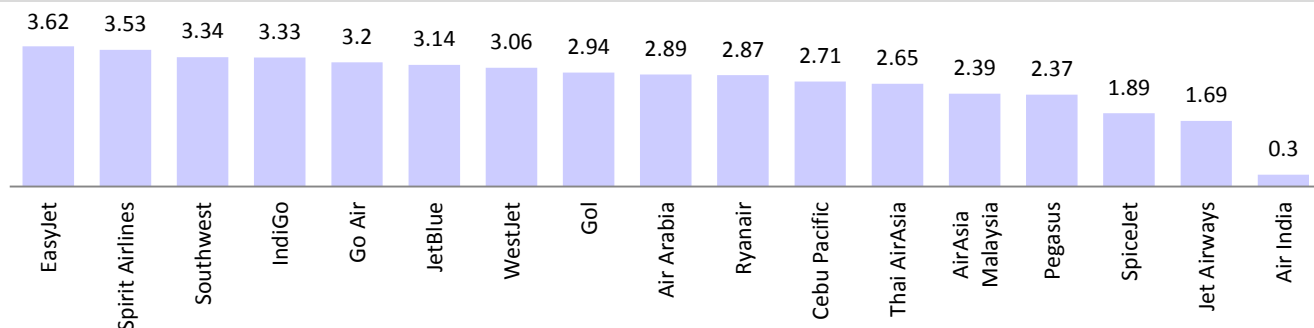
## Indigo v/s global LCCs

**Exhibit 64: IndiGo operational costs per ASK (excl. fuel, in USD) one of the lowest among global LCCs in 2014...**



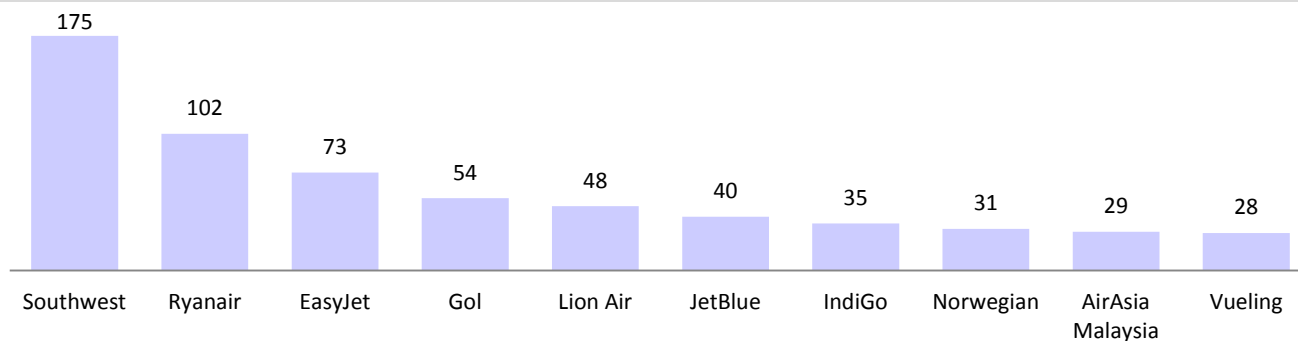
Source: SAP Report, Company, MOSL

**Exhibit 65: ...and one of the highest profits per ASK (RASK minus CASK excl. fuel, in USD) among global LCCs in 2014**



Source: SAP report, Company, MOSL

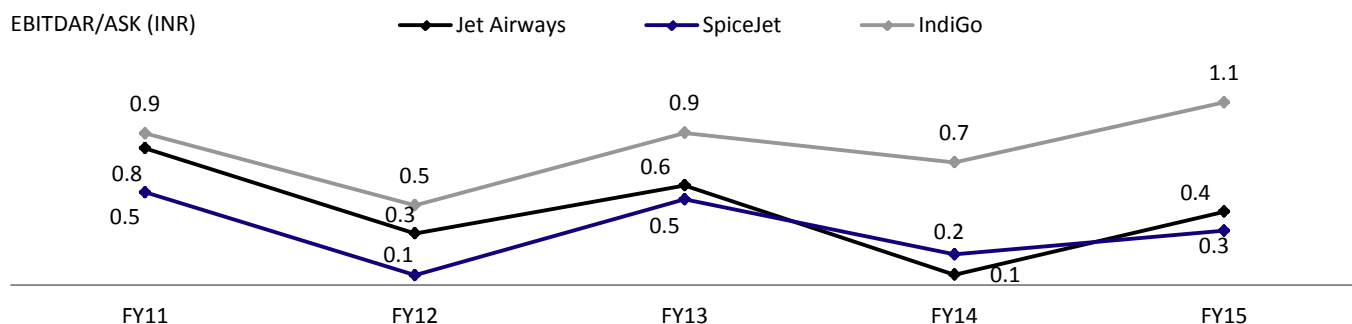
**Exhibit 66: ...and one of the highest profits per ASK (RASK minus CASK excl. fuel, in USD) among global LCCs in 2014**



Source: SAP report, Company, MOSL

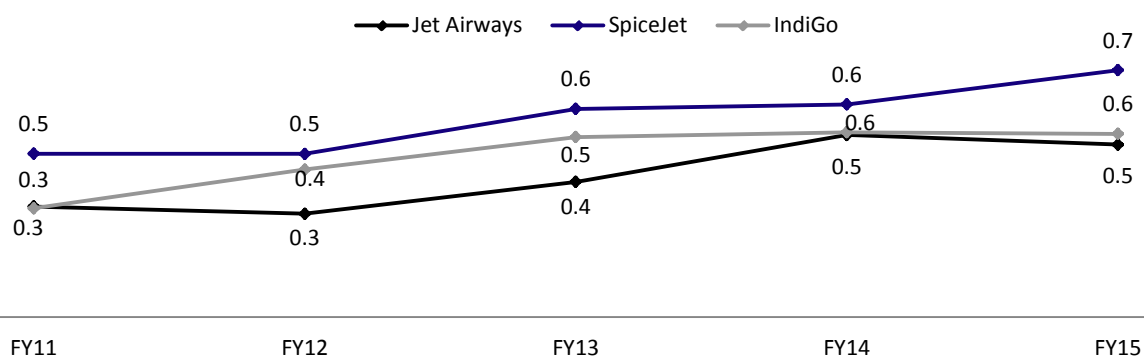
## Indigo v/s domestic airlines

**Exhibit 67: Indigo's EBITDAR margins consistently higher than Indian peers**



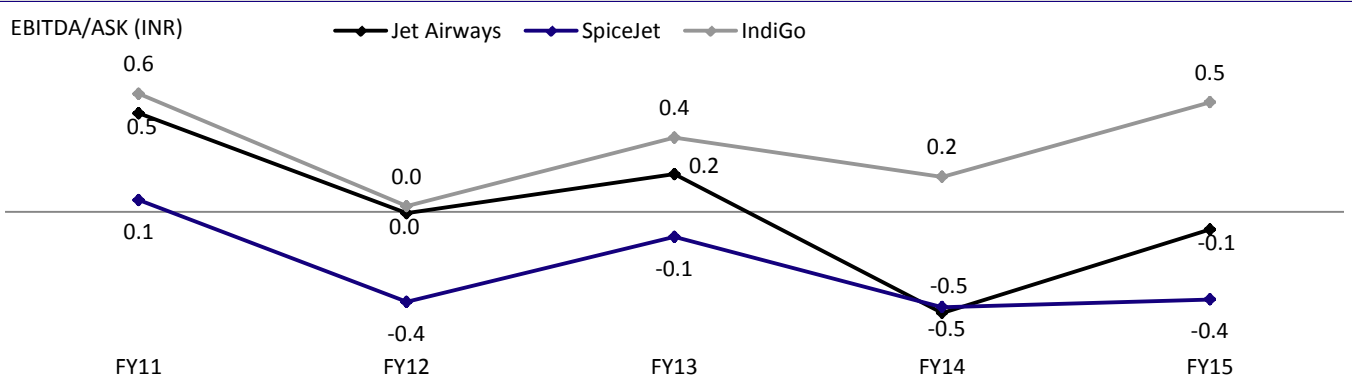
Source: Company financials, MOSL

**Exhibit 68: IndiGo's rentals comparable to that of Indian peers...**



Source: Company financials, MOSL

**Exhibit 69: ...resulting in it being the only airline making consistent profits even at EBITDA levels**



Source: Company financials, MOSL

### Indigo—the only domestic airline to remain profitable for last seven years

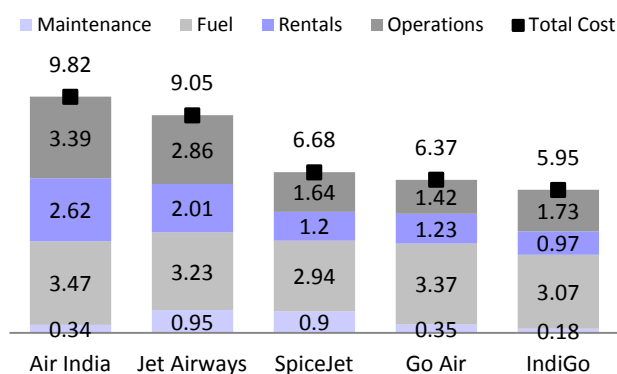
- IndiGo is the only airline in India that remained profitable for the last seven years. We believe that its fleet strategy plays a pivotal role in this along with management focus on continually lowering the operating costs – IndiGo's non-fuel cost has remained flat for the last five years.

**Exhibit 70: Indigo the only airline making consistent profits**

	FY09	FY10	FY11	FY12	FY13	FY14	FY15
IndiGo	Yes	Yes	Yes	Yes	Yes	Yes	Yes
SpiceJet	No	Yes	Yes	No	No	No	No
Jet Airways	No	No	No	No	No	No	No
GoAir	No	No	Yes	No	Yes	Yes	Yes
Air India	No	No	No	No	No	No	No
Kingfisher	No	No	No	No	Ceased Operations		

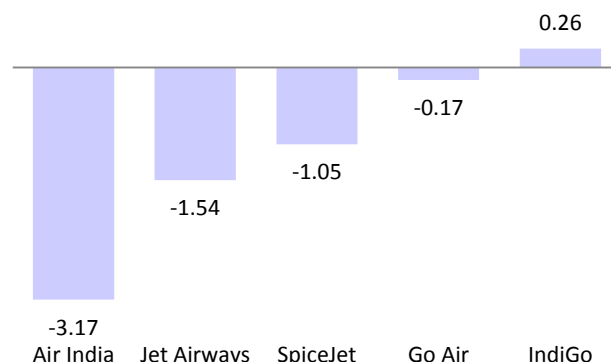
Source: CAPA, Company, MOSL

**Exhibit 71: Lower total costs than competitors in FY14 (USD/ASK)...**



Source: CAPA, Company

**Exhibit 72: ...resulted in only IndiGo making profits\* in FY14 (USD/ASK)**



\*Profits as determined by RASK – CASK

Source: CAPA, Company

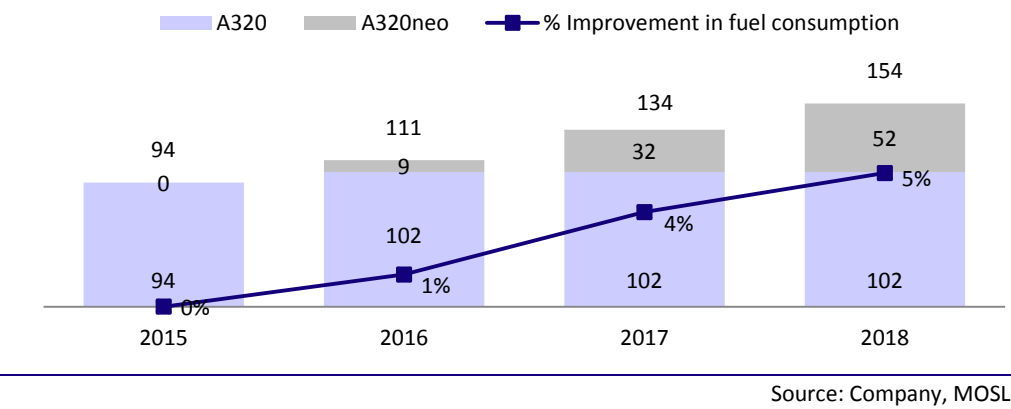
### A320 neo induction to be game changer for Indigo

Airbus is introducing new aircraft in its A320 family – A320neo (new engine option), expected to deliver 15% fuel cost savings. Indigo is one of the early “launch customers” for A320neo and will start getting deliveries in current financial year. We estimate the A320neo's share to reach to ~33% by FY18 and give a significant lead over its competitors as lower fuel cost will help its to keep ticket prices lower.

- 10-15% fuel cost savings on A320neos:** Typically, fuel is the largest cost element of an airline—accounting for ~40-50% of its total costs. Hence, efficient management of fuel cost is the key to operating cost leadership of an airline. IndiGo already has the second lowest fuel costs in India. Induction of A320Neos in its fleet (from November 2015), will result in further 10-15% in fuel cost savings on new aircrafts.
- IndiGo to have first mover advantage:** Since A320Neos have the same sub-systems as A320s, the maintenance costs aren't expected to rise. Moreover, with Boeing and Airbus's order book full until 2020, the competitors will not be able to enjoy the same advantages till 2020-2022 by ordering new aircrafts.
- Higher seating capacity to improve economies of scale:** A320Neo also have increased seat capacity (186 v/s 180 in the existing A320s). Hence, its induction

is likely to increase the revenue per aircraft while keeping the employee per aircraft same.

**Exhibit 73: Induction of A320Neos to improve fuel consumption progressively**



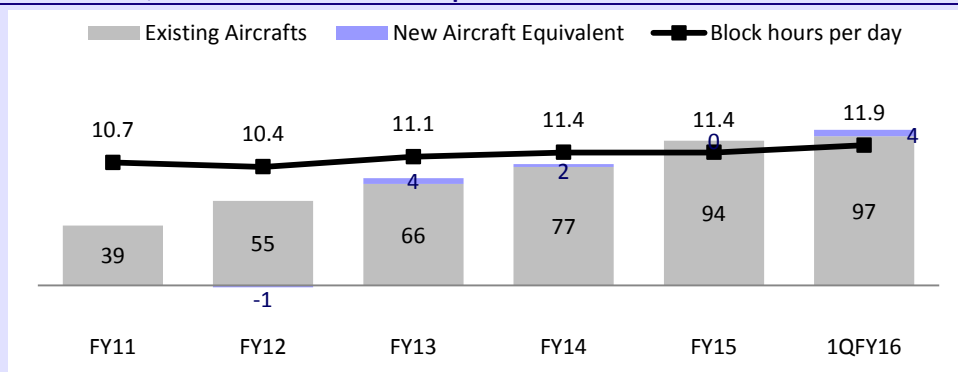


### Some key things to know

#### 1. Increase in block hours $\approx$ new aircraft addition

- As measured by daily block hours, IndiGo's aircraft utilization has consistently increased— increased to 11.9 hours in 1QFY16 from 11.4 hours in FY15.
- Based on the analysis of global LCCs, we believe IndiGo has room to improve its block hours performance. For its FY15 fleet size, we estimate that an addition of 0.5 block hours is equivalent to adding four new aircraft!

**Exhibit 74: 1QFY16 block hour increase equivalent to addition of four new aircraft**



Source: Company, MOSL

#### 2. Indigo is a low-cost but not low-fare airline

- Historically, Indigo has stayed away from flash ticket sales and till date it has not sacrificed profitability for market share.
- Analysis of 2014 airfares and profitability makes us conclude that while Indigo might have higher share of low-priced tickets, its profitability is ahead of competition. Further, the low-priced ticket cost is comparable to even FSCs — implying that Indigo is essentially a low-cost airline and not a low-fare one.
- We believe that while other airlines might offer low fares in promotional schemes from time to time, they are not able to sustain it—possibly due to higher costs. However, IndiGo is able to keep prices low sustainably owing to its cost leadership.
- Promotional sales are typically characteristic of industries facing strong price competition, and we believe this will continue to weigh on the profitability of all the players.

**Exhibit 75: Indigo's minimum fares comparable to FSCs; however, it stays away from high discounts to maintain profitability**

	Minimum fare offered in 2014					Low air fare bucket in 2014 as % of revenue				
	IndiGo	GoAir	SpiceJet	Jet	Air India	IndiGo	GoAir	SpiceJet	Jet	Air India
BOM – DEL	2,600	2,600	2,399	2,481	2,608	20.1	3.3	7.9	7.7	1.7
BOM - MAA	2,090	2,141	2,194	2,015	2,589	20.1	4.8	6.9	9.4	1.8
DEL - MAA	3,170	NA	864	2,186	2,385	21.8	2.1	8.0	9.9	1.6
BLR - BOM	1,789	1,901	486	1,439	1,902	22.4	6.2	6.8	7.2	1.4
BLR - DEL	2,649	3,400	952	2,594	2,525	24.3	7.9	7.5	6.9	0.3

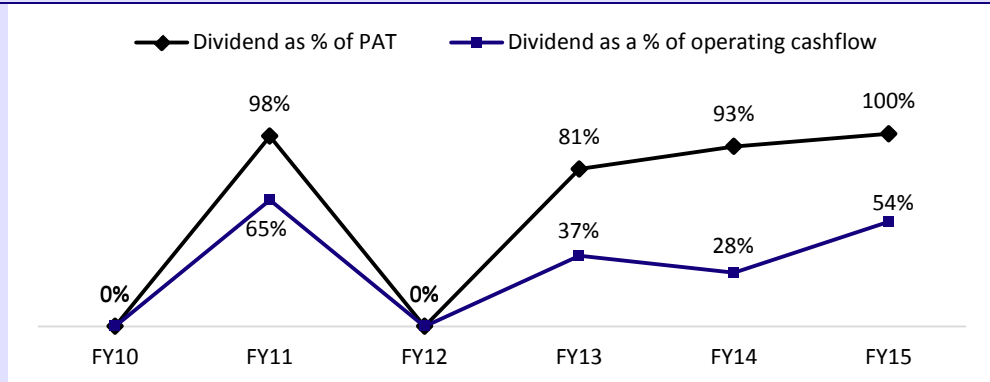
Source: DGCA, MOSL

### Addressing some investor concerns

#### Negative net worth before IPO due to dividend payout

- We believe this is not a concern, given Indigo's business model. Indigo operates with a negligible fixed capital (higher share of operating leases) and negative working capital, resulting in very high conversion of profits into distributable free cash flows.
- During FY11-15, Indigo paid out ~40% of the operating cash flow as dividend. While the management has not made any promises on dividend, it has indicated that in future it will follow a similar policy.
- **Management on dividend:** "We are not in a steady business. This is an airline business and there will be volatility on fuel, competitors doing things. But our philosophy on dividends is very simply: We will have a certain amount of profit, keep what we need for capital needs, excluding aircraft and ground equipment, and the rest belongs to shareholders, which should go back to them. That is why we don't have a steady percentage dividend number" (BS, Oct 23, 2015).

#### Exhibit 76: Indigo's historical dividend payout significantly high; we model similar trend to continue



Source: Company, MOSL

#### Are cash incentives on bulk ordering sustainable and predictable

- At the outset, we would like to note that almost all airlines globally use a mix of operating and finance lease—similar to Indigo.
- **Cash incentives on aircraft** = Purchase price paid by the third-party lessor to airline manufacturer less negotiated price by Indigo with airline manufacturer
- The incentives are recorded in the balance sheet as deferred incentives and then amortized over the lease term by reducing the rental cost. Amortization ensures minimal volatility in earnings.
- As on June 30, 2015, Indigo had deferred incentives of INR16.5b and amortized value benefit will be reflected for the remaining period of the lease.
- Given that the negotiated aircraft price is lower than the list price, this benefit will continue (till 2026 for Indigo) as long as the company adds new aircraft.

## Initiate coverage with a Buy; TP at INR1,478

### Valuations driven by rapid capacity growth and high margins

- **Market leadership likely to strengthen further:** With 34% market share, IndiGo is well positioned to benefit in the underpenetrated Indian aviation market. Current macro factors offer favorable conditions for demand drivers and we expect IndiGo to further strengthen its leadership position.
- **Low cost a sustainable competitive advantage:** IndiGo is not only the lowest-cost operator domestically, but is also comparable with global low-cost airlines. IndiGo's (a) unique fleet strategy, (b) focus on lowering operating costs, (c) visionary management and (d) scale gives it a sustainable competitive advantage over peers.
- **Highly efficient management:** IndiGo's management has proven its expertise in the unique fleet strategy and its focus on containing non-fuel costs (flat for the last 5 years). Also, management's commentary that it is a low-cost carrier and not low-fare carrier implies preference to profitability over market share.
- **Investor-friendly dividend policy:** IndiGo's focus to lower fixed costs (through higher operating leases) and negative working capital helps it to significantly increase distributable free cash flow. For the last five years, its dividend stood at 30% of operating cash flow and 76% of profit. Management has indicated that it expects to continue its dividend policy of high payouts.

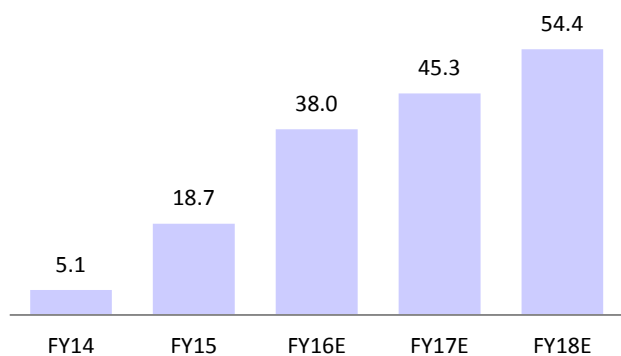
### Key assumptions

- In our estimates through FY18, we model (a) fleet size growth from 94 in FY15 to 154 in FY18 and (b) load factor (seat utilization) moving from 80% in FY15 to 84% in FY18.

### Expect 43%/44% EBITDA/PAT CAGR through FY18

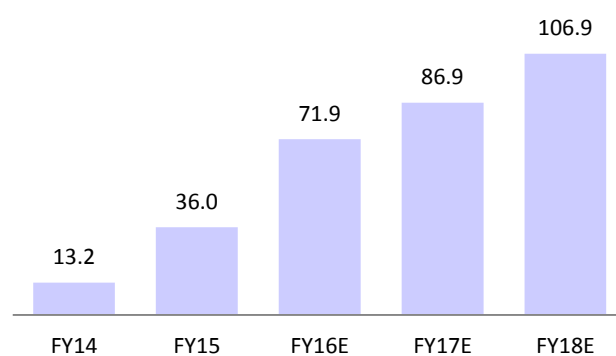
- We model EBITDAR/EBITDA CAGR at 33%/43%, leading to PAT CAGR of 44% led by revenue passenger kilometer (RPK) CAGR of 21% (v/s 28% in the last four years) and expansion in EBITDA margin from 13.4% in FY15 to 22.3% FY18.

**Exhibit 77: Expect FY15-18 EBITDA CAGR at 43% (INR b)**



Source: Company, MOSL

**Exhibit 78: Expect FY15-18 EPS CAGR at 44% (INR)**



Source: Company, MOSL

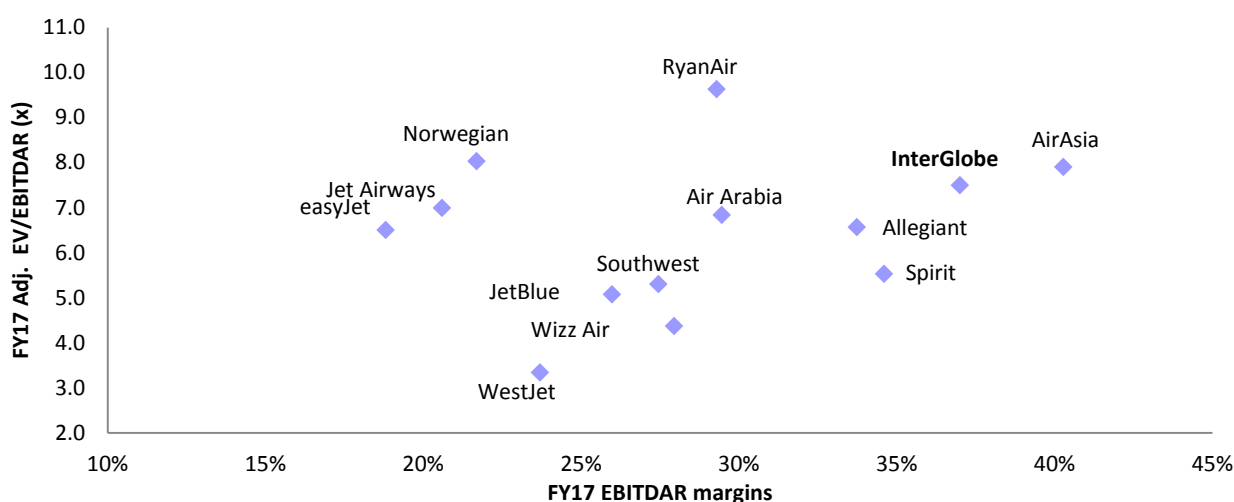
**Value IndiGo at INR1,478/share**

- **IndiGo warrants a premium:** We believe that IndiGo warrants a premium valuation compared with international LCC peers due to (a) it being positioned at the forefront of Indian aviation market growth story and (b) consistently comparable and higher EBITDAR margins even when present in a country that has comparatively high ATF prices (fuel expenses are the biggest cost component for an airline).
- Further, it should command a premium over Indian peers due to (a) it being the only airline to post profits consistently in the last seven years and (b) rapid fleet expansion in the next 3-4 years.
- **Upside to payout assumptions:** Our dividend payout assumption of 60% has an upside risk as the last three years average payout was 91%. Nevertheless, we note that even on our reduced payout ratio assumption, the dividend yield is attractive at >4%.
- While the long-term earnings trajectory for IndiGo is very promising, we remain cognizant of the volatility in oil prices—which could result in significant fluctuations in earnings. Hence, despite our 44% earnings CAGR through FY18, we assign lower FY17E P/E target multiple of 17x (10% premium to global LCC player RyanAir).
- We value IndiGo at 17x FY17E EPS to arrive at a fair value of INR1,478/sh (48% upside. At our target price, implied FY17E EV/EBITDAR stands at 9.7x (v/s 9.6x for RyanAir).
- On FY17E, the stock currently trades at 11.5x EPS and adj. EV/EBITDAR of 7.4x with an implied dividend yield of >4%. Initiate coverage with a Buy.

**Exhibit 79: Global peers trade at 6x-16x FY17E earnings**

	M Cap (USD B)	EPS CAGR (%)		PE (x)		Adj. EV/EBIDTAR (x)			Div Yield
		FY15-17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY17E
Asia Pacific - EM									
AirAsia Bhd	0.9	179.9	90.7	7.8	5.8	9.7	8.1	7.9	3.4
Cebu Air Inc	1.1	196.4	60.9	7.1	6.7	8.8	5.7	n.a.	2.5
Jet Airways India Ltd	1.0	LP	n.a.	13.9	8.2	13.4	7.2	6.5	n.a.
North America									
Southwest Airlines Co	29.0	56.6	21.0	12.6	11.0	8.6	5.8	5.3	0.7
JetBlue Airways Corp	8.1	28.4	22.7	13.3	11.4	9.7	5.8	5.1	
WestJet Airlines Ltd	1.8	13.6	13.6	6.5	6.9	3.8	3.4	3.3	3.0
Spirit Airlines Inc	2.9	12.0	24.5	10.1	10.6	6.9	5.6	5.5	0.0
Allegiant Travel Co	2.9	65.0	16.0	13.8	13.1	13.3	7.0	6.6	0.9
Eurasia & ME									
Air Arabia PJSC	1.5	11.8	12.5	9.4	8.0	9.4	7.8	6.8	8.6
easyJet PLC	10.1	14.1	12.4	12.3	11.3	8.7	7.5	7.0	3.6
Norwegian Air Shuttle ASA	1.2	LP	n.a.	17.4	9.8	40.0	9.9	8.0	0.0
Ryanair Holdings PLC	21.0	57.7	20.6	17.8	15.8	17.0	12.4	9.6	0.0
Wizz Air Holdings Plc	1.3	n.a.	n.a.	1.3	14.9	5.9	4.6	4.4	0.0
Indigo	5.4	55.5	27.8	13.9	11.5	5.0	8.5	7.4	4.3

Source: Bloomberg, MOSL

**Exhibit 80: Despite superior margins, Interglobe (Indigo) trading at discount to RyanAir**

Source: Bloomberg, MOSL

**Exhibit 81: IndiGo—Key assumptions**

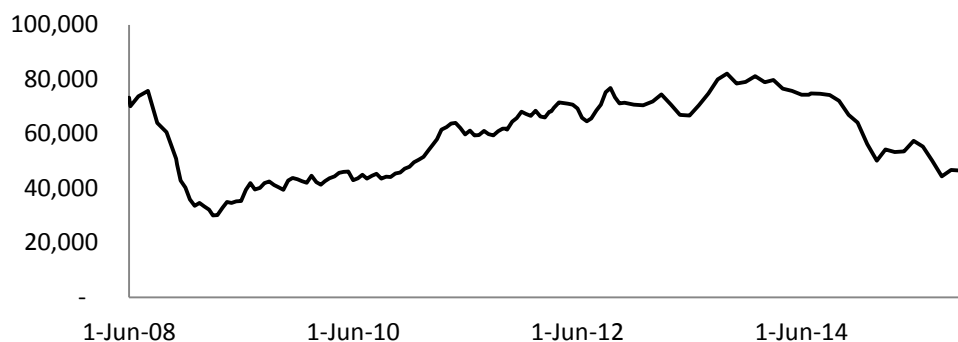
Y/E March	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
<b>Fleet and capacity</b>								
Fleet size (No)	39	55	66	77	94	111	134	154
Fleet Size Chg (No)		16	11	11	17	17	23	20
YoY (%)		41%	20%	17%	22%	18%	21%	15%
ASK per airplane (millions)	320	383	413	419	413	414	416	417
ASK (millions)	12,491	18,006	24,977	29,967	35,327	42,435	50,955	60,074
YoY (%)		44%	39%	20%	18%	20%	20%	18%
Load Factor	85%	82%	81%	77%	80%	82%	83%	84%
RPK (millions)	10,634	14,826	20,260	23,136	28,177	34,797	42,293	50,463
YoY (%)		43%	39%	37%	22%	23%	22%	19%
<b>Revenue Calculation</b>								
	<b>15.0</b>	<b>19.0</b>	<b>17.4</b>	<b>17.7</b>	<b>15.7</b>	<b>11.9</b>	<b>13.1</b>	<b>13.7</b>
Ticket Revenue (INRm)	33,910	49,873	82,667	99,240	122,939	144,408	179,800	216,392
Yield (INR/RPK)	3.19	3.36	4.08	4.29	4.36	4.15	4.25	4.29
Yield - INR/RPK (YoY %)	2%	5%	21%	5%	2%	-5%	2%	1%
Ancillary revenues	4,424	5,774	9,365	11,926	16,314	18,701	23,284	28,023
<b>Total Revenue (INR mn)</b>	<b>38,334</b>	<b>55,647</b>	<b>92,031</b>	<b>111,166</b>	<b>139,253</b>	<b>163,109</b>	<b>203,085</b>	<b>244,414</b>
YoY (%)		45%	65%	21%	25%	17%	25%	20%
<b>Fuel Cost</b>								
Exchange rate (INR/USD)	45.6	47.9	54.4	60.5	61.2	60.0	66.0	66.0
Brent Price (USD/bbl)	86.7	114.5	110.5	107.6	85.5	50.0	55.0	60.0
ATF Prices (INR/ltr)	47.8	63.8	70.8	75.7	68.4	49.5	55.7	58.8
YoY (%)		33%	11%	7%	-10%	-28%	12%	6%
Avg. aircraft utiliz. (block hours / day)	10.7	10.4	11.1	11.4	11.4	11.4	11.4	11.4
Block hours (number)	125,553	179,252	246,140	297,653	354,276	418,874	509,723	599,184
Fuel (m litres / block hour)	2,535	2,513	2,475	2,445	2,373	2,351	2,295	2,259
Fuel cost per block hour (INR)	121,170	160,310	175,210	185,227	162,260	116,382	127,718	132,770
<b>Aircraft fuel expenses (INRm)</b>	<b>15,213</b>	<b>28,736</b>	<b>43,126</b>	<b>55,134</b>	<b>57,485</b>	<b>48,749</b>	<b>65,101</b>	<b>79,554</b>

Source: Company, MOSL

### Earnings Sensitivity

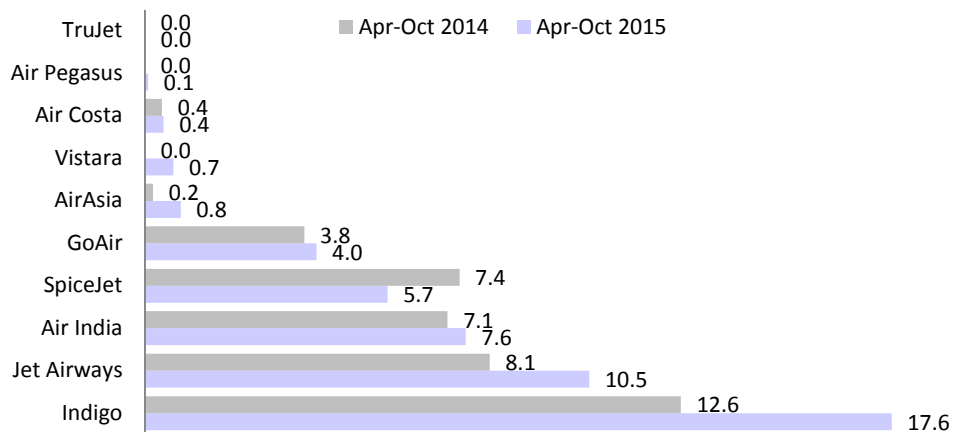
We have done sensitivity analysis for FY17 EPS with respect to ATF price and passenger growth. Aviation fuel cost stands 30%-50% of revenues and has a direct impact on ticket prices and in turn passenger growth.

**Exhibit 82: Average ATF prices (INR/KL) across Delhi, Chennai, Kolkata and Mumbai**



Source: Bloomberg, MOSL

**Exhibit 83: IndiGo's passenger volumes up 39.3% YTD**



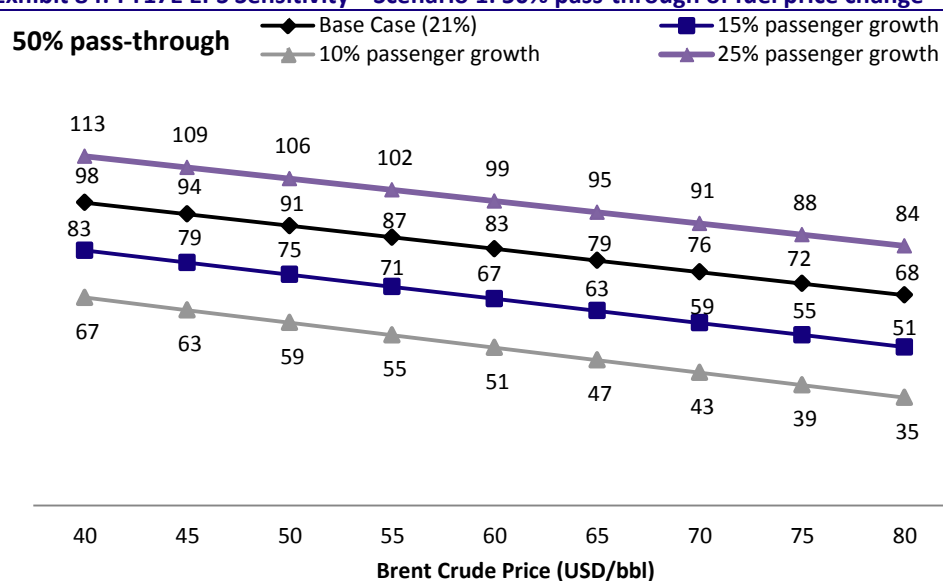
Source: DGCA, MOSL

For scenario analysis, we have assumed two scenarios:

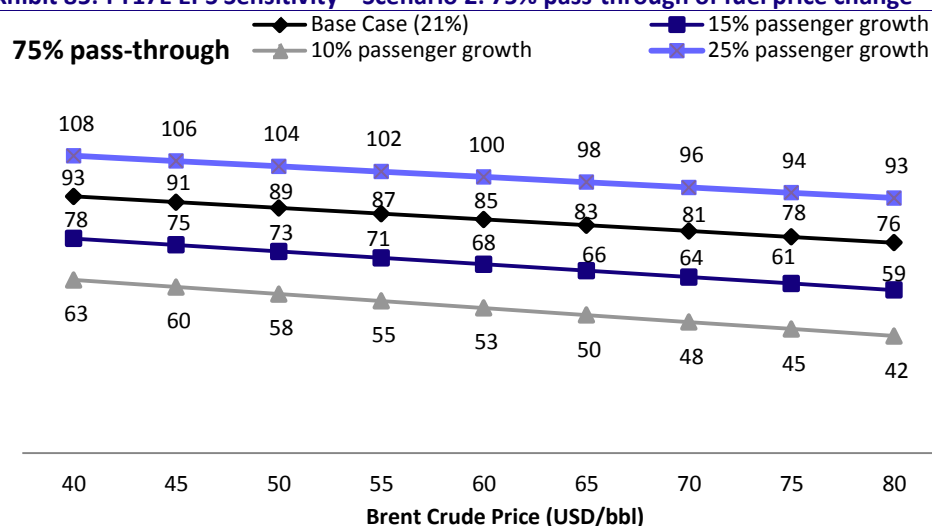
**Scenario 1:** 50% pass-through of fuel price change,

**Scenario 2:** 75% pass-through of fuel price change.

And within these scenarios, our passenger traffic growth ranges between 10% and 25%.

**Exhibit 84: FY17E EPS Sensitivity—Scenario 1: 50% pass-through of fuel price change**

Source: Bloomberg, MOSL

**Exhibit 85: FY17E EPS Sensitivity—Scenario 2: 75% pass-through of fuel price change**

Source: Bloomberg, MOSL

## Key risks

**Economic risks:** Airline industry passenger growth is closely linked to GDP growth rates. Any slowdown in domestic GDP growth, seasonality will impact overall passenger growth.

**Infrastructural constraints:** Many large airports in India have capacity constraints to handle flights in the prime time slots. Any delay in debottlenecking the capacity will limit the growth in those cities.

**Increased competition:** Any move by competitors like high cash burn to gain market share will impact market share during that period. We believe IndiGo management will not sacrifice profitability for the sake of market share.

**Sharp increase in oil prices:** Oil price is an airline's biggest cost component (40-50% of total costs). While LCCs are in a better position versus FSCs during a high oil price scenario, high short-term volatility and inability to commensurately change ticket price will impact margins.

**Currency risk:** While almost all the revenue is in INR terms, ~70% of the expenses are USD denominated. Inability to pass the forex impact could reduce margins.

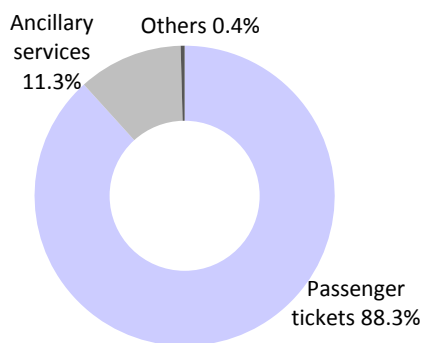
**Regulatory risks:** While the proposed aviation policy is intended to ease airlines, any delay in policy implementation or any adverse rules could have implications for the sector growth.



## Company background

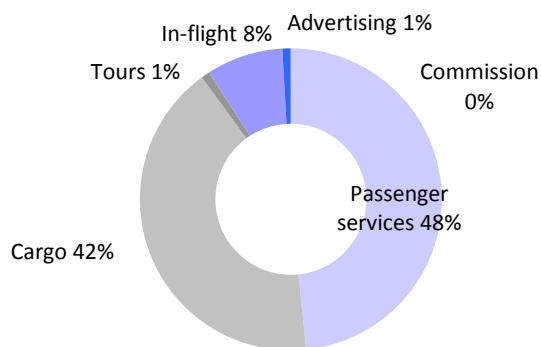
- Incorporated in January 2004, InterGlobe Aviation Limited (IAL) operates IndiGo—India's largest passenger airline with 33.9% and 37.4% market share of domestic passenger volume for FY15.
- The company operates on a low-cost carrier (LCC) business model and focuses on the domestic Indian air travel market. It caters to 33 airports in India and to 5 international airports, with a maximum of 603 domestic flights per day in the week ending August 31, 2015.
- It is continuously focused on maintaining the cost advantage and a high frequency of flights while striving to fulfill the simple brand message of providing "low fares, on-time flights and a hassle-free experience" to passengers.
- The company commenced operations in August 2006 with a single aircraft, and has grown to a fleet of 97 aircraft (75 are on an operating lease while 22 are on financial lease) as of August 31, 2015, all of which are Airbus A320.
- InterGlobe has identified geography as its primary segment; it reports its revenue in two segments: (a) Domestic and (b) international.
- It primarily generates revenue through passenger ticket sales. Additional revenue is generated through cargo services and typical activities associated with air-travel like ticket modification and cancellation, in-flight sale of eatables, special service requests etc.

**Exhibit 86: Total FY15 revenue breakup**

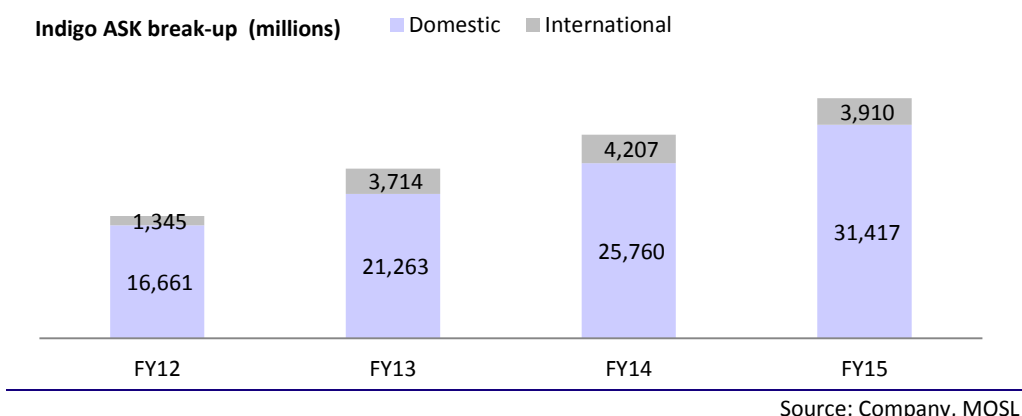
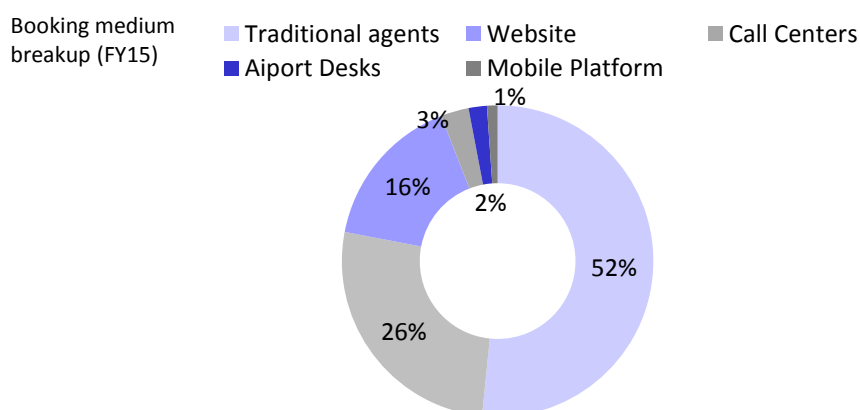


Source: Company, MOSL

**Exhibit 87: Total FY15 ancillary services breakup**



Source: Company, MOSL

**Exhibit 88: Indigo primarily operates on domestic routes****Exhibit 89: IndiGo's ticket booking medium breakup****Exhibit 90: Key milestones**

Year	Milestone
January, 2004	Incorporated
June, 2005	Placed a landmark order of 100 A320 aircraft with Airbus
July, 2006	Took delivery of the first aircraft
August, 2006	Launched its domestic operations
April, 2007	Crossed the one million passenger mark
April, 2009	Crossed the 10 million passenger mark
June, 2011	Placed another order of 180 A320neo aircraft with Airbus, which was again one of the largest orders
September, 2011	Launched its international operations
September, 2011	Became the largest domestic carrier in India by market share
October, 2011	Took delivery of 50th aircraft.
December, 2012	Crossed the 50 million passenger mark
February, 2013	Took delivery of 75th aircraft
April, 2014	Crossed the 75 million passenger mark
November, 2014	Took delivery of 100th aircraft
March, 2015	Crossed the 100 million passenger mark
August, 2015	Placed an order of 250 A320neo aircraft with Airbus

Source: Company, MOSL

**Exhibit 91: Promoters and key management**

Mr. Rakesh Gangwal,  
Promoter and Non-  
executive Director

- Mr. Gangwal has more than 30 years of experience in the aviation industry.
- He was the leader of driving hard bargains with Airbus and engine and spare parts manufacturers, something learnt from the President and CEO of US Airways Group.
- Most recently (from June 2003 to August 2007), he was the Chairman, President and CEO of Worldspan Technologies, Inc.
- He holds a bachelor's degree in mechanical engineering from IIT Kanpur and an MBA from Wharton with a major in finance.



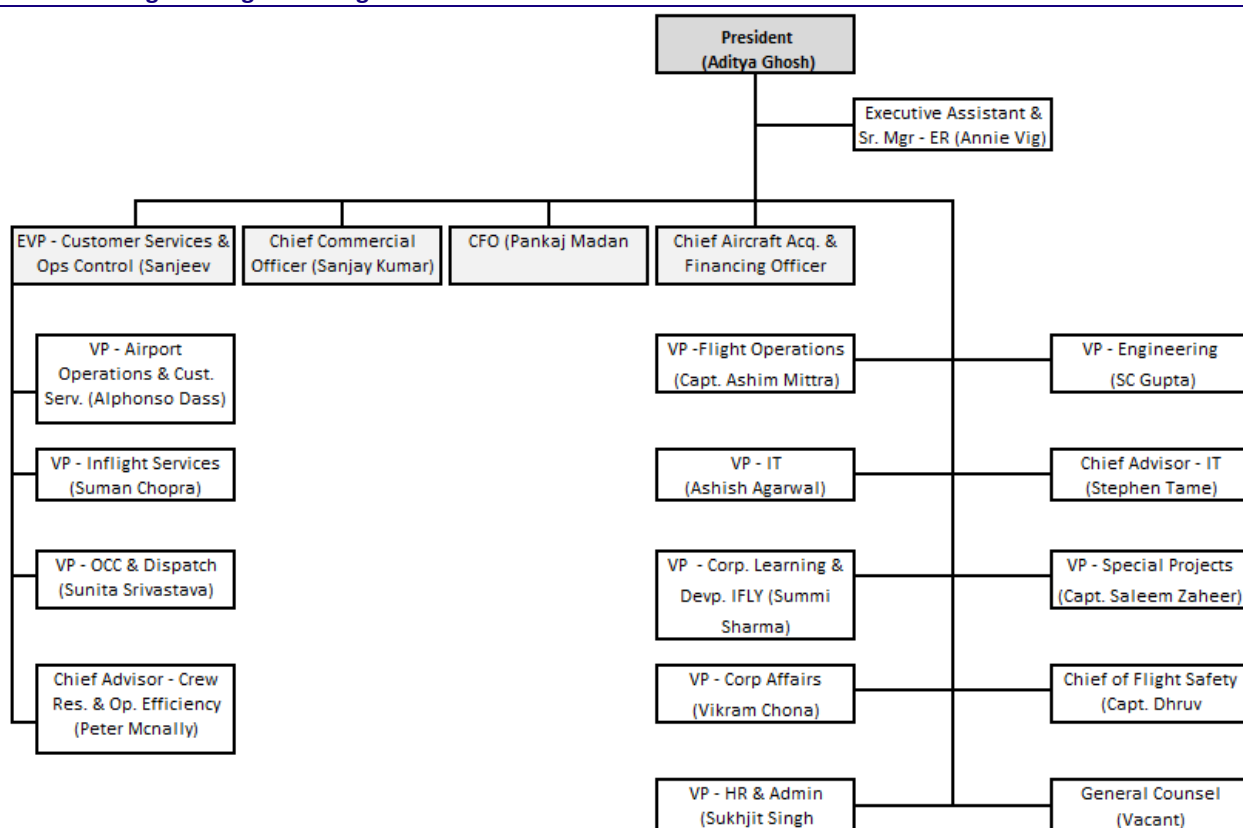
Mr. Rahul Bhatia,  
Promoter and Non-  
executive Director

- He holds a degree in electrical engineering from the University of Waterloo in Ontario, Canada.
- Mr. Bhatia was instrumental in the formation of InterGlobe Enterprises in 1989 with its flagship business of air transport management.
- He has more than 25 years of experience in the travel industry.



Mr. Aditya Ghosh,  
President and Whole-  
time Director

- Mr. Ghosh heads all operations and management of IndiGo. He became Director in May 2007 and President in August 2008.
- He also serves on the executive committee of InterGlobe Enterprises, which is responsible for managing the company's various businesses.
- Mr. Ghosh holds a bachelor's of law degree from Delhi University.
- Prior to joining InterGlobe Aviation in 2008, Mr. Ghosh was the group general counsel for InterGlobe Enterprises from 2004 to August 2008.
- He also practiced law from 1998 to 2004 at J. Sagar Associates, Advocates & Solicitors.

**Exhibit 92: Indigo management organization structure**

Source: Company, MOSL

## Annexure 1: Aviation regulatory environment

### Key features of the proposed aviation policy

- **India targeting 4-5x passenger growth by 2022:** The government is targeting 300m domestic tickets by 2022 (versus 70m now) and 500m by 2027. Similarly, it is targeting increasing international ticketing to 200m by 2027.
- **Encouraging addition of new locations:** Under the regional connectivity scheme (RCS), the government plans to provide subsidies to airlines for flying on certain routes and limiting the flying cost to INR2,500 per flying hour. The government will exempt ATF drawn from RCS airports from excise duty, apart from not levying airport charges for 10 years and no service tax on tickets under RCS.
- **Reviving airports:** The government would also revive underutilized or unserved airports and airlines at 400 locations at an estimated cost of around INR50cr to support flights to these new locations. Requirement of project IRR of 12% will be relaxed for airports under the Airport Authority of India (AAI).
- **Promoting new airports near congested airport locations:** Further, under the current regulations, development of an airport within 150km radius of an existing AAI airport is not permitted; the government will relax this requirement. However, AAI may have the right of first refusal (to prohibit development of such an airport) or can have equity participation of 49% in the new airport. We believe that since major airports are near capacity, the relaxation will invigorate airport infrastructure development in India.

Exhibit 93: Of the 476 airports and strips in India, only 75 are served fully



Source: AAI, MOSL

- **Incentives to shift aircraft maintenance to India:** Currently, Indian airlines incur 90% of their annual INR5,000cr maintenance, repair and overhaul (MRO) expenditure outside India. Overseas repairs increases the overall costs of airlines, and a domestic well-functioning MRO industry is expected to reduce these expenses. To develop the MRO sector, the government is considering providing service tax waiver, apart from relaxing import of some spare parts. Further, the state governments will be encouraged to waive VAT charges.

#### Exhibit 94: India's existing aviation policy comparison with that of developed countries

Policy/Regulation for the following	India	US	UK	Australia	Singapore	Germany	France	Hong Kong	Dubai
FDI in airlines	✓	✓	✓	✓	×	✓	✓	×	×
Licensing of airline in terms of timelines	×	✓	✓	✓	✓	✓	✓	✓	✓
Bilateral	×	✓	✓	✓	✓	✓	✓	×	×
Regional connectivity	✓	✓	✓	✓	×	✓	✓	×	
Airport economic policy	×	✓	✓		✓	×	✓	×	×
Public-Private Partnership in airports	✓	×	×	✓	×	×	×	×	
SI allocation	×	✓	×	✓	×	✓	✓	✓	×
Environment	✓	✓	✓	✓	✓	✓	✓	✓	✓
Safety	✓	✓	✓	✓	✓	✓	✓	✓	✓
Security	✓	✓	✓	✓	✓	✓	✓	✓	✓
Security/regulatory requirements	×	×	✓	✓		✓	×		×
Car and express	✓	✓	×	✓	×	✓	×	×	
Aerospace		✓	✓	×	×	×	×	✓	×
General aviation and business aviation	×	✓	✓	✓	✓	×	×	×	×

Source: CAPA, MOSL

#### New proposed route dispersal guidelines

- Indian government introduced route dispersal guidelines in 1994. The underlying objective of the guidelines was to ensure air connectivity to J&K, NE, island territories and Tier-2 and Tier-3 cities.
- Category-II and Category-III routes under the earlier guidelines have seen more than required capacity deployed, which points out that there is adequate potential to expand Category-I.
- We believe that addition of routes under Category-I will provide space to airlines to rationalize their existing network.

#### Exhibit 95: Categorization of routes under the existing route dispersal guidelines

Category-I Routes	Category-II Routes	Category-III Routes
Mumbai - Bangalore	Stations in:	Routes other than Category I and II
Kolkata - Delhi	North Eastern region,	
Mumbai - Kolkata	Jammu & Kashmir	
Kolkata - Bangalore	Andaman & Nicobar	
Mumbai - Delhi	Lakshadweep	
Kolkata - Chennai		
Mumbai - Hyderabad		
Delhi - Bangalore		
Mumbai - Chennai		
Delhi - Hyderabad		
Mumbai - Trivandrum		
Delhi - Chennai		

Source: Ministry of Civil Aviation, MOSL

- Under the guidelines, any airline operating on one or more of the Category-I routes is required to provide services on Category-II and Category-III routes as defined in the following points.
- On Category-II routes, an airline will have to deploy at least 10% of the capacity it deploys on Category-I routes. Within the required capacity to be deployed, at least 10% should be deployed on services operating exclusively within NE, Jammu and Kashmir, Andaman & Nicobar, and Lakshadweep.
- At least 50% of the capacity deployed on Category-I routes will be deployed on Category-III routes.
- On a route connecting destinations that fall under different categories, the route will be broken into point-to-point sub-routes and these sub-routes will be counted toward each category requirement.
- For example, on a Delhi-Kolkata-Guwahati-Imphal route, the capacity on Kolkata-Guwahati route will be counted under Category-II routes and that on the Guwahati-Imphal route will be again counted under exclusive capacity within Category-II routes.

#### **Exhibit 96: Guidelines for defining new Category-I routes**

##### **Category-I Routes**

The routes should have a flying distance of at least 700 km

The routes should have an average seat factor of 70% (timeline for computing average factor not specified)

The routes should have an annual traffic of 50mn passengers

Source: Ministry of Civil Aviation, MOSL

**Annexure 2: Fare structure for a standard air ticket in India**


Some charges that appear on a common air ticket are not actually levied by the airline, but by airport authorities and the government. These charges are hence passed on to the relevant authorities and appear in expenses of an airlines income statement.

**Exhibit 97: Components of a standard air ticket**

Name	Agency/Airline	Brief Description
Base Fee	Charged by airlines	Basic fare charged by airlines to passengers
Passenger Service Fees	Charged by AAI airports and private airports.	To cover Security and Facilitation at all airports. This part is passed through to airport authorities
User Development Fees/Development Fees	Charged by AAI airports and private airports.	Levied by airports to fund passenger facilitation. This part of fare is passed through to airport authorities
CUTE Fee	Charged by airlines	Common Use Terminal Equipment fee - fee charged for check-in process
Service Tax	Charged by Central Board of Excise and Customs, Central Government	Service Tax on transportation by air (journeys starting in India).
Fuel Surcharge	Charged by airlines	Not passed through to others. Some airlines now club this with base fees
Carrier Imposed Misc Fees	Charged by airlines	Charged under various names

Source: Air India , MOSL

**Exhibit 98: Fare structure of a standard IndiGo ticket**

Price Summary	
 <b>Departing</b>	
<b>DEL</b> Sun 10 Jan 16 05:30	<b>BOM</b> Sun 10 Jan 16 07:40
Flight No. 6E 171	
<b>Price Details</b>	
Airfare Charges	<b>2,785.00 INR</b>
Taxes & Fees	
Development Fee	<b>115.00 INR</b>
Passenger Service Fee	<b>149.00 INR</b>
User Development fee	<b>562.00 INR</b>
Swachh Bharat Cess	<b>6.00 INR</b>
Government Service Tax	<b>156.00 INR</b>
<b>Total Price:</b>	<b>3,773.00 INR</b>

Source: Company, MOSL

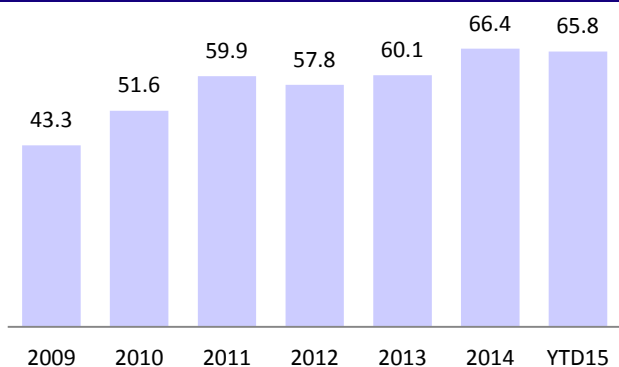
**Exhibit 99: Fare structure of a standard SpiceJet ticket**

Price Summary [ Indian Rupee (INR) ]	
Sun 10 Jan, 2016 DEL to BOM	
Flight SG 153 6:35 AM to 8:45 AM	
<b>Price Summary</b>	
<b>1 Adult (SpiceFlex Fare)</b>	<b>4,549.00</b>
CUTE Fee	50.00
Passenger Service Fee	149.00
User Development Fee – Departure (UDF)	676.00
Government Service Tax	267.00
<b>Total Price:</b>	<b>5,691.00</b>

Source: Company, MOSL

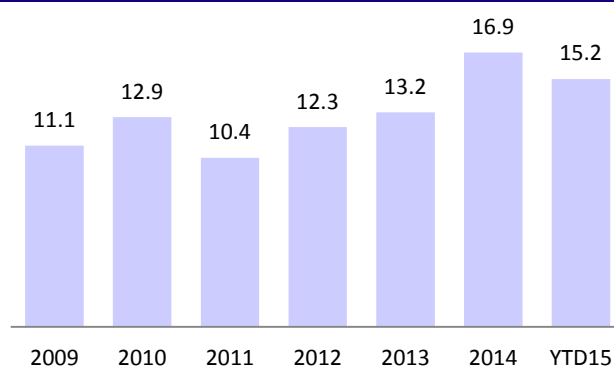
## Annexure 3: Indian aviation sector statistics

**Exhibit 100: Total domestic passengers (m)**



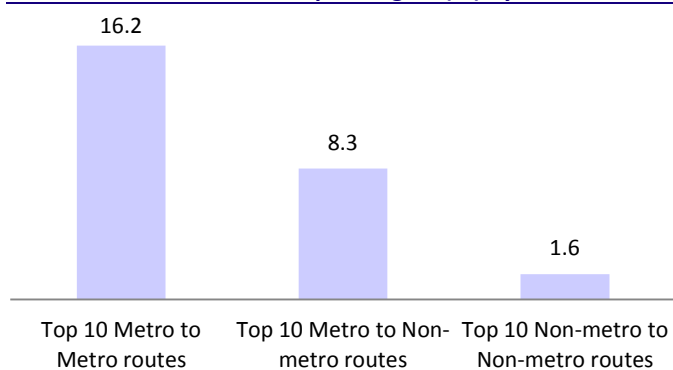
Source: DGCA, MOSL

**Exhibit 101: Total international passengers (m)**



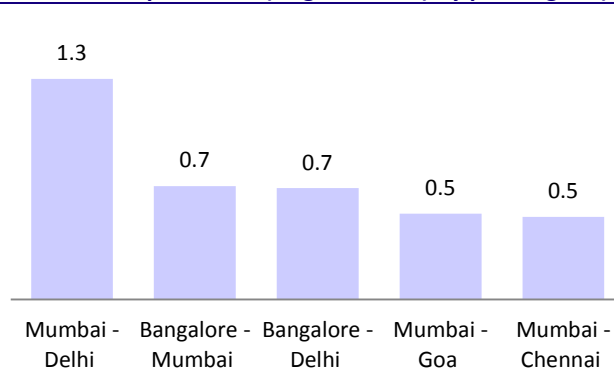
Source: DGCA, MOSL

**Exhibit 102: Distribution of passengers (m) by routes in FY15**



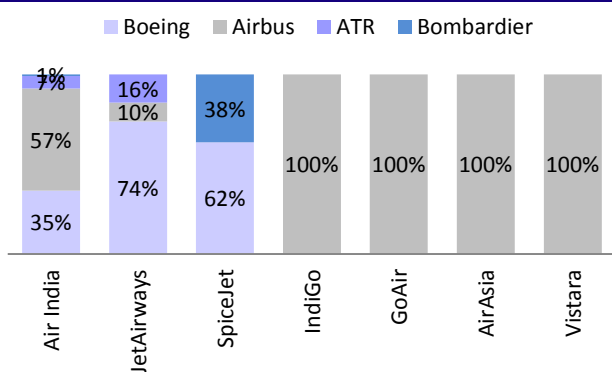
Source: CAPA, Company, MOSL

**Exhibit 103: Top 5 routes (Aug-Oct 2015) by passengers (m)**



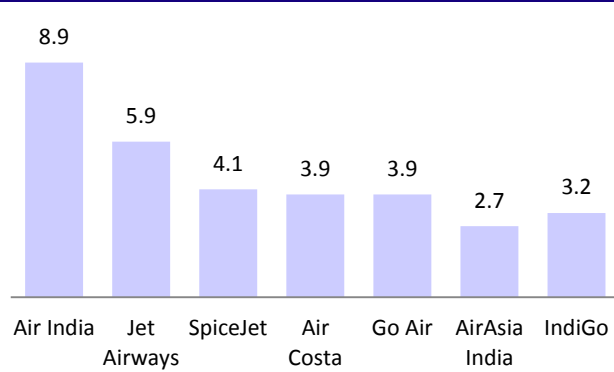
Source: DGCA, MOSL

**Exhibit 104: Fleet distribution of major airlines**



Source: CAPA, DGCA, Company, MOSL

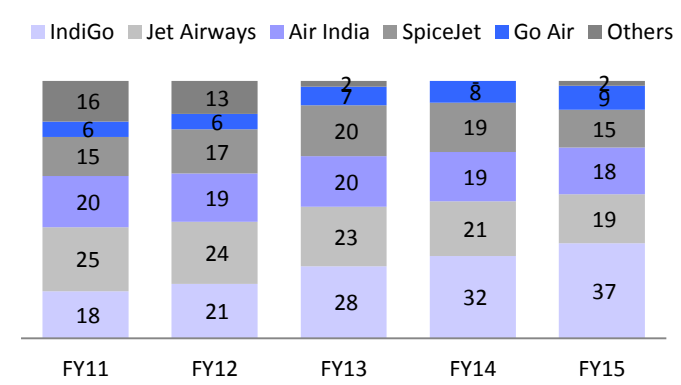
**Exhibit 105: Average fleet age of major airlines**



Source: DGCA, Company, MOSL

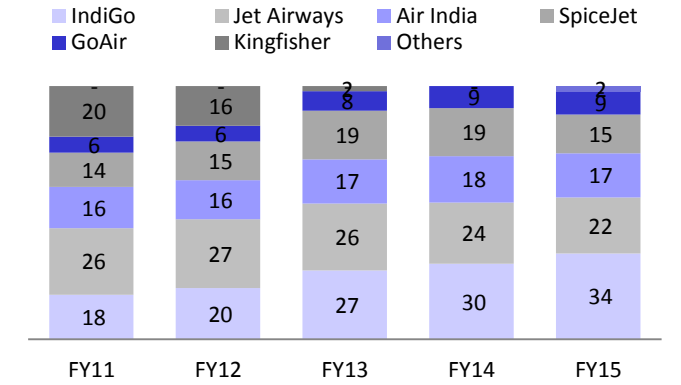


Exhibit 106: Capacity market share (ASK) of major airlines



Source: CAPA, DGCA, Company, MOSL

Exhibit 107: Passenger market share of major airlines



Source: DGCA, Company, MOSL

Exhibit 108: A few of India’s states are equal to some European countries in area, implying huge air travel opportunity with increasing per capita income: Clockwise (1) Uttar Pradesh~ UK, (2) Bihar ~ Hungary, (3) Haryana ~ Denmark (excl. Greenland) and (4) Arunachal Pradesh ~ Austria



Source: Storypick, MOSL

## Annexure 4: FSC v/s LCC business model

- **The LCC model:** Southwest Airlines, in the US, is usually cited as pioneering the business model of low-cost carriers in 1970s with the sole objective of offering cheap air-fares to the passengers. Naturally, the business model required a re-look at each business area, from seating arrangements to other high cost areas of the business. Fleets began to be standardized, and fare structure simplified with some elimination of in-flight amenities.

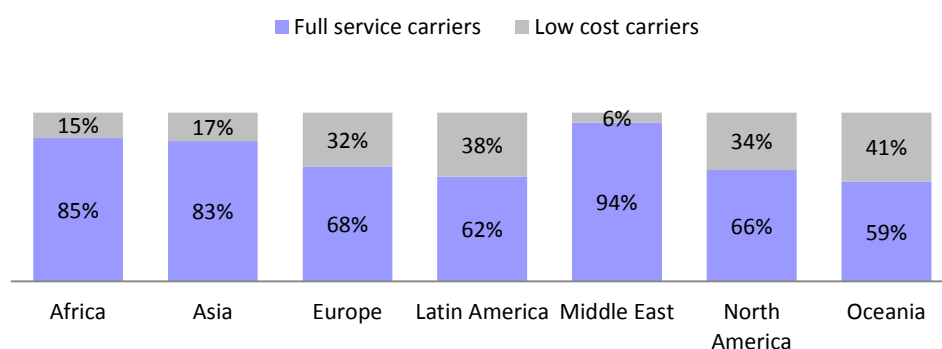
**Exhibit 109: Comparison of Low-Cost Carrier business model and traditional airlines**

	Full Service Carrier (FSC)	Low Cost Carrier (LCC)
<b>Fare structure</b>	Multiple fare structures with various restrictions.	Simplified fare structure.
<b>Distribution</b>	Low direct sales, high dependency on travel agents.	High direct sales and low dependency on travel agents.
<b>Route structure</b>	High frequency Hub and Spoke route structure.	High frequency Point to Point route structure.
<b>Seating</b>	Multiple classes with mixed seating density (Economy/Business/First). Pre assigned seating.	Single class high density seating, unreserved seating.
<b>In flight</b>	Hot meals and in-flight entertainment.	No hot meals. Snacks and light beverages only, no in-flight-entertainment
<b>Frequent flyer</b>	Frequent flyer program.	No frequent flyer program
<b>Aircraft</b>	Multiple aircraft types and low utilization of aircraft (9 hours/day)	Limits many aircraft type, high utilization rate (12 hours per day)
<b>Trip Length</b>	Medium to long	Short to medium.
<b>Airport</b>	Primary airport with major international connections.	Secondary/uncongested airports which facilitates fast turnaround of aircraft.
<b>Staff</b>	High wage but low productivity. No profit sharing.	Competitive wage, profit sharing plan and highly productive employees

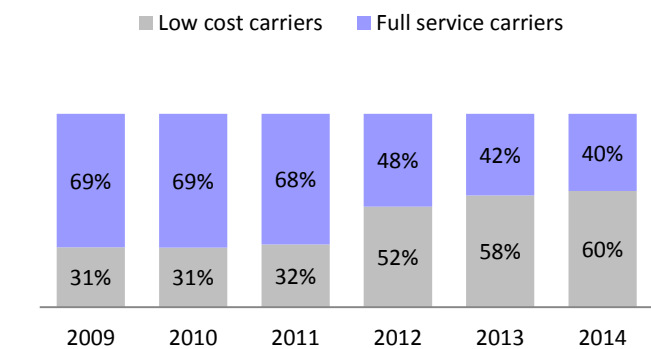
Source: Carleton University, MOSL

- **Shift in market shares:** Due to lower fares, market share began shifting towards LCC. This shift was more prevalent in developing economies where passengers are more price-sensitive. Difference in market shares in developing South-East Asian countries and the developed North-East Asian countries (Japan, Korea etc.) highlights this trend.

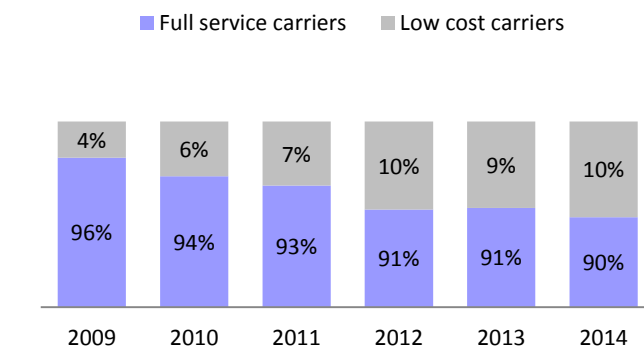
**Exhibit 110: LCCs' average 2009-14 market shares in domestic air travel**



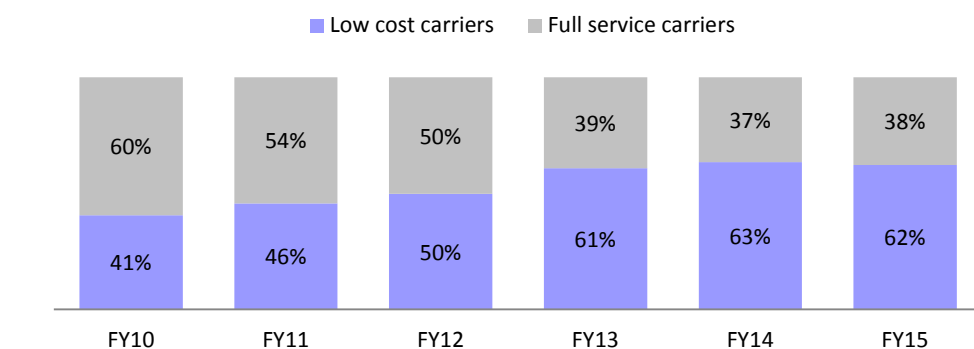
Source: Amadeus, MOSL

**Exhibit 111: LCCs dominate developing economies...**

Source: CAPA, MOSL

**Exhibit 112: ...FSCs dominate developed economies**

Source: CAPA, MOSL

**Exhibit 113: Similar to Southeast Asian countries, Indian aviation dominated by LCCs**

Source: DGCA, Company, MOSL

- Hybridization:** With loss of market shares, legacy and full service carriers have started adopting features of LCC model. This trend was furthered by the global financial crisis and post-crisis developments. At the same time, some LCCs began expanding their service offerings. According to KPMG, cost difference between LCCs and traditional carriers have reduced to 2.5 US cents in 2012 from 3.6 US cents per ASK. Further, some airlines have launched their own LCC services. For example, Jet Airways operates as a FSC, while JetLite was operated as a LCC.

## Annexure 5: Key terminologies for the airline industry

### 1. Available Seat Kilometer (ASK): The Basic Measure of Capacity

- One seat (empty or filled) flying one kilometer is an ASK
- A 180-seat A320 flying 100 kilometers creates 18,000 ASKs

### 2. Revenue Passenger Kilometer (RPK): The Basic Measure of Production

- A paying passenger flying one kilometer creates an RPK
- 150 passengers flying 100 kilometers generate 15,000 RPKs

### 3. Load Factor: Production Compared to Capacity

- To calculate the load factor, divide RPKs by ASKs
- For an individual flight, 15,000 RPKs divided by 18,000 ASKs, or 83%
- High load factor means high utilization, but how much each passenger pays is also important

### 4. Yield: Revenue per Passenger Kilometer

- To calculate the yield, divide passenger revenue by total RPKs
- To calculate a customer's individual yield, divide ticket price by kilometers; if a customer pays INR3,000 for the 500 kilometers, the yield would be INR6 per kilometer

### 5. Revenue per Available Seat Kilometer (R/ASK): The Basic Measure of Revenue

- It is a measure of how much revenue we generate per increment of capacity
- To calculate unit revenue, divide total operating revenue by total ASKs

### 6. Cost per Available Seat Kilometer (C/ASK): The Basic Measure of Cost

- Unit costs represent how much it costs to fly one seat (empty or filled) one mile
- To calculate unit costs, divide total operating expenses by total ASKs

### 7. Code Sharing

- Almost every airline in the world has a unique two letter code (some are one letter and one number) assigned by the International Air Transport Association (IATA) to identify its flights, tickets and other commercial documents. Many airlines have now entered into agreements whereby they share these codes, and usually coordinate their schedules as well. The result is that each airline can offer its passengers more destinations, and a more convenient routing to those destinations, than would be possible for either one of them alone. The motive, of course, is to control that traffic by keeping it within the joint system and avoid losing passengers who are going to points outside the route network of one or the other of the partners.

### 8. Utilization

- The word refers to the number of hours per day, usually Block, that an airplane operates. Its importance lies in the fact that the only way an airline can carry more passengers without adding new airplanes to the fleet is by increasing the load factor or the daily utilization.

## Financials and valuations

### Standalone income statement

(INR Million)

Y/E March	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
<b>Total Income from Operations</b>	<b>55,647</b>	<b>92,031</b>	<b>111,166</b>	<b>139,253</b>	<b>163,109</b>	<b>203,085</b>	<b>244,414</b>
YoY Chg (%)	45.2	65.4	20.8	25.3	17.1	24.5	20.4
<b>Total Expenditure</b>	<b>47,151</b>	<b>69,533</b>	<b>89,396</b>	<b>101,034</b>	<b>100,930</b>	<b>127,885</b>	<b>153,725</b>
<b>EBITDAR</b>	<b>8,496</b>	<b>22,498</b>	<b>21,769</b>	<b>38,219</b>	<b>62,178</b>	<b>75,199</b>	<b>90,689</b>
Margin (%)	15.3	24.4	19.6	27.4	38.1	37.0	37.1
Aircraft & Engine Lease Rentals	8,007	13,561	16,703	19,522	24,154	29,874	36,277
<b>EBITDA</b>	<b>489</b>	<b>8,936</b>	<b>5,066</b>	<b>18,697</b>	<b>38,024</b>	<b>45,326</b>	<b>54,412</b>
Margin (%)	0.9	9.7	4.6	13.4	23.3	22.3	22.3
Depreciation	665	856	2,260	3,022	3,710	4,383	5,091
<b>EBIT</b>	<b>-176</b>	<b>8,080</b>	<b>2,806</b>	<b>15,675</b>	<b>34,315</b>	<b>40,943</b>	<b>49,321</b>
Int. and Finance Charges	514	578	1,226	1,155	1,057	866	866
Other Income	1,440	2,371	3,155	3,838	3,774	4,679	6,591
<b>PBT</b>	<b>749</b>	<b>9,873</b>	<b>4,736</b>	<b>18,357</b>	<b>37,032</b>	<b>44,755</b>	<b>55,046</b>
Current Tax	0	837	0	1,839	11,110	13,427	16,514
Deferred Tax	-657	1,202	-9	3,563	0	0	0
Tax Rate (%)	-87.7	20.7	-0.2	29.4	30.0	30.0	30.0
<b>Reported PAT</b>	<b>1,406</b>	<b>7,834</b>	<b>4,744</b>	<b>12,956</b>	<b>25,922</b>	<b>31,329</b>	<b>38,532</b>
<b>Adjusted PAT</b>	<b>1,406</b>	<b>7,834</b>	<b>4,744</b>	<b>12,956</b>	<b>25,922</b>	<b>31,329</b>	<b>38,532</b>
Change (%)	-75.7	457.2	-39.4	173.1	100.1	20.9	23.0
Margin (%)	2.5	8.5	4.3	9.3	15.9	15.4	15.8

### Standalone balance sheet

(INR Million)

Y/E March	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Equity Share Capital	344	344	344	344	3,604	3,604	3,604
Total Reserves	2,090	3,547	3,874	3,918	17,604	30,201	45,695
<b>Net Worth</b>	<b>2,433</b>	<b>3,890</b>	<b>4,217</b>	<b>4,262</b>	<b>21,208</b>	<b>33,805</b>	<b>49,298</b>
Deferred Tax Liabilities	0	537	529	4,091	4,091	4,091	4,091
Total Loans	10,156	18,004	33,462	39,262	27,262	27,262	27,262
<b>Capital Employed</b>	<b>12,589</b>	<b>22,432</b>	<b>38,208</b>	<b>47,615</b>	<b>52,561</b>	<b>65,158</b>	<b>80,651</b>
Gross Block	10,737	20,362	44,505	56,727	67,531	79,292	91,244
Less: Accum. Deprn.	1,877	2,718	4,945	7,967	11,677	16,060	21,151
<b>Net Fixed Assets</b>	<b>8,860</b>	<b>17,645</b>	<b>39,560</b>	<b>48,760</b>	<b>55,854</b>	<b>63,232</b>	<b>70,093</b>
Capital WIP	0	69	0	5	1,201	1,440	1,488
<b>Total Investments</b>	<b>5,234</b>	<b>11,383</b>	<b>12,715</b>	<b>5,168</b>	<b>5,168</b>	<b>5,168</b>	<b>5,168</b>
<b>Curr. Assets, Loans&amp;Adv.</b>	<b>21,711</b>	<b>29,428</b>	<b>38,759</b>	<b>53,805</b>	<b>65,403</b>	<b>87,829</b>	<b>114,006</b>
Inventory	374	523	673	1,306	1,304	1,653	1,986
Account Receivables	389	685	891	1,046	1,225	1,525	1,835
Cash and Bank Balance	13,088	13,406	11,015	19,994	26,025	38,771	54,967
Loans and Advances	7,860	14,814	26,180	31,460	36,849	45,881	55,218
<b>Curr. Liability &amp; Prov.</b>	<b>23,882</b>	<b>36,093</b>	<b>52,826</b>	<b>60,123</b>	<b>75,066</b>	<b>92,511</b>	<b>110,104</b>
Account Payables	1,585	2,648	3,828	4,755	4,750	6,018	7,234
Other Current Liabilities	21,952	32,906	43,985	53,316	60,423	77,127	91,350
Provisions	345	539	5,013	2,051	9,893	9,366	11,519
<b>Net Current Assets</b>	<b>-2,170</b>	<b>-6,665</b>	<b>-14,067</b>	<b>-6,318</b>	<b>-9,663</b>	<b>-4,682</b>	<b>3,902</b>
Deferred Tax assets	665	0	0	0	0	0	0
<b>Appl. of Funds</b>	<b>12,589</b>	<b>22,432</b>	<b>38,208</b>	<b>47,615</b>	<b>52,560</b>	<b>65,157</b>	<b>80,651</b>

E: MOSL Estimates

## Financials and valuation

### Ratios

Y/E March	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
<b>Basic (INR)</b>							
<b>EPS</b>	<b>3.9</b>	<b>21.7</b>	<b>13.2</b>	<b>36.0</b>	<b>71.9</b>	<b>86.9</b>	<b>106.9</b>
Cash EPS	5.7	24.1	19.4	44.3	82.2	99.1	121.1
BV/Share	10.6	14.8	11.3	11.8	58.9	93.8	136.8
DPS	0.0	15.2	10.5	30.0	50.4	43.5	53.5
Payout (%)	0.0	81.4	93.1	99.7	83.7	59.8	59.8
<b>Valuation (x)</b>							
P/E			75.8	27.8	13.9	11.5	9.3
Cash P/E			51.4	22.5	12.1	10.1	8.2
P/BV			85.3	84.4	17.0	10.6	7.3
EV/Sales			0.5	0.4	2.2	1.7	1.4
Adj. EV/EBITDAR			8.0	5.0	8.5	7.4	6.5
EV/EBITDA			11.2	2.9	9.5	7.7	6.1
Dividend Yield (%)	0.0	1.5	1.0	3.0	5.0	4.4	5.4
FCF Yield (%)				3.8	6.8	7.7	9.3
<b>Return Ratios (%)</b>							
RoE	57.9	171.2	100.9	310.7	203.6	113.9	92.7
RoCE	10.4	55.1	18.7	44.6	76.0	77.5	76.7
<b>Working Capital Ratios</b>							
Inventory (Days)	3	2	2	3	3	3	3
Debtor (Days)	5	6	6	7	9	9	8
Creditor (Days)	12	11	13	12	11	11	11
Working Cap. Turnover (Days)	-91	-74	-83	-69	-80	-78	-76
<b>Leverage Ratio (x)</b>							
Net Debt/Equity	-1.2	1.2	5.3	4.5	0.1	-0.3	-0.6

### Standalone cash flow statement

(INR Million)

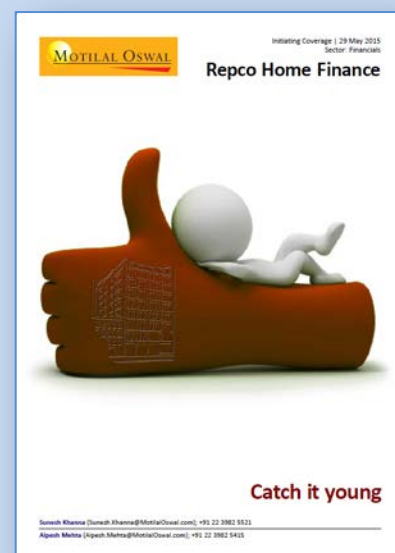
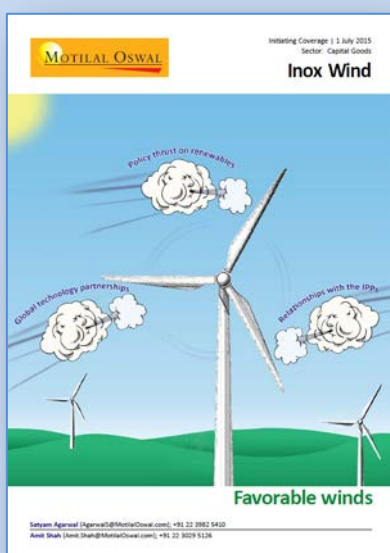
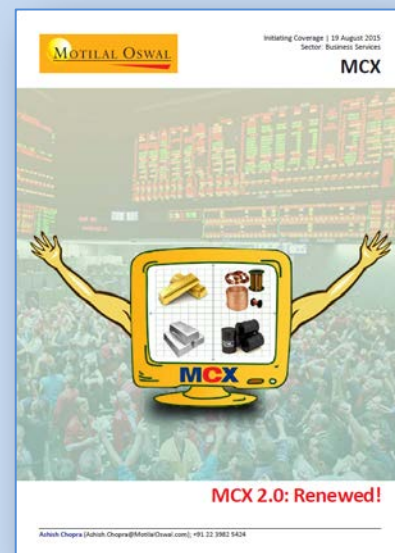
Y/E March	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
OP/(Loss) before Tax	639	9,932	4,778	18,358	37,032	44,755	55,046
Depreciation	665	856	2,260	3,022	3,710	4,383	5,091
Interest & Finance Charges	457	543	1,019	-1,667	-2,717	-3,813	-5,725
Direct Taxes Paid	-371	-1,852	-1,076	-3,951	-11,110	-13,427	-16,514
(Inc)/Dec in WC	8,740	9,819	11,309	7,765	8,403	1,339	4,013
<b>CF from operations</b>	<b>10,130</b>	<b>19,299</b>	<b>18,291</b>	<b>23,526</b>	<b>35,317</b>	<b>33,238</b>	<b>41,912</b>
Others	-1,169	-1,892	-2,341	312	0	0	0
<b>CF from operating including EO</b>	<b>8,961</b>	<b>17,407</b>	<b>15,950</b>	<b>23,839</b>	<b>35,317</b>	<b>33,238</b>	<b>41,912</b>
(Inc)/Dec in FA	-331	-9,153	-23,237	-10,170	-11,026	-5,573	-8,402
<b>Free cash flow</b>	<b>8,630</b>	<b>8,254</b>	<b>-7,287</b>	<b>13,669</b>	<b>24,291</b>	<b>27,665</b>	<b>33,510</b>
(Pur)/Sale of Investments	0	0	0	8,583	0	0	0
Others	3,078	-8,298	-7,952	-193	3,774	4,679	6,591
<b>CF from investments</b>	<b>2,747</b>	<b>-17,451</b>	<b>-31,189</b>	<b>-1,779</b>	<b>-7,252</b>	<b>-894</b>	<b>-1,811</b>
Issue of Shares	0	0	0	0	12,722	0	0
Inc/(Dec) in Debt	-219	7,270	13,638	3,817	-12,000	0	0
Interest Paid	-144	-169	-186	-101	-1,057	-866	-866
Dividend Paid	-4,904	-5,486	0	-13,575	-21,699	-18,732	-23,039
Others	-1,108	-1,253	-603	-3,223	0	0	0
<b>CF from financial activity</b>	<b>-6,376</b>	<b>361</b>	<b>12,848</b>	<b>-13,081</b>	<b>-22,034</b>	<b>-19,598</b>	<b>-23,905</b>
<b>Inc/Dec of cash</b>	<b>5,332</b>	<b>317</b>	<b>-2,390</b>	<b>8,979</b>	<b>6,031</b>	<b>12,746</b>	<b>16,196</b>
Opening Balance	7,757	13,089	13,405	11,015	19,994	26,025	38,771
<b>Closing balance</b>	<b>13,089</b>	<b>13,405</b>	<b>11,015</b>	<b>19,994</b>	<b>26,025</b>	<b>38,771</b>	<b>54,967</b>

E: MOSL Estimates



# REPORT GALLERY

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