

Stars Are Shining Bright : Indian Aviation



The ground reality of the Indian Aviation Sector is reflected in the following headlines being carried in the media nowadays :-

- Indian aviation industry to remain on growth path in near future
- Aviation stocks soar as oil dips further
- Riding the re-rating wave, Stocks of Aviation companies surge 5-8%
- Prices of Brent crude oil touched multi-year lows.
- Scrips are getting higher valuations as demand stays strong

How correct or misplaced are these ? Your views are welcome.

Overview.



On a high

Indian Aviation Industry has become one of the fastest-growing aviation industries in the world. No doubt about this. And this has more to do with growth in population. [See India to become]. This industry promises huge growth potential on account of large and growing middle class population, rapid economic growth, higher disposable incomes, rising aspirations of the middle class and overall low penetration levels at present. Factors such as foreign direct investment (FDI) in domestic airlines, low-cost carriers (LCC), information technology (IT) interventions, a rising need for regional connectivity, and the government's initiatives have pushed the growth in the domestic aviation as a whole. Indian aviation sector is aspiring to become the world's third-largest aviation market by 2020 and the largest by 2030. [See Fastest Growing]

Rise in passengers carried by domestic airlines.

In the second quarter of current financial year:

Domestic air passenger traffic – 20.17 million

same period of last year – 16.732 million

Total passengers carried in October 2015 – 7.039 million



same period of last year – 5.925 million

Private Airlines Market Share. September 2015.

1. Indigo – 43.34%
2. Jet – 22.79%
3. Spicejet – 14.61%
4. Go Air – 10.33%

5. Jet Lite – 3.3%

AirAsia+Vistara+AirCosta+Trujet+Air Pegasus – 5.58%

Top 4 command 91% of the market share.

Recent Developments

India's largest carrier IndiGo came up with the country's largest initial public offering (IPO) in 3 years. Optimism Indicator. This was the biggest IPO in the Indian market since Bharti Infratel's over Rs 4,000-crore public offer in December, 2012. India's only consistently profitable airline, sold shares at Rs 765 and plans to use the money raised to expand operations and trim debt. The Rs 3,018-crore public offer of IndiGo's parent InterGlobe Aviation was subscribed more than expected.

Tata Advanced Systems (TASL) has signed a joint venture with Boeing to establish a centre of excellence for manufacturing aero structures for Apache helicopter initially and collaborate on integrated systems development opportunities in India in the long term. [See Tata]. A company like Boeing recognizes potential here.

Government Initiatives.



Civil Aviation Minister of State Mahesh Sharma

The Union government had released Draft National Civil Aviation Policy 2015 on October 30 which aimed to make flying affordable for the masses. The draft underlines 16 critical areas of civil aviation including safety, regional connectivity, bilateral traffic rights, and MRO operations. A series of government initiatives and recent developments have

already provided huge support to aviation sector and companies related to this industry witnessed tremendous growth in recent months. [See Govt Clears]. The government has unveiled draft aviation policy. The main objective of this policy is to Enhance regional connectivity through fiscal support and infrastructure development. Enhance ease of doing business through deregulation, simplified procedures and e-governance, Promote the entire aviation sector chain: cargo, MRO, general aviation, aerospace manufacturing and skill development. In view of this, the Airports Authority of India (AAI) is planning to revive and operationalise around 50 airports in India over the next 10 years. As a result, even the Air Charter operators have estimated growth up to Rs 5,000 crore. [See Baron].



More and More greenfield airports are coming up

The Reserve Bank of India (RBI), is relaxing norms for aircraft and helicopter imports and has said that banks can allow advance remittances for imports once the company has approval from aviation regulator DGCA.

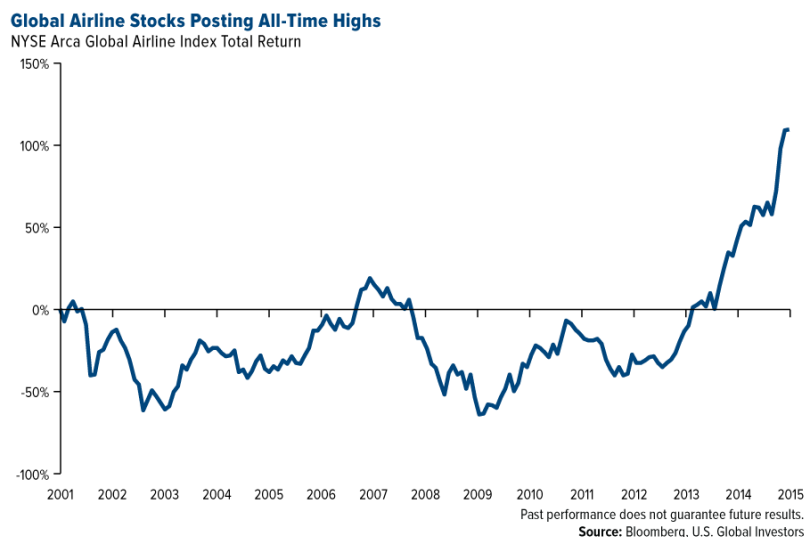
The Ministry of Civil Aviation has signed Memorandum of Understanding (MoU) with Finland, Kazakhstan, Kenya, Sweden, Norway, Denmark, Oman and Ethiopia for increased co-operation between the countries in terms of additional seats, sharing of airlines codes, increased frequencies and additional points of call, during the International Civil Aviation Negotiations (ICAN), 2015 held in Antalya, Turkey.

Outlook

Appears to be Bright. The outlook for Indian aviation industry for near and middle term has improved due to a fall in aviation fuel prices, which account for nearly 35% the operating expenses of airlines in India. The passenger traffic

has also witnessed a strong growth in the second quarter of current financial year and it is expected to continuously grow in near future. It is expected to maintain the momentum in future too. Losses of Indian aviation companies are expected to decrease, while IndiGo and SpiceJet are expected to generate profit due to fall in crude oil prices, and increase in traffic in the current financial year.

Stock Market Scenario.



Globally, aviation stocks are looking up. The most important factor is Oil price. Crude oil prices fell below \$35 a barrel – about 43% decline from the 2015 peak of \$67.77 per barrel. Prices of Brent crude oil touched multi-year lows. Aviation scrips attracted more buyers posting gains of 5-8.5 per cent. InterGlobe Aviation and Jet Airways shares touched their 52-week highs. SpiceJet also made smart gains. With fuel costs falling and passenger numbers rising, analysts have re-rated aviation sector and given higher multiples for such listed stocks.

Motilal Oswal Securities in a recent report attributed a fair value of Rs 1,478 to the Indigo stock. The stock has been continuously re-rated since the time of its initial public offering (IPO). Expectations of an attractive dividend yield upwards of five per cent (Rs 60 a share) is adding to the Street's interest. InterGlobe Aviation shares closed at a price of Rs 1,184.5 in the BSE, have rallied more than 50% since the stock got listed on the bourses in November. The

company had raised more than Rs 3,000 crore from the primary market via IPO.



Spicejet became the best performing aviation stock in the world. [See Best Performing]. SpiceJet recorded more than 90% load factors continuously for 6 months due to the same reasons: Low fuel cost, passenger growth and aggressive pricing. This is a big positive for its re-rating. Shares of Airline companies were bullish since last one month after several High Networth Individuals (HNIs) including Rakesh Jhunjhunwala increased their stock holdings in Airlines. Shares of Jet Airways soared nearly 17% since November.

Even then, as is usual, investors are apprehensive. Doubts spring up naturally.

- Is the re-rating justified?
- Should I buy at these levels?
- Stocks such as Indigo are already up 54 per cent from issue price of Rs 765! How high will it go?



The Street's view is mixed. The Indigo stock is fairly valued and might not correct below Rs 1,100. Santosh Hiredesai of Edelweiss Securities in a note last month said the company's premium valuations were justified because of its market leadership position. Indigo is going ahead with firm steps. Its structural cost advantage and expansion strategy will help it register stronger growth than peers. While SpiceJet trades at a discount to Indigo, analysts say the discount will narrow only if the company manages to post consistent net profits.

As is widely understood:

- Aviation sector in India is going through its best period
- This sector is dependent on external factors which are beyond its control
- Fuel prices are sensitive
- If crude oil prices move up, passenger load and profit projections could go awry.

With these factors in view, Daljeet Kohli of IndiaNivesh says looking at valuations in this way at this stage might be wrong to judge future prospects. The sector should not get premium valuations and that applies to Indigo also.

Negatives.

In Mid November, Competition Commission of India (CCI) passed an order penalising three airlines for cartelisation in determining the fuel surcharge on air cargo. CCI, which is the government authority to enforce the Competition Act. It imposed penalties of Rs 151.69 crore and Rs 63.74 crore on Jet Airways and InterGlobe Aviation while SpiceJet was ordered to pay Rs 42.48 crore. All three were aptly labelled "unfair

business practitioner". [See Penalised More]

Airlines like Indigo often face public anger and cases in consumer and labor courts. [See Indigo leaves passengers in lurch]. This might affect its credibility when it comes to rankings in terms of hospitality or customer services.