INTERGLOBE AVIATION LIMITED (Indigo Airlines) — IPO REVIEW

ISSUE HIGHLIGHTS:

Issue Opens:	Tuesday, October 27, 2015
Issue Closes:	Thursday, October 29, 2015
Price Band:	Rs. 700 to Rs. 765
Bid Lot:	15 Equity Shares & in multiples of 15 thereafter
Face Value:	Rs.10/-
Listing:	BSE & NSE
Issue Size:	Rs. 3100 Crs at Lower Band & Rs. 3270 Crs at Upper Band. (Fresh Issue of Rs. 1272.2 Crs and offer for sale 26,112,000 Equity Shares. Out of which 3,200,000 Equity Shares Reserved for eligible Employee.)
Allocation:	QIB: 50%; NIB: 15%; Retail: 35%

OBJECTIVE OF ISSUE:

Offer for Sale : The proceeds from Offer for Sale (net of Issue related expenses incurred by the Selling Shareholders) will go to the Selling Shareholders and Company will not receive any proceeds except reimbursement of Issue expenses incurred by the Company on behalf of the Selling Shareholders.

Objects of the Fresh Issue: The Company proposes to utilize the funds which are being raised through the Fresh Issue for the following objects:

a) Retirement of certain outstanding lease liabilities and consequent acquisition of aircraft;
b) Purchase of ground support equipment for our airline operations; and
c) General corporate purposes;

COMPARISON WITH LISTED INDUSTRY PEERS:

Name of the Company	Face Value per equity share (₹)	For the year ended March 31, 2015			
		EPS (₹)	P/E	RoNW (%)	NAV (₹)
Jet Airways India Limited	10	-184.64	n/m	n/m	n/m
SpiceJet Limited	10	-13.38	n/m	n/m	n/m

Source: Company filings

**P/E, RoNW and NAV are denoted as n/m for Jet Airways India Limited and SpiceJet Limited as it is negative.*
The peer group listed companies as stated above are engaged in the scheduled air transportation business.

STATEMENT OF PROFIT AND LOSSES, AS RESTATED:

Statement of Profit and Losses, as restated						(Rs. In Millions)
Particulars	For 3 Months 01-Apr-15 to 30-Jun-15	Year ended March 31,2015	Year ended March 31,2014	Year ended March 31,2013	Year ended March 31,2012	Year ended March 31,2011
Total Income	43171.99	143091.41	114321.18	94402.34	57086.20	39441.57
Total Expenditure	33919.29	124733.96	109585.35	84529.16	56337.16	32294.07
Profit Before Tax	9252.70	18357.45	4735.83	9873.18	749.04	7147.50
Profit after Tax	6,404.35	12,955.85	4,744.41	7,833.57	1,405.94	5,794.65
E.P.S.(Rs.) Basic	20.64	42.20	15.45	25.52	4.58	18.88
E.P.S.(Rs.) Diluted	18.63	37.69	13.80	22.79	4.09	16.86
RONW (%)	-	306.61	113.48	203.27	-	-

For the three month period ended June 30, 2015, the RoNW was (459.47)% (not annualized).

BUSINESS OVERVIEW:

Company operate IndiGo, India's largest passenger airline with a 33.9% and 37.4% market share of domestic passenger volume for fiscal 2015 and the five months ended August 31, 2015, respectively, according to the DGCA. The Company operates on a low-cost carrier, or LCC, business model and focus primarily on the domestic Indian air travel market. Indigo was the seventh largest low-cost carrier globally in terms of seat capacity in fiscal 2015, according to CAPA. Company continuously focus on maintaining their cost advantage and a high frequency of flights while striving to fulfill their simple brand message of providing "low fares, on-time flights and a hassle-free experience" to their passengers.

The company commenced operations in August 2006 with a single aircraft, and has grown their fleet to 97 aircraft as of August 31, 2015, all of which are Airbus A320 aircraft. Currently company has an order book of 430 A320neo aircraft and expects to take delivery of 14 additional aircraft, including nine A320neos, by March 31, 2016. As of August 31, 2015, the average age of aircraft was 3.7 years. As of March 31, 2015, the average age of aircraft was 3.2 years, which, according to CAPA, was the second youngest average fleet age among Indian carriers and one of the youngest fleets of any LCC globally.

As of the week ended August 31, 2015 the company operated scheduled services to 33 airports in India, with a maximum of 603 domestic flights per day. The company operated an average of 570 domestic flights per day, for the month ending March 31, 2015. The company also had the highest market share in each of the top five domestic routes in India by traffic during fiscal 2015, according to CAPA.

From fiscal 2011 to fiscal 2015, our domestic passenger volume increased at a CAGR of 25.8% from 9.5 million domestic passengers in fiscal 2011 to 23.7 million domestic passengers in fiscal 2015 and 12.6 million domestic passengers as of August 31, 2015, according to the DGCA. The market share of the company, of domestic passenger volume increased from 17.6% in fiscal 2011 to 33.9% in fiscal 2015, according to the DGCA.

The company had the second highest load factor on domestic scheduled services in fiscal 2015, according to the DGCA and the second lowest level of complaints per 10,000 passengers in fiscal 2015, according to CAPA. It has received industry accolades in recognition of the quality of their airline service, including the award for "Best Low-Cost Airline in Central Asia & India" at the SkyTrax World Airline Awards for six consecutive years from 2010 to 2015.

IN FAVOUR OF THE IPO:

1) **Largest market share:** In the last 7 years, market share of the company has grown from 12.5 per cent to over 36 per cent. That means 1 out every 3 air traveler in India flies Indigo every day on nearly 650 flights that it operates daily. It's market share is likely to go up with addition of more carriers.

   IndiGo's market share has increased from 14.5 per cent in FY10 to about 36 per cent with passenger volumes increasing 26 per cent. Higher volumes and load factors, along with growing revenue per passenger, has translated to 40 per cent annual growth in domestic revenues over FY10-15, while earnings before interest, taxes, depreciation, amortisation and rentals (Ebitdar) have grown 25 per cent. The company has also benefited due to the multiple challenges faced by competition (management change, high cost structure, lack of pricing discipline, etc.), which helped IndiGo move ahead.

2) **Indigo Airlines is the most profitable and one among the only two profit making airlines in India, other being GoAir.**

3) **Sustainable low cost structure:** Costs per available seat km (CASK, measured in US cents) at 5.95 is much lower than SpiceJet's 6.68 and Jet Airways' 9.05. Excluding fuel, the single biggest cost item, its CASK at 2.87 cents is lower than GoAir and SpiceJet, the other low-cost carriers. A single aircraft type, low distribution costs and a younger fleet have helped keep down costs on operations and maintenance. Its decision to order 100 A320s in 2005 helped it negotiate favourable terms, analysts say. The sale-and-lease back arrangement helped it gain about Rs 3,500 crore.

   IndiGO aims to keep it simple even in future. Unlike most full service carriers, IndiGo does not offer free lounges or include food and beverages in ticket price for non-corporate passengers which has further helped it in reducing costs. "Reliability is our frequent flyer program - on time flights, maintaining frequency, affordable rates, no fancy hospitality, no red carpets, great customer service. We are so focused on keeping our cost structure low, there's no plan for in-flight entertainment,"said Aditya.

4) **Focus on domestic market for growth and business:** In the last 10 years, India continues to be one of the most unpenetrated market in the world. There are merely 391 aircrafts to serve India's rising middle class populace. "It is one of the primary reasons why we got into the airline business in 2005. There were only 130 commercial airplanes back then. After ten years, there are 391. Indian middle class is growing to about half a billion people in the next 48 months, about 1.5 times the size of the population of US. Out of 56 Indian airports where Airbus A320 can land and take-off, we fly to 33 of them. We add 2-3 new destination every year. So we have a long way to go within India," said Aditya.

5) **Cost structure to come down further:** With Airbus A-320-Neo, the new variant of the Airbus A320, joining Indigo's fleet, cost structure will come down further. It will cut the fuel cost by 10-15 per cent which in turn will further help the profitability of the carrier. "Our order book of 430 A-320-NEO aircrafts to be delivered till 2026 will ensure we are able to service the domestic market well. I guess 90 per cent of our business will be from the domestic business," said Aditya.

   Moreover, when the capacity goes up, the market share naturally rises, especially since there is a huge unpenetrated domestic air passenger market. "After the IPO, the promoters and founders will hold about 85 per cent. The interest of founders, interest of the management team, and interest of new investors is towards growth of the stock price," the company president said. Moreover, at the moment, out of the total 97 aircrafts, 22 are on finance lease and 75 are on operating lease. Even as operating lease might be more expensive, it is of benefit in the longer run as it guarantees lesser maintenance cost, looks new to passengers every time they fly in IndiGo and also ensures higher aircraft efficiency.

6) **No capital working debts:** Indigo has debt of Rs 3,912 crore and all of it is aircraft acquisition debt, there are no working capital debt. About Rs 1,166 crore from the IPO proceeds will be used for retiring the debt and financial obligations related to aircraft acquisition.

7) **IPO preferred over FDI:** IPO was the preferred route for raising funds for the company and not getting a foreign airline as equity partner as the latter could have diluted the LCC focus. "We do not really need a crutch from anybody else. We never even thought of foreign investments option as conflicting thoughts or strategies can slows down decision-making," said Aditya.

8) **A few favourable tailwinds will benefit the entire sector going ahead:** The first is passenger volumes. The sector has been growing at about 12 per cent annually and analysts say demand would be 1.2-1.5 times gross domestic product growth which should help all players. Especially IndiGo, given its fleet strength and the fact that it is growing faster than the market. Growth in recent months has been a strong 20 per cent for the sector, with IndiGo outperforming peers. The other positive for the company is cheaper fuel costs which should boost its profits.

CONCERNS:

Indigo has some clear strong points in its favour but also raises some red flags.

1) **Negative net worth of Rs.139.38 crore as of 30 June:** InterGlobe Aviation posted a net profits of Rs.640.43 crore for the three months ended 30 June on a revenue of Rs.4,317.19 crore. However, company has reported a negative net worth of Rs.139.38 crore as of 30 June with an interim dividend of Rs.1,207.08 crore for fiscal 2016.

   The company says this may make it difficult or expensive to obtain future financing or to meet liquidity needs.

2) **Newly commenced routes resulting in initial losses:** Indigo has cautioned that on newly commenced routes, load factors and fares initially tend to be lower than those on established routes, resulting in initial losses.

   Plans to start operation in many new routes and there will be some promotional offers initially such as lower fares, higher commission to travel agents. These routes are expected to be profitable over time, but it will have impact on the cash flow and profitability in the near term and also there is a risk of success of these routes in future.

3) **Failure to comply with covenants could have a negative impact:** Failure to comply with covenants contained in aircraft and engine lease agreements or financing agreements could have a negative impact on IndiGo.

4) **Inability to grow domestic networks and frequencies in a profitable manner**

5) **Inability to acquire additional licenses and traffic rights**

6) **Delay or inability to procure, flight slots on financially viable terms**

7) **Aviation Industry historical performance has been weak:** The opportunity in the aviation industry remains massive. But the sector's worldwide historical performance has been weak. Strong headwinds - regulatory hurdles coupled with volatile fuel prices as well as high competition and its effect on pricing power - have kept industry players from truly flourishing over time.

OUR VIEW:

IndiGo: A robust business model but no discount in IPO price

While there is little doubt about the company's capability to deliver, the pricing could have been more attractive. While the company deserves a higher multiple given that the Indian market is growing faster, the IndiGo IPO, at about 7.6 times its FY16 EV/Ebitdar estimates, is slightly on the expensive side. Analysts say the company should have left something on the table for investors.

Indian aviation industry has high mortality rate and we have seen Kingfisher going bankrupt and Jet Airways was rescued by Etihad. Since last decade, not a single listed airlines is able to generate positive returns to indian investors. But IndiGo’s positive results are providing cushion for its current liabilities. Current benefit of low crude oil prices may be eroded entirely by the increase in fuel price.

Considering all these factors, we think it is better to avoid this overpriced IPO, and it is sensible to wait for it to go listed and invest when the real price is reflected in the secondary market.