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Institutional Equity

Aviation

SpiceJet Ltd.

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Shareholding (%)

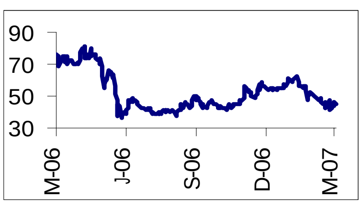
Foreign Promoters	16.9
FII's	21.5
MFs	2.8
Others	58.8

Share price performance

52-week high/low (Rs) 83/35			
	-1m	-3m	-12m
Abs (%)	-7.8	-16.4	-38.9
Rel* (%)	0.5	-14.6	-54.3

*to Nifty

Stock chart



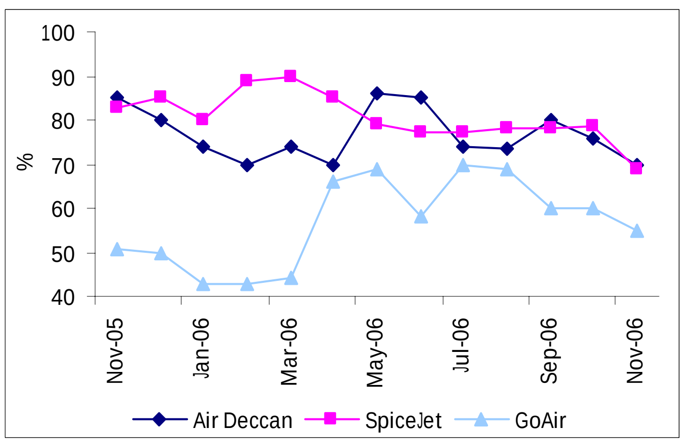
SpiceJet – Management meeting note – Improving operating performance

We recently met the management of SpiceJet Ltd, one of India's Low Cost Carrier (LCC). The company has a market share of 7% and has so far flown more than 3mn passengers in almost two years of its operations. The Delhi-based airline currently covers 14 sectors and plans to expand into cities of Raipur and Indore in Central India, and Trivandrum, Cochin and Coimbatore in Southern India, amongst others, thereby attaining a strong pan-India presence. With the market growing by about 25-30%, SpiceJet expects to grow along with the industry.

Key takeaways

- **High Passenger Load Factor (PLF):** In FY06, the company achieved PLF of 86%, which however fell to 80% in FY07.

Chart 1: Highest domestic passenger traffic load factor (PLF)



Source: IISL research, company

Not Rated

Rs46

21 March 2007

Market cap
Rs bn 8
US$ mn 190

Avg 3m daily volume
538,254

Avg 3m daily value
Rs mn 29

Shares outstanding (mn)
184

Reuters
MDIL.BO/MODILUFT.NS

Bloomberg
SJET IN

Sensex
12,946

Nifty
3,765

Year-end	Sales	YoY	EBITDA	YoY	NP	YoY	EPS	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
May	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(%)	(Rs)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
FY2005	20	-	-288	0	(287)	0	(1.9)	0.0	(26.2)	335.9	(0.1)	0.8	-0.39	0.0	0.0
FY2006	4196	-	-604	109.6	(414)	44.3	(2.4)	0.0	(19.2)	1.9	0.0	3.2	-0.02	0.0	0.0

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- Benefits of standardised aircrafts: The company strategically operates only Boeing 737-800s, all of which are 189-seaters. This standardised fleet enables high inter-operability of staff and efficient utilisation of manpower coupled with low engineering, maintenance, inventory and crew costs. As against this, Full Service Carriers (FSC), which maintain multiple types of aircrafts, entail higher costs of multi-skilled pilots, maintenance staff and huge inventory of spares. As part of its fleet expansion, SpiceJet would also be inducting two Boeing 737-900s which would accommodate 212 passengers.
- Aircraft utilisation: SpiceJet's aircraft utilisation averages about 12.36 hours per day in comparison to about 10 hours for FSCs, thereby enabling it to improve revenues per aircraft.

In December 2005, SpiceJet raised $80mn via an FCCB issue, proceeds of which are being utilised for PDP of first ten aircrafts. Subsequently, in January 2007, it raised additional $67 mn through preferential allotment to strategic investors

- Fund raising: In December 2005, the Company raised $80mn through an FCCB issue, proceeds of which are being utilised for the Pre-Delivery Payments (PDP) of first ten aircrafts. Cost of an aircraft typically ranges between $38-40mn and PDP is usually about 20-25% of this cost, i.e. about $8-10mn. Further, in January 2007, it raised additional $67mn through preferential allotment to strategic investors.
- Additional fleet strength: The company currently operates 11 aircrafts, all of which are leased out. Additionally, it plans to add seven aircrafts each in 2007 and 2008; this would take its total fleet tally to 25 by December 2008. In addition, the company will shortly be signing an option with Boeing for 10 more aircrafts beginning calendar year 2009.

Table 1. Fleet expansion schedule

Month/Year	2007	2008
February		1
May		1
June	1	1
July	2	1
August	1	1
September	1	1
October		1
November (Boeing 737-900)*	1	
December (Boeing 737-900)*	1	

Source: IISL research, company

**Seating capacity of Boeing 737-900 is 212 seats (about four more rows); it also offers one extra tonne cargo space.*

- A conscious depth strategy: SpiceJet is focussing not on increasing the number of routes that it has but on the optimisation of its routes. While some of the Southern cities like Trivandrum, Cochin and Coimbatore may get added into its routes, yet it would continue to be a Northern India centric LCC operator.
- Booking system: The company uses the Navitaire booking system, used by most LCCs worldwide. Internet booking account for 70% of the total bookings, of which 50% is direct passenger booking and 20% is travel agent booking. Of

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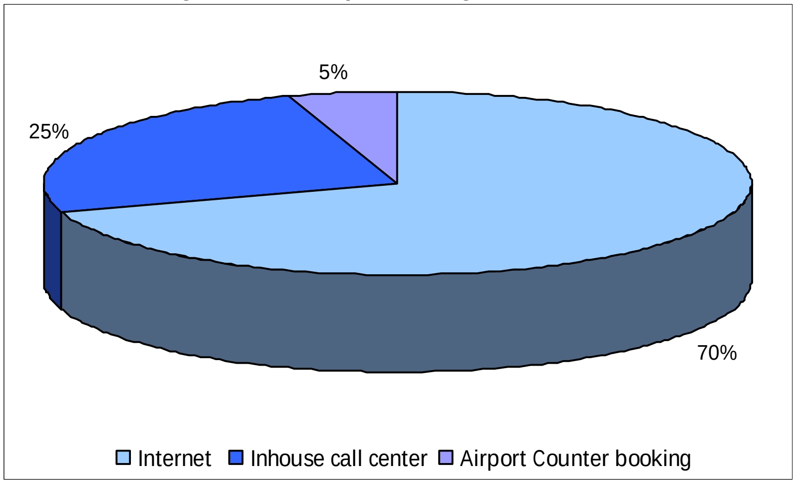
the remaining 30%, 25% is from in-house call centre (entailing an extra charge of Rs100) and 5% from airport ticketing counters.

Chart 2: Percentage-wise break-up of bookings



Source: IISL research, company

- Fare system: The company follows a dynamic fare structure; these are continuously adjusted wherein, as the number of tickets available in the lower slab gets filled up, automatically the fare gets increased to the next slab and as the PLF increases, there is a progressive increase in the fare structure. Fares consist of basic fare, fuel surcharge Rs750 (started by SpiceJet) and congestion charge Rs150. In the current context, the Government of India has reportedly asked the airlines to remove this congestion charge.
- Low turnaround time leads to improved aircraft utilization: Turnaround time averages about 30 minutes, with certain airports like Ahmedabad having fewer taxiways taking just 20 minutes. This is further aided by the fact that they do not serve eatables and drinks aboard and can hence save on an average 6-8 minutes on loading and unloading time of food items. Yields average at about Rs2,800-3,000 per seat.
- No commission paid to travel agents: While SpiceJet continues to keep ticket prices low, it does not pay commission to its travel agents; on the contrary, it permits them to charge 5% extra on the basic ticket price from customers. However, other full fledged carriers incur around 10-12% of their ticket charges on commission given to their travel agents.

  SpiceJet has not tied-up with the global distribution services (GDS) network, which enables a saving of about Rs160-175 per ticket; however, as a result it is not able to tap inward bound foreign tourist traffic, mainly because foreign tourists by and large prefer to tie up all the tour bookings in advance.

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Cost savings and Benefits to LCCs

- Lower manpower costs- Due to standardised fleet, the optimum utilization of pilots, engineers, cabin crew, operational & maintenance staff and landing & handling staff leads to lower manpower costs per aircraft.
- Lower maintenance costs on account of standardised aircraft.
- Lower ticketing cost to the customer on account of higher web based booking.
- Lower turnaround time (about 30 minutes) improves aircraft utilisation (about 12 hours per day / per aircraft).

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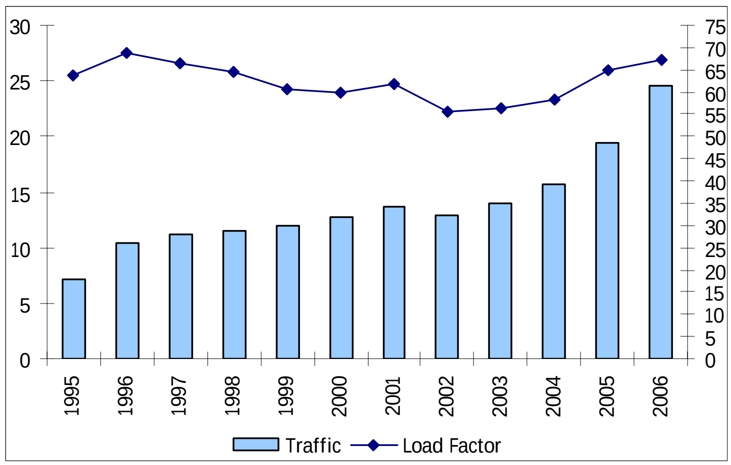
Industry scenario

The airline industry is experiencing buoyant growth on the back of increased rate of urban development, rising income levels, growth of IT/ITES, growth in leisure and tourist traffic, and India's emergence as a global employer and low cost hub for the world. Domestic air travel in India is at 0.02 trips per person/per year, which hardly matches up to 2.06 trips in the US. India has 449 airports/airstrips, of which 16 cater to the International movement of passengers. Five airports, namely Delhi, Mumbai, Bangalore, Hyderabad and Cochin are currently being modernised under the Public Private Partnership (PPP) model to meet growing traffic volumes.

Chart 3: Growth in air traffic (mn)



Source: IISL research, company

Despite a 175% rise in Available Seat Kilometres (ASKM) from 10,000mn in 1995 to 27,500mn in 2005, India has managed to sustain the PLF at 65-70% on account of steep rise in passenger traffic from 7.2mn in 1995 to 24.5mn in 2006, a growth of 240%.

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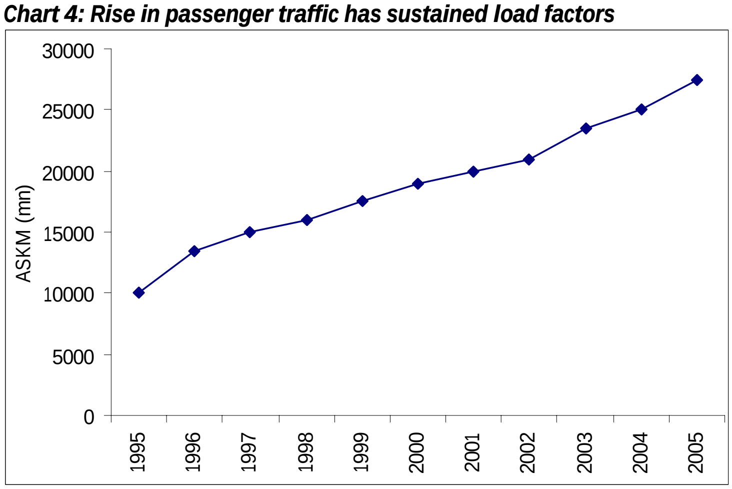
Chart 4: Rise in passenger traffic has sustained load factors



Source: IISL research, company

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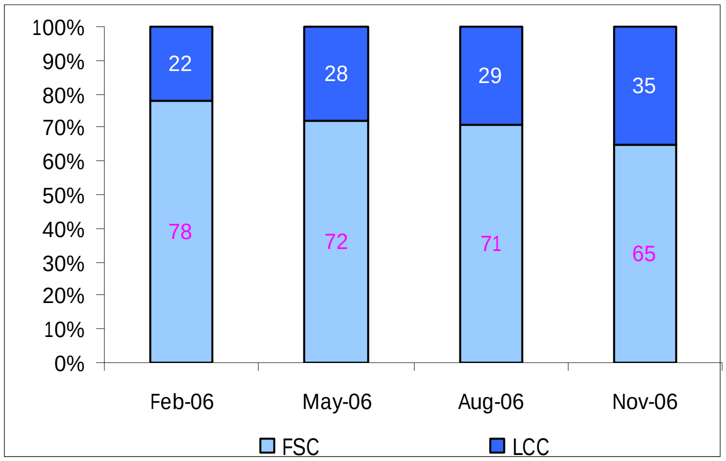
Opening up of the aviation space has attracted a number of private players like Air Deccan, SpiceJet, GoAir, Indigo, amongst others to establish operations on the LCC model. Within a short span of time, since they entered the domestic aviation space, airlines operating on this model have increased their market share to about 35%.

Chart 5: Rising domestic market share of LCCs



Source: IISL research, company

We believe that the Indian aviation sector stands at an inflexion point, poised for robust growth. A few factors that would be instrumental in driving air traffic growth from 24.5mn in FY06 to 50-55mn by FY2010 are:

- Entry of LCCs has made air travel affordable
- Shift in the mode of travel from rail to air on account of diminishing gap between the upper class railway fares and low cost airlines accompanied with huge savings in travel time
- Rising disposable incomes on the back of strong economic growth
- Growth in leisure and tourist traffic (domestic tourist traffic is slated to rise by 8.6% over 2006-15)
- Improvement in airport infrastructure and development of new airports
- Shift of corporate travellers to LCCs

Low entry barriers have led to overcapacity resulting in eroding bottom line:

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Low entry barriers coupled with greed to garner maximum market share has led LCCs to cut prices indiscriminately, albeit at the cost of profitability. This has emerged as a boon for air travellers who have so far been paying twice the price in comparison to rail travellers. Although market expansion has since taken place, however, due to aggressive fleet acquisition by LCCs (taking the domestic capacity

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to about 49mn passengers), the sector has been plagued with overcapacity since demand has only risen to 24.5mn passengers.

Going ahead, we believe that low entry barriers could attract more players in the aviation space and aggressive acquisition of aircrafts to continue. This would increase supply even further and the consequent expanding demand-supply gap could dampen the already rock-bottom prices, thereby amplifying losses.

Risks

- Rising fuel costs (fuel accounts for about 40% of total costs)
- Availability of adequate funds with airlines for fleet expansion and meeting operating losses
- Rising competition to dampen fares further
- Lack of infrastructure facilities at airports leading to congestion
- Regulatory issues

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