

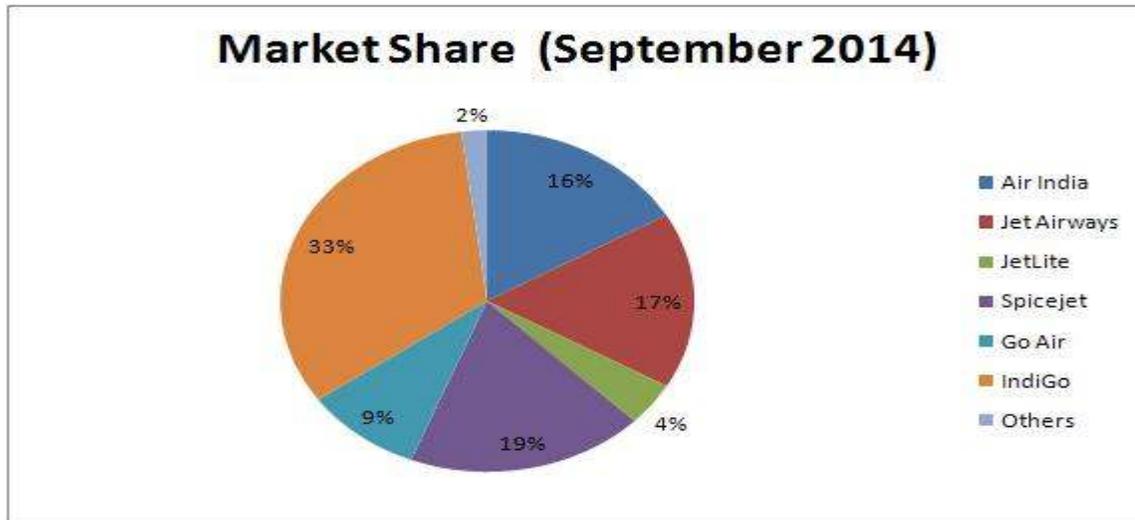
Aviation sector could see huge growth in coming days

NOV 18, 2014

The Indian civil aviation industry is on a high growth trajectory. India has a vision of becoming the third largest aviation market by 2020. The civil aviation industry in India has ushered in a new era of expansion driven by factors such as low-cost carriers (LCC), modern airports, foreign direct investments (FDI) in domestic airlines, cutting edge information technology (IT) interventions and a growing emphasis on regional connectivity. Simply going by the market size, the Indian civil aviation industry is amongst the top 10 in the world with a size of around \$16 billion.

In India, air traffic in terms of aircraft movement and passenger traffic has increased during the last three years. The total aircraft movements and passengers have registered a compounded annual growth rate (CAGR) of 3.3 per cent and 5.6 per cent respectively during FY11 to FY14. In the April-May period of the current financial year, aircraft movements and passengers have increased by 5 per cent each over traffic handled during the corresponding period of FY14. The freight traffic during April-May, FY15, also grew by 9.9 per cent over traffic handled during the same period of the last fiscal.

Airports Authority of India (AAI) has estimated that aircraft movements, passengers and freight at all Indian airports to grow at the rate of 4.2 per cent, 5.3 per cent and 5 per cent, respectively, for the next five years. Moreover, two new airlines are likely to enter into the industry in FY15. One is AirAsia's joint venture with the Tatas, a low-cost carrier which began in June, 2014. The other, a full-service carrier to be formed separately by the Tatas and Singapore Airlines (SIA), which is likely to begin in the fourth quarter of 2014.

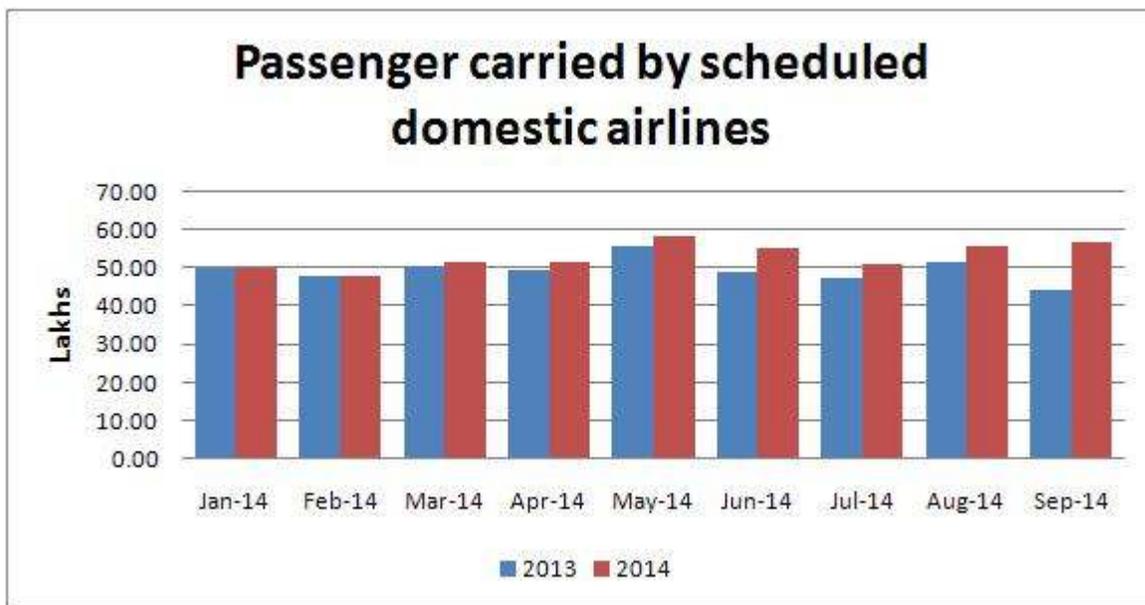


Present passenger traffic Scenario:

India's domestic air traffic grew at a record pace of over 26 per cent in September compared to the same month last year with low air fares stimulating the travel demand. International Air Transport Association attributed this growth, which was several times that of 7.6 per cent

recorded in August, to market stimulation measures by the Indian carriers which continued to offer low fares on the domestic sectors. Whereas previous improvements in growth rates potentially were attributable to revived confidence over the new business- supportive government, the strong increase in September was owing to market stimulation measures introduced by carriers.

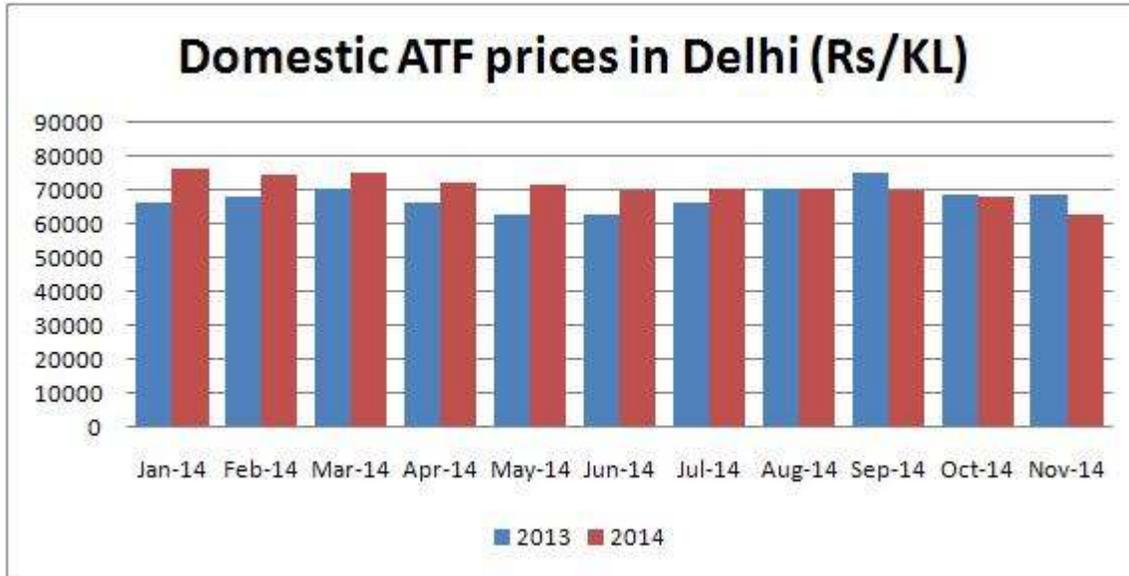
On international air travel, the Asia Pacific airlines reported a demand growth of 4.8 per cent compared to a year ago. Although this is a weaker rise than August, the recent trend has been positive and reflects better demand conditions in the region, including stronger trade activity that encourages business travel.



ATF prices remains bone of contention

Jet fuel or ATF accounts for over forty per cent of an Indian carrier's operating cost, compared to 20-25 per cent globally. Ad valorem taxes of 20-29 per cent are making domestic airlines shell out nearly 52 per cent more for the fuel compared to the average global price. The international airlines pay nearly 16 per cent more than the global average as they are exempt from state-level taxes, while Indian airlines are paying 50 per cent more for aviation turbine fuel here than the price in West Asian and the European markets.

Meanwhile, Aviation Turbine Fuel (ATF) rates were cut by a steep 7.3 per cent on November 1, 2014 by Rs 4,987.7 per kilolitre, or 7.3 per cent, to Rs 62,537.93 per kilolitre in Delhi. This is the fourth straight reduction in prices since August on back of falling international oil prices, bringing relief to airlines. The oil companies have also lowered retail petrol and diesel prices as international crude oil prices are hovering near \$85 per dollar level.



Domestic capacity is projected to grow by 8-10% in FY2015

Domestic capacity is expected to grow between 8-10% in FY15 and will largely be driven by IndiGo and start-up carriers. IndiGo is expected to deploy six A320s in the domestic market between April 2014 and March 2015, which will take its fleet size to 85. AirAsia India, which was launched with one A320 in June-2014, is likely to reach a fleet size of five to six aircraft by March-2015. The Tata Sons-Singapore airlines JV, Vistara, may have about five aircraft in operation by the end of FY2015. However, the final number of aircraft may vary as AirAsia India's plans are subject to change, while Vistara's growth is dependent on the timing of its launch.

Expected induction of additional aircraft for deployment on domestic services in FY15

| Airlines | Equipments |
|-----------------|-------------------|
| Indigo | 6 x A320s |
| AirAsia India | 5-6 x A320s |
| Vistara | 5x A320s |
| Air India | 2-3 x A320s |
| Air Costa | 2 x ERJs |
| Air Pegasus | 2 x ATR-72s |
| Go Air | 2 x A320s |

Positives for the industry

Indian carriers to pursue expansion on international routes in FY15:

Jet Airways will be the fastest growing Indian international carrier and could expand capacity by 10-12%. Most of the growth will come from connecting non-metro Indian cities with Abu Dhabi to support the integrated network with Etihad. The increasing focus on the Abu Dhabi hub may distract from turning around domestic operations. Moreover, Jet Airways has to hold its plan to launch daily services to New York Newark and Chicago via Abu Dhabi until India restores its Category I status with the US FAA. Meanwhile, Air India's international expansion has primarily been in Europe. Last year, Air India launched Birmingham and this year it has added Milan, Rome and Moscow to its network, with Amsterdam, Munich, Madrid and Barcelona expected in the coming months. A new triangular route to Sydney and Melbourne has been performing below expectations due to the high fuel costs on the long sectors and frequencies may be reduced. However, operations to London, Paris and Frankfurt have resulted in an improvement in route economics as the carrier transitions from 777 to 787 equipment.

Lots of startups queuing to grab Indian aviation pie

Six start-up airline's projects have received No Objection Certificates (NOC) in August-2014 and all are planning to launch by 3Q2016. There are at least a further four or five airlines at the business planning stage which are yet to apply for a licence. If all of the recent and planned new entrants materialise, India's aviation sector is likely to have significant over-capacity in the next 12-18 months. These six startup airlines -- including AirAsia India and Vistara -- could deploy up to 70-75 aircraft by the end of 2016. The incumbents are expected to greet the new entrants with very aggressive pricing and capacity deployment as a result of which the start-ups will need to ensure they are sufficiently capitalised to withstand the competitive response.

Ancillary revenues likely to be a key focus for LCCs in FY15:

So far Indian carriers have treaded softly with respect to unbundling, partly because of regulatory restrictions and partly due to a reluctance to make the first move. But strong ancillary revenues will be necessary to support a low base fare pricing strategy. AirAsia India tried to lead the way when it launched in June-2014 by removing the free baggage allowance. However, its experiment was short lived as the Directorate General of Civil Aviation (DGCA) stepped in and stated that a 15kg allowance was mandatory for all passengers. Despite this setback, it is anticipated that regulations will be eased significantly over the next few months, with the DGCA expected to take a more liberal approach towards ancillary services. By the end of FY2015, LCCs are likely to be generating ancillary revenue right across the value chain.

Concerns

India's downgrade to Category II by the FAA: With a new Director General in place at the Directorate General of Civil Aviation, the regulator is beginning to adopt a more stringent

approach to safety oversight and steps have been taken to address the shortage of inspectors. As a result India is expected to restore its Category I status by or before the end of the financial year, although this will likely come with some conditions attached and increased scrutiny.

Poor Infrastructure: The infrastructure continues to be a major constraint for Indian Airline Industry, aggravated further due to excess capacity created during good times. Maintenance and Air Traffic Control (ATC) infrastructure are grossly inadequate if the industry expects to grow any further. While, steps are being taken on this front to upgrade major airports in Mumbai, Delhi and Hyderabad, there are many concerns still that remain to be addressed. Attracting investments from the private sector will go a long way to develop and maintain the infrastructure, which is crumbling due to the built-up excess capacity.

India's airlines posted an estimated loss of Rs 10,600 crore in FY2014: The Indian airlines have reported a loss of around Rs 10,600 crore in FY14. This figure excludes Kingfisher Airlines, which remains a listed entity but has been non-operational since Oct-2012. With the exception of IndiGo -- which had a net income of Rs 320 crore -- every Indian carrier posted a net loss, even IndiGo's profit was down almost 60% year-on-year. IndiGo's result included sale and leaseback and engine credits which are netted off its costs. Air India accounted for more than half of the combined industry loss at Rs 5390 crore. Jet Airways Group and SpiceJet reported their highest ever full-year losses of Rs 4100 crore and Rs 1000 crore respectively.

| Total PAT/ (Losses) | FY13 (Rs Crore) | FY14 (Rs Crore) |
|---------------------|-----------------|-----------------|
| IndiGo | 790 | 370 |
| Jet Airways | -490 | -3670 |
| Spicejet | -190 | -1000 |
| Air India | -5490 | -5390 |
| Go Air | 100 | -120 |
| JetKonnnect | -300 | -430 |
| Air India Express | -300 | -100 |
| Alliance Air | -180 | -180 |
| Total | -6050 | -10520 |

Growth Drivers

- Five international airports (Delhi, Mumbai, Cochin, Hyderabad, Bengaluru) have been completed successfully under PPP mode.
- Greenfield airport at Navi Mumbai, Mopa (Goa) and some brownfield airports of Airports Authority of India (AAI) and 50 airports under the low cost model are to be developed all over the country, including under PPP.
- Indian aviation is experiencing dramatic growth across the board, from the emergence of LCC/new carriers to a growing middle class ready to travel by air as well as growth in business and leisure travel.
- India's middle income population is expected to increase from 160 Million in 2011 to 267 Million by 2016.
- Greater focus on infrastructure development; increasing liberalisation ' Open Sky Policy; AAI driving modernisation of airports, Air and Navigation Systems.
- Growth in aviation accentuating demand for MRO (maintenance, repair and overhaul) facilities.
- Large scale collaborations/M&A deals - Etihad Airways & Jet Airways; Tata Group & Singapore Airlines, Tata Group & AirAsia.
- India plans to increase the number of operational airports to 250 by the year 2030.

Recent developments

SpiceJet in the middle of a restructuring programme: In a bid to arrest losses, SpiceJet has reduced its capacity in a 'fleet standardization' exercise. Over the past six months, the airline's fleet has shrunk from 58 aircraft to 48 planes with the carrier returning 10 Boeing 737s to lessors. Three planes have been returned in the past two months alone. The airline now operates 48 aircraft, including 33 Boeing 737s and 15 Bombardier Q400. The reduction in capacity and the grounding of a Boeing 737 following a collision with a buffalo in Surat have impacted the airline's schedule, leading to cancellation of some flights. Meanwhile, further downsizing is expected as cash flow challenges are visible. The airline has been in discussions with a number of prospective investors to raise \$200 million, alongside which the current promoters would infuse a further \$50 million.

Air India's entry into Star Alliance: Air India's entry into Star Alliance in July-2014 was a major milestone for the carrier. However, in the short term it may increase costs due to the need to upgrade product and services, while the incremental revenue may be less than expected.

Outlook

India's civil aviation market is already among the top 10 in the world and is expected to be the third-largest by 2020. India's aviation sector could see huge growth, with many smaller towns in need of better air transport links. Individual business magnates or companies in the real estate or mining sectors could well buy a few small planes to connect two or three cities. It makes more

sense to focus on frequency at few locations than spreading geographically since every new station has a high fixed cost.

The government allowed 49 percent foreign direct investment (FDI) in domestic airlines last September, and Lufthansa, Qatar Airways, Emirates, Thai Airways, and Cathay Pacific are all said to be interested in joint ventures in India. The recent approvals include three regional carriers: Turbo Megha, Air Carnival, and Zav Airways. Three national airlines -- Air One Aviation, Zexus Air and Premier Air -- were also approved. Nevertheless, Six start-up airline projects received No Objection Certificates (NOC) in Aug-2014 and all are planning to launch by 3Q2016 and if all of the recent and planned new entrant becomes operational, India's aviation sector is expected to have significant over-capacity in the coming 5-6 quarters.

Companies Financial Data In Industry

| Company Name | CMP | MCAP | BOOK VALUE | DIV. YEILD % | TTM EPS | TTM PE |
|-----------------------------|--------|---------|------------|--------------|---------|--------|
| Global Vectra Helicorp Ltd. | 85.80 | 120.12 | -20.11 | 0.00 | 14.53 | 5.90 |
| Jagson Airlines Ltd. | 3.09 | 6.23 | 14.62 | 0.00 | -0.80 | 0.00 |
| Spicejet Ltd. | 15.23 | 815.23 | -27.85 | 0.00 | -17.35 | 0.00 |
| Kingfisher Airlines Ltd. | 1.52 | 122.93 | -199.92 | 0.00 | -59.80 | 0.00 |
| Jet Airways (India) Ltd. | 276.15 | 3136.99 | -236.89 | 0.00 | -226.18 | 0.00 |
| | | | | | | |

Sorted with TTM EPS (High to Low)

Source – Ace Equity

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