JM JainMatrix Investments	A quality report by JainMatrix Investments
IndiGo IPO – Flying High, Wide and Handsome	IndiGo
• **Date Oct 27th 2015 and IPO Period: 27-29th Oct 2015** • **Advice: Good offering with medium risks.** • **BUY with a minimum 1 year horizon**	• **Industry – Airlines** • **Price range: Rs. 700-765** • **Large Cap – 27,600 cr mkt cap**

- **Overview:** IndiGo is the market leader in Indian aviation with a low cost carrier model. The 97 aircraft cover 647 flights daily to 38 destinations including 5 abroad.
- The Income, EBITDA and profits have grown 35.8%, 30.6% and 22.0% CAGR over 5 years.
- It has a 5 year record of profitable operations, and was free cash flow positive in 3 of the last 6 years. The fall in crude prices will be a windfall for IndiGo and lower costs.
- The airline sector is known to destroy value globally, due to high costs and cyclical demand. But IndiGo appears to be an outlier.
- A sharp rise in fuel prices remains the primary risk to profitability.
- **Opinion**: Buy with a minimum 1 year horizon

Here is a note on the Interglobe Aviation Ltd (IndiGo) IPO.

IPO highlights

- The IPO period is from 27-29 Oct 2015 and the Price range: Rs. 700 to 765. Each Lot Size is 15 shares.
- About 4 crore shares will be offered of Face Value Rs 10, making up 17% of the post issue equity.
- The amount to be raised: Rs. 3018 cr. and the market cap will be Rs 27,566 cr. (upper end).
- The quotas are Retail 35 %, institutional 50% and 15% for non-institutional investors. See Fig 1b.
- The funds raised from the IPO will be used for:
  - Exit by promoters/ investors: Rs 1746 cr.
  - Retirement of outstanding lease liabilities and acquisition of aircraft: 1166 cr.
  - Purchase of ground support equipment for our airline operations: 34 cr.
  - General corporate purposes: 72 cr.
- The P/E of IndiGo is 19.4 - 21.2 times at Lower - Upper price limits, based on the FY15 nos.

Introduction

- Commencing operations in 2006, IndiGo is a low-cost carrier (LCC) airline based in Gurgaon, India.
- IndiGo's revenue and profit were Rs 14,309 and Rs 1,295 crores respectively for FY15.
- Market share based on passenger volume was 33.9% in FY15 for the domestic market.
- Owned by InterGlobe Enterprises, IndiGo operates 647 daily flights to 38 destinations including 5 international to Bangkok, Dubai, Kathmandu, Muscat and Singapore. It has its primary hub at Indira Gandhi International Airport, Delhi and operates 97 aircrafts all of which are Airbus A320.
- IndiGo's domestic ASKs (Available Seat-Kilometer) increased from 530 crore (FY09) to 3140 crore in FY15, growing at 28.9% CAGR, while other Indian carriers declined at 0.5% CAGR over the period.
- It has an aggressive growth plan, with a current order book of 180 aircraft from Airbus.
- IndiGo's maintenance costs are the lowest among Indian carriers. It had the second youngest average fleet age of 3.2 years, others were AirAsia India 2.7, GoAir 3.9, Air Costa 3.9, SpiceJet 4.1, Jet Airways 5.9 years, and Air India 8.9 years, as of Mar 31, 2015

- Leadership team is Aditya Ghosh (President), Riyaz Mohamed (Aircraft Acquisition/ Financing), Sanjay Kumar (Commercial), Sanjeev Ramdas (Cust. Service/ Operations) and Pankaj Madan (CFO).
- IndiGo gets 9% of its revenues from International business, see Fig 1b.

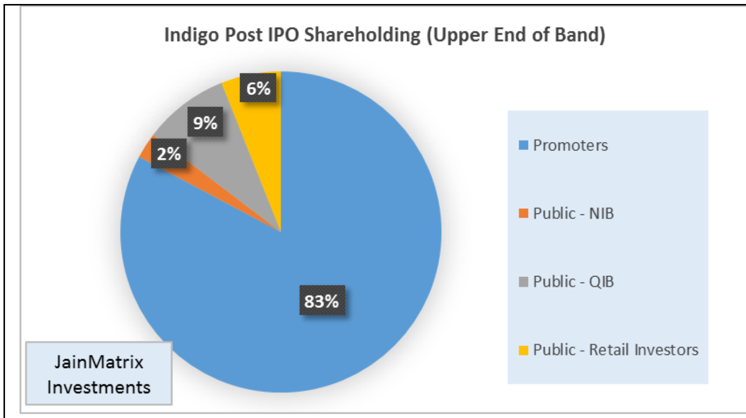


Fig1a – Shareholding post IPO

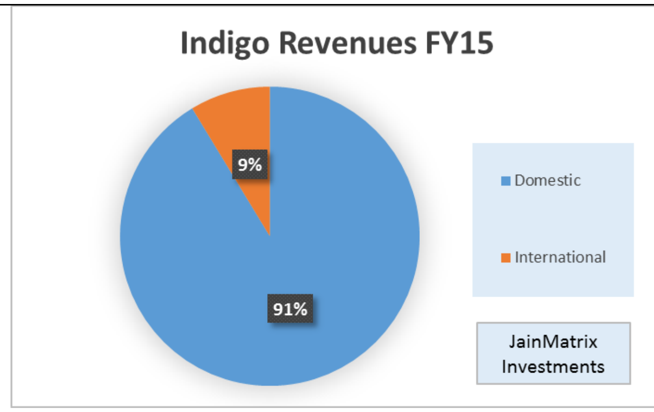


Fig 1b – Revenue Breakdown

News and Notes

- A large interim dividend (Rs 1,003 cr.) was declared in June 2015 which pushed its net worth into the negative. IndiGo declared profits of Rs 1,295 crores so about 83% of profit was paid as dividend.
- Ahead of the IPO, anchor investors including Goldman Sachs, Fidelity, BlackRock, etc. bought IndiGo shares reserved for FIIs at Rs 765 each, the top end of the IPO indicative price range, helping the airline to raise Rs 832 crore and flagging strong investor appetite for the offering.
- The IPO is already subscribed 87% by 5pm on 27th, the first day of the IPO.
- This will be India's Biggest IPO in 3 Years.

Financials of IndiGo IPO

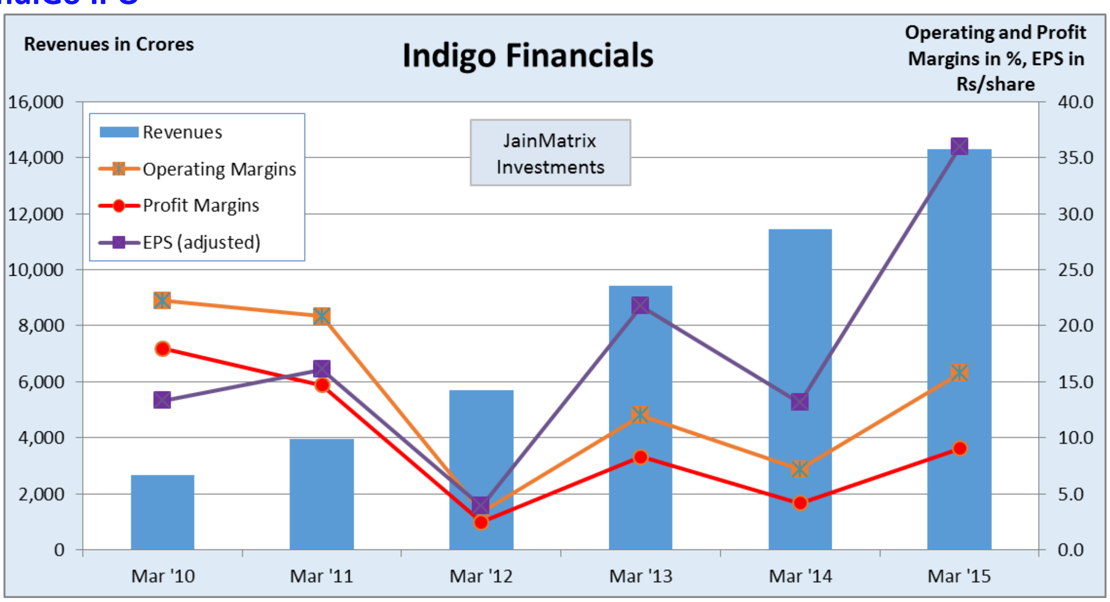


Fig 2 Financials

- The Income, EBITDA and profits have grown 35.8%, 30.6% and 22.0% CAGR over 5 years. See Fig 2.
- The margins are good with Operating and Profit margins at 15.7% and 9.1% for FY15.
- The D/E of the firm post IPO will be 2.42 (assuming IPO success and pricing at upper band).
- The business managed positive free cash flows during 3 of the last 6 years. Heavy investments were made during FY13-FY14. See Fig 3. IndiGo does not have any working capital related indebtedness.

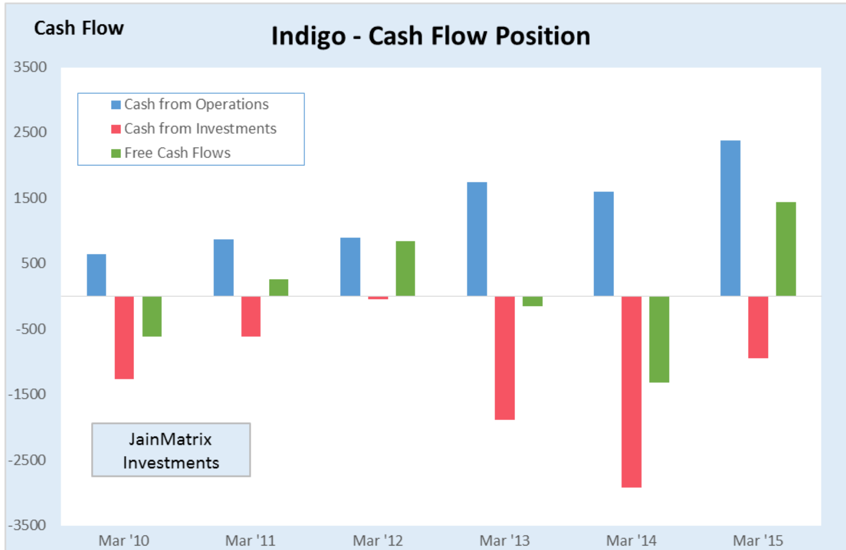


Fig 3 – Free Cash Flows

- One characteristic of the airline business is that fuel costs can be a significant proportion of overall revenues of the business.
- In this context, we can see IndiGo's ratio over 5 years. The recent fall has been helped by the fall of global crude prices. This factor is certainly helping IndiGo perform well today.

Fig 4 – Ratio of Fuel Costs to Revenues in %.

Ratio of Fuel/Revenues %	
2010	34.2
2011	38.6
2012	50.3
2013	45.7
2014	48.2
2015	40.2

Industry Notes and Trends

Industry Notes:

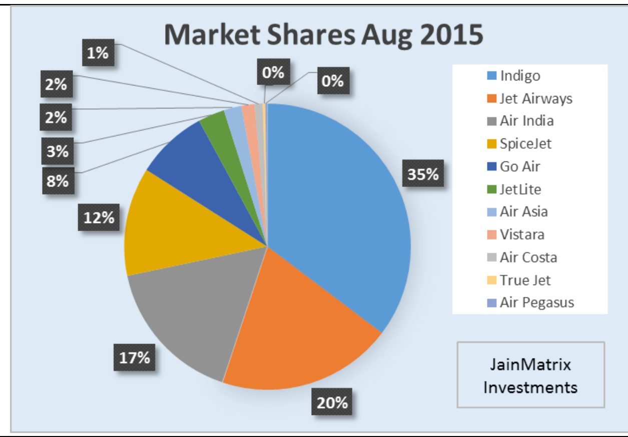
- The Indian aviation industry is the 9th largest market globally. Total passenger traffic stood at 16.3 crores in 2013 and there were 85 international airlines connecting to over 40 countries.
- In terms of number of seats per capita, India is quite low – India has 0.08 domestic seats per capita, while Philippines (0.29), China (0.31), Indonesia (0.41) and Thailand (0.48) are much higher.
- With 7.5% GDP growth in FY16, CAPA expects traffic growth of 15% (domestic) and 10% (intl.).
- The Airline industry is a very tough globally, characterized by high airplane costs (the Airbus and Boeing duopoly), high fuel, parking, airport and MRO charges. Costs are largely fixed. On the other hand, demand is cyclical and varies by season & economic cycle.
- Anecdotal evidence is that the sector is a destroyer of value. Many countries support their national carriers, even though there are losses, as it may be a matter of national prestige.
- The Indian aviation industry has been aided by a slow moving Indian Railways, that has in the past lost market share, had weak capacity growth, poor passenger service levels and slow trains.
- Indian aviation is expected to become the 3rd largest market by 2020. Indian carriers plan to increase their fleet to 800 aircrafts by 2020. (Source: GoI/ Dept of Industrial Policy & Promotion).
- A number of foreign investors are present in India including Airbus, Boeing, AirAsia, Singapore Airlines, Rolls Royce, Frankfurt Airport Services, Honeywell Aerospace, Malaysia Airports Holdings, GE Aviation, Airports Company South Africa Global and Alcoa Fastening Systems Aerospace.

Trends: Indian aviation is experiencing dramatic growth with the emergence of LCC, as well as new carriers, and a growing middle class ready to travel by air for business and leisure. The Indian middle income population may increase from 16 crores (2011) to 26.7 cr. (2016).

- Industry market shares in Aug 2015 are presented in Fig 5. (Source DGCA).

- Growth in airlines is causing demand growth for MRO (maintenance, repair and overhaul) facilities.
- Indian authorities plan to double the number of airports to 250 by 2030.
- Large scale collaborations/M&A deals are happening – Etihad Airways & Jet Airways; Tata Group & Singapore Airlines (Vistara), Tata Group & AirAsia.

Fig 5 – Industry Market Shares



Positives of the firm and IPO

- IndiGo has the largest market share in one of the largest & fastest growing aviation markets.
- A successful implementation of the LCC business model with single aircraft type, high aircraft utilization, high operational reliability, no-frills product, and low distribution & maintenance costs.
- IndiGo is a strong brand developed with good advertising & marketing strategies.
- It has maintained consistent profitability and strong cash flow generation since the last 6 years.
- By placing a large Airbus aircraft order, IndiGo has gained a structural cost advantage with favorable terms on aircraft, engines and components, and got a young, modern and fuel-efficient fleet. On delivery, the aircrafts are sold and leased back. This arrangement is efficient as it converts fixed costs into variable. The asset light approach helps IndiGo to keep debts under control.
- Crude price fall reduced the Fuel Costs/Revenues to 40.2% in FY15 with more reduction possible.
- From FY2010 to date, IndiGo has generated over Rs 9,000 crores of cash from operations.
- IndiGo has minimized turnaround time between flights with highest utilization of 11.4 hours/ day.
- Experienced management with US background, has executed well so far in the Indian context.

Internal Risks and Negatives

- Business plans and Airbus orders target a fleet size of 154 by 2018, from current 97. This aggressive asset plan needs to be matched with revenue growth. A mismatch will cause finance costs to jump.
- Any production delays with ordered Airbus A320neo aircraft would affect IndiGo's expansion plans.
- Depreciation of the INR against USD may have an adverse effect on IndiGo's operations and costs.
- IndiGo's international routes expose them to higher operational risks. However it is believed that these routes have higher profit potential compared to domestic routes.
- IndiGo's financials may fluctuate due to seasonality as well as economic cycles.
- There may be a skills shortage in areas such as airline pilots, maintenance engineers, etc. In the past airlines needed to hire expatriate staff at high costs to overcome this.
- The June 2015 pre IPO interim dividend has weakened the IndiGo balance sheet. It is to be seen if this was a one-time reward for pre IPO investors, or if high dividends will continue post IPO. From a business point of view, it would have been better for IndiGo to have retained cash and cut debt.

External Risks

- Crude oil prices are a high cost component that is out of management control. While prices have fallen in the last 1 year, they can rise sharply again. IndiGo does not hedge for fuel cost volatility.
  - Our belief is that there is currently a crude production glut globally. Renewables like solar and wind are galloping forward as a preferred fuel source and may win market share from oil.
- Airlines are a big cause of pollution due to usage of fossil fuels. There will be increasing pressure on airlines to reduce this, either in terms of fuel costs or capacity limitations.

- IndiGo, like other airlines, faces operational risks such as accidents and terrorism.
- There are early signs that the Indian Railways is on a revival path. This includes capacity investments, technology upgrades, etc. This may increase competition, but over a medium term.
- Competition may intensify with the entry of Air Asia and Vistara, which have strong backgrounds.
- There are high regulatory challenges for IndiGo including DGCA and AAI compliances, policies and execution and ATF taxes. However the business climate in India should improve from here.

Benchmarking

We benchmark IndiGo against listed peers, a US based LCC and an Indian Infra asset firm:

Particulars	Indigo	Spicejet	Jet Airways	Southwest Airlines USA	Adani Ports
Market Cap (Rs in crores)	27,566	2,620	4,675	1,93,830	65,069
Revenues (FY15)	14,309	6,304	21,561	1,20,900	6,152
Profits (FY15)	1,296	(1,003)	(2,641)	7,384	2,314
P/E	21.2	negative	negative	16.7	27.2
3 year Revenue Growth	35.8	29.9	8.9	5.9	31.6
Debt-equity ratio (x)	2.4	-	-	0.4	1.6
EBITDA margin (%)	15.7	-11.4	-1.9	12.0	74.6
Net Profit Margin (%)	9.1	-15.9	-9.7	6.1	37.6

Exhibit 6 – Benchmarking

Based on Exhibit 6, we come to the following thoughts:

- Indigo is clearly ahead on most parameters compared to the listed Indian peers.
- Growth has been impressive at IndiGo over the last 3 years.
- Debt is high and that is expected in this industry. With cash flow improving at IndiGo in recent quarters, we can reasonably expect that they are able to reduce debt over the next few years.
- Margins while not being the best, appear healthy for IndiGo.

Overall Opinion

- There's no doubt that the Airline industry in India is at a very early phase of growth. With high population, growth of the industry will follow economic growth and affluence in India.
- IndiGo has a strong brand, a commanding domestic market share and high growth rates. It has a good track record of profitability and free cash flows. It has executed well on its LCC strategy, and this has resonated well with consumers. IndiGo has expanded the market with its growth.
- The recent fall in crude prices (and hence ATF) makes IndiGo a good business to invest in. Cash flows should accelerate in FY16. A 60% growth plan over 3 years looks doable.
- Early indicators on day 1 of the offering are that there is a good appetite for the IPO.
- A sharp rise in fuel prices remains the primary risk.
- IndiGo is a medium risk investment. BUY with a minimum 1 year holding period.

Disclaimer