

# 3Q marred by higher fuel cost, lower yields

## Cut PO on rising fuel cost

We have cut our EBITDAR estimates by 6%-15% for FY11-13E on account of (a) hike in average crude assumption by 2%-12% over FY11E-13E, (b) cut in yield assumptions by 2-4% over FY11-13E. However we have raised our traffic assumptions by 1%-9% over FY11-13E on account of strong demand. To factor in the lower EBITDAR we have cut our PO to Rs.91 (from Rs107).

## 3QFY11: Results disappoint on lower yields

SpiceJet reported net profit of Rs944mn (-13% YoY) in Q3FY11 compared to our estimates of Rs1.49bn. Operating revenues at Rs8.3bn (+28% YoY) was 8% below BofA-MLe. This was largely due to lower than expected yields despite higher fuel costs. Yields were flat sequentially and down 2% on a YoY basis. EBITDAR margins at 26.5% were below our estimate of 32.5%.

## Adding capacity to meet future demand

SpiceJet has aggressive plans to add capacity to capture the strong domestic demand. It is expected to add 6-7 B737 and 4-6 Q400s (70-seater turboprops) in FY12. We expect this will enable SpiceJet to show strong traffic growth. However there may be near term concerns on softness in yields due to (a) lean season and (b) bunching up of new capacity.

## Attractive valuations for strong growth

SpiceJet trades at FY12E EV/EBITDAR of 7.3x, representing a 5%-10% discount to Jet Airways & other regional peers. We are valuing SpiceJet at a mid-cycle multiple of 8x EV/EBITDAR FY12E which is similar to Jet at its PO. We expect SpiceJet to achieve 45% EPS CAGR over FY10-13E.

### Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	(3,336)	614	2,057	2,827	3,368
EPS	(13.8)	2.5	5.1	7.0	8.3
EPS Change (YoY)	-149.5%	NM	100.4%	37.1%	19.2%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(6.4)	8.7	3.1	1.7	(0.3)

### Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	NM	27.0x	13.5x	9.8x	8.3x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	NM	209.15x	24.97x	17.64x	14.83x
Free Cash Flow Yield*	-5.6%	7.5%	4.5%	2.5%	-0.5%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 6.

## Bank of America Merrill Lynch

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### Stock Data

Price	Rs68.70
Price Objective	Rs91.00
Date Established	27-Jan-2011
Investment Opinion	C-1-9
Volatility Risk	HIGH
52-Week Range	Rs49.70-Rs97.45
Mrkt Val / Shares Out (mn)	US\$607 / 404.1
Average Daily Volume	1,676,953
BofAML Ticker / Exchange	MDLFF / BSE
Bloomberg / Reuters	SJET IN / SPJT.BO
ROE (2011E)	NA
Net Dbt to Eqty (Mar-2010A)	NA
Est. 5-Yr EPS / DPS Growth	15.0% / NA
Free Float	60.0%

### Key Changes

(Rs)	Previous	Current
Price Obj.	107	91
2011E EPS	7.3	5.1
2012E EPS	9.2	7.0
2013E EPS	9.6	8.3

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11013772

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## iQprofile<sup>SM</sup> SpiceJet Ltd

### Key Income Statement Data (Mar)

	2009A	2010A	2011E	2012E	2013E
<b>(Rs Millions)</b>					
Sales	16,894	21,811	29,810	40,580	44,912
Gross Profit	5,892	11,854	15,608	20,045	21,778
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	(4,304)	185	2,102	2,991	3,550
Net Interest & Other Income	934	549	470	543	627
Associates	NA	NA	NA	NA	NA
Pretax Income	(3,370)	734	2,571	3,533	4,176
Tax (expense) / Benefit	(33)	(64)	(514)	(707)	(808)
Net Income (Adjusted)	(3,336)	614	2,057	2,827	3,368
Average Fully Diluted Shares Outstanding	241	242	404	405	405

### Key Cash Flow Statement Data

Net Income	(3,403)	670	2,057	2,827	3,368
Depreciation & Amortization	73	76	88	110	137
Change in Working Capital	1,857	1,458	(1,236)	(2,768)	(4,115)
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	21	64	514	707	671
Cash Flow from Operations	(1,453)	2,268	1,424	875	62
Capital Expenditure	(93)	(174)	(182)	(192)	(201)
(Acquisition) / Disposal of Investments	4	0	0	0	0
Other Cash Inflow / (Outflow)	3,136	(1,297)	0	0	0
Cash Flow from Investing	3,047	(1,471)	(182)	(192)	(201)
Shares Issue / (Repurchase)	0	0	3,680	0	0
Cost of Dividends Paid	0	0	0	0	0
Cash Flow from Financing	(547)	(566)	248	(554)	441
Free Cash Flow	(1,546)	2,095	1,241	683	(139)
Net Debt	1,808	(124)	(2,345)	(6,353)	(9,178)
Change in Net Debt	(1,476)	(736)	(4,872)	(629)	199

### Key Balance Sheet Data

Property, Plant & Equipment	676	769	858	942	1,020
Other Non-Current Assets	1,853	3,150	3,150	3,150	3,150
Trade Receivables	124	190	265	396	482
Cash & Equivalents	3,080	4,507	3,345	6,853	10,178
Other Current Assets	1,776	1,275	2,288	2,672	3,047
Total Assets	7,508	9,891	9,906	14,013	17,878
Long-Term Debt	4,555	4,150	837	386	750
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	333	233	163	114	250
Other Current Liabilities	6,914	8,929	8,708	10,479	10,611
Total Liabilities	11,802	13,312	9,708	10,979	11,611
Total Equity	(4,293)	(3,420)	198	3,035	6,266
Total Equity & Liabilities	7,510	9,892	9,907	14,014	17,877

### iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	-125.2%	21.4%	155.7%	101.1%	53.0%
Return On Equity	NM	NM	NM	174.8%	72.4%
Operating Margin	-25.5%	0.8%	7.1%	7.4%	7.9%
EBITDA Margin	-25.0%	1.2%	7.3%	7.6%	8.2%

### iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	NM	3.7x	0.7x	0.3x	0x
Asset Replacement Ratio	1.3x	2.3x	2.1x	1.7x	1.5x
Tax Rate (Reported)	NM	8.7%	20.0%	20.0%	19.3%
Net Debt-to-Equity Ratio	NM	NM	-1,182.3%	-209.3%	-146.5%
Interest Cover	-36.2x	3.0x	42.9x	NM	NM

### Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

### Company Description

SpiceJet is a dedicated low-cost domestic carrier which has rapidly gained market share in the last and is now in top-5 domestic carriers. It began its services in May-2005. Currently it has a single-aircraft-type fleet of 25 B-737s and has an extensive network between 20 destinations in India and 2 destinations in the South East Asia.

### Investment Thesis

SpiceJet is one of India's leading low cost carriers. We expect the company to post strong EBITDAR growth in FY11 on the back of strong passenger growth over FY10-12, rising yields and efficient cost structure. Its business model exploits the changing preference of price sensitive Indian flyers.

### Stock Data

Price to Book Value 140.0x

## Key result takeaways

SpiceJet reported 3QFY11 results below our expectations. EBITDAR margin at 26.5% was below our expectations of 32.5%. This was largely driven by flat yields despite higher fuel cost.

Table 1: Table 1: SpiceJet - Quarterly results

Rs. Mn	3QFY11	3QFY10	YoY (%)	2QFY11	QoQ(%)
Operating Revenues	8,302	6,491	27.9%	6,282	32.2%
Non Operating Revenues	72	98	-27.0%	126	-43.1%
<b>Total Revenues</b>	<b>8,374</b>	<b>6,589</b>	<b>27.1%</b>	<b>6,408</b>	<b>30.7%</b>
<b>Employees Remuneration &amp; Benefits</b>	<b>608</b>	<b>492</b>	<b>23.6%</b>	<b>529</b>	<b>14.9%</b>
<b>Aircraft Fuel Expenses</b>	<b>3,115</b>	<b>2,078</b>	<b>49.9%</b>	<b>2,608</b>	<b>19.4%</b>
Airport Charges	474	379	25.1%	406	16.7%
Aircraft Maintenance	683	527	29.6%	720	-5.2%
Other Operating Costs	861	578	49.0%	690	24.7%
Other Expenditure	360	362	-0.5%	249	44.5%
<b>Total Other Operating Expenses</b>	<b>2,378</b>	<b>1,920</b>	<b>23.9%</b>	<b>2,066</b>	<b>15.1%</b>
<b>EBITDAR</b>	<b>2,201</b>	<b>2,000</b>	<b>10.0%</b>	<b>1,078</b>	<b>104.1%</b>
Margin	26.5%	30.8%	-4.3%	17.2%	9.3%
Interest	10	17	-42.9%	14	-29.4%
Depreciation	23	19	18.3%	22	5.0%
Aircraft Lease Rental	1,060	965	9.8%	1,043	1.6%
Prior period adjustments	-	10	-	-	-
<b>PBT</b>	<b>1,180</b>	<b>1,087</b>	<b>8.6%</b>	<b>126</b>	<b>835.4%</b>
Taxes	235	-	-	25	833.8%
<b>Recurring PAT</b>	<b>945</b>	<b>1,087</b>	<b>-13.1%</b>	<b>101</b>	<b>835.8%</b>

Source: BofA Merrill Lynch Global Research estimates

## Strong traffic growth...but weak yields

- Operating revenue was at Rs. 8.3bn, rising sharply by 28% YoY on account of improving traffic.
- Load factors at 88% were strong on both sequential as well as YoY basis.
- Passengers carried during the quarter were at 2.39mn vs. 1.8mn in Q3FY10 and 1.81mn in Q2FY11
- Yield was the major disappointment during quarter at Rs. 3.46/RPK, showing a 2% annual drop despite a rise in fuel prices. On a sequential basis, yields were flat.

Table 2: SpiceJet- Operating metrics

(Rs mn)	3QFY11	3QFY10	YoY (%)	2QFY11	QoQ(%)
Operating Revenue	8,302	6,491	27.9%	6,282	32.2%
EBITDAR	2,201	2,000	10.0%	1,078	104.1%
EBITDAR Margin	27%	31%	-4.3%	17%	9.3%
RPKs (mns)	2,398	1,833	30.8%	1,821	31.7%
ASKs (mns)	2,731	2,291	19.2%	2,474	10.4%
Load Factor (%)	87.8%	80.0%	7.8%	73.6%	14.2%
Revenue Passengers (mn)	2.39	1.80	32.9%	1.81	32.2%
Passenger Yield (Rs per RPK)	3.46	3.54	-2.2%	3.45	0.3%

Source: BofA Merrill Lynch Global Research estimates

## Price objective basis & risk

### SpiceJet Ltd (MDLFF)

Our PO of Rs.91 is based on 8x FY12E EV/EBITDAR, which is in line with the regional airlines with similarly high EBITDAR growth in the mid cycle. Downside risks to our price objective: Rising fuel costs and an increase in competition. Upside risks would be a decline in fuel prices and faster-than-expected economic recovery.

## Link to Definitions

### Industrials

Click [here](#) for definitions of commonly used terms.

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**India - General Coverage Cluster**

Investment rating	Company	BoFA Merrill Lynch ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Aditya Birla Nu	ADYAF	ABNL IN	Reena Verma Bhasin, CFA
	Anant Raj Industries Ltd	XNRJF	ARCP IN	Gagan Agarwal
	Brigade Enterprises	XBDGF	BRGD IN	Gagan Agarwal
	Chambal Fertilisers & Chemicals	CHBZF	CHMB IN	Prasad Deshmukh
	Cummins India	CUIDF	KKC IN	Sanjaya Satapathy
	DLF Limited	XVDUF	DLFU IN	Gagan Agarwal
	Exide Indus Ltd	XEDRF	EXID IN	Sanjaya Satapathy
	Fortis Healthcare Limited	XFFTf	FORH IN	Prasad Deshmukh
	Havells	HVLIF	HAVL IN	Sanjaya Satapathy
	Housing Development and Infrastructure	XGHSF	HDIL IN	Gagan Agarwal
	Indiabulls Real Estate Ltd	IBELF	IBREL IN	Gagan Agarwal
	Jaypee Infratech	XJAYF	JPIN IN	Gagan Agarwal
	Jet Airways	JTAIF	JETIN IN	Anand Kumar
	Motherson Sumi	XMSUF	MSS IN	Sanjaya Satapathy
	Puravankara Projects Ltd	XPJVF	PVKP IN	Gagan Agarwal
	Renuka Sugars	SRNKF	SHRS IN	Sanjaya Satapathy
	SINTEX INDUSTRIES LTD	SIXDF	SINT IN	Prasad Deshmukh
	Sobha Developers	SBDRF	SOBHA IN	Gagan Agarwal
	SpiceJet Ltd	MDLFF	SJET IN	Anand Kumar
	Voltas	VTSJF	VOLT IN	Sanjaya Satapathy
<b>NEUTRAL</b>				
	Grasim	GRSJF	GRASIM IN	Reena Verma Bhasin, CFA
	Grasim -G	GRSJY	GRAS LX	Reena Verma Bhasin, CFA
	Jain Irrigation Systems Ltd	JNIDF	JI IN	Prasad Deshmukh
	Shree Cements	SREEF	SRCM IN	Reena Verma Bhasin, CFA
	Unitech Ltd	UTKIF	UT IN	Gagan Agarwal
<b>UNDERPERFORM</b>				
	Ambuja Cements	AMBUF	ACEM IN	Reena Verma Bhasin, CFA
	APIL	ANSFF	APIL IN	Gagan Agarwal
	Assoc. Cement	ADCLF	ACC IN	Reena Verma Bhasin, CFA
	Bajaj Hindusthan	BJJHF	BJH IN	Sanjaya Satapathy
	Balrampur Chini	BMPRF	BRCM IN	Sanjaya Satapathy
	Container Corp	CIDFF	CCRI IN	Sanjaya Satapathy
	India Cements	INIAF	ICEM IN	Reena Verma Bhasin, CFA
	India Cements -G	IAMUY	ICEM LX	Reena Verma Bhasin, CFA
	Jindal Saw	SWPFF	JSAW IN	Sanjaya Satapathy
	Nagarjuna Fertilizers & Chemicals Ltd	NFACF	NFCL IN	Prasad Deshmukh
	Omaxe Limited	XOMXF	OAXE IN	Gagan Agarwal
	Tata Chemicals Ltd	TTCXF	TTCH IN	Prasad Deshmukh
	Triveni Engg	TVIEF	TRE IN	Sanjaya Satapathy
	UltraTech Cemen	XDJNF	UTCEM IN	Reena Verma Bhasin, CFA
	Welspun Corp Ltd	XUQRF	WLCO IN	Sanjaya Satapathy

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**iQmethod<sup>SM</sup> Measures Definitions**

<b>Business Performance</b>	<b>Numerator</b>	<b>Denominator</b>
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

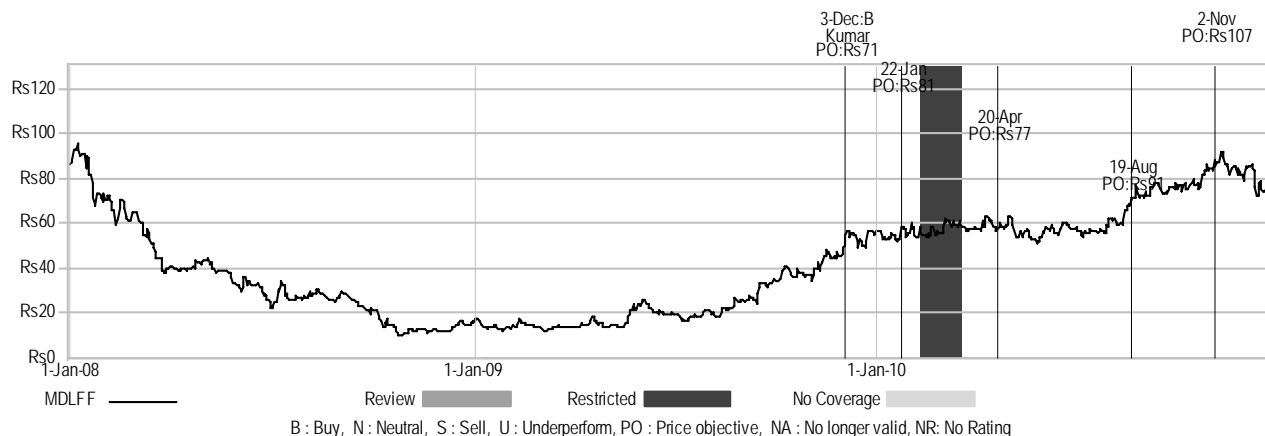
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### Investment Rating Distribution: Transport/Infrastructure Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	90	58.44%	Buy	38	44.71%
Neutral	22	14.29%	Neutral	9	40.91%
Sell	42	27.27%	Sell	8	19.51%

### Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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