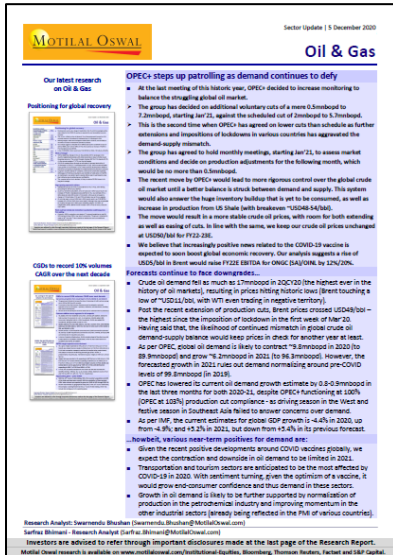
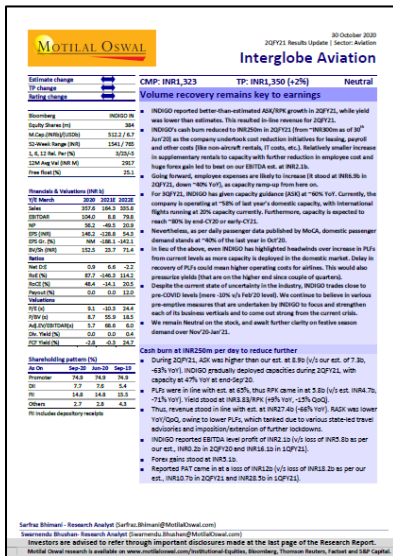


## Our earlier reports: OPEC+ steps up patrolling as demand continues to defy



## Indigo: Volume recovery remains key to earnings



## How airlines weathered the pandemic and the road ahead

### ...Indian carriers expensive v/s global peers

- It's been six months since the resumption of domestic flight operations in India (post complete grounding over April–May'20). Domestic operations in India are still ~50% of pre-COVID levels, recording a gradual improvement over these last six months.
- Globally, domestic market RPK stands at ~60% of pre-COVID levels, primarily driven by growth witnessed in China and Russia. China, which came out of lockdown before other countries, has almost achieved pre-COVID levels, with PLFs reaching ~78% mark in Oct'20 (v/s ~66% in India).
- While the global domestic and international markets' combined RPK is at only ~30% of pre-COVID levels, weighed by poor recovery in international travel. Europe continues to see deterioration in traffic due to an increase in the number of COVID cases.
- A rise in the number of unique city pairs has resulted in huge growth in the international market over the last two years. However, the COVID disruption has resulted in a significant reduction in such city pairs (down -67% YoY). Thus, we believe international travel is likely to take longer to recover, with confidence likely to first improve in intracontinental flying (v/s intercontinental flying).
- Despite subdued improvement in operations, Indian aviation stocks have risen 34–107% in the last three months (INDIGO – on the back of COVID-19 vaccine optimism and gains in market share; SJET – further supported by the re-licensing of the Boeing 737 MAX). On a YoY basis, INDIGO is up ~29% (outperforming Nifty by ~16%), while SJET is up mere 2% YoY.
- In this report, we highlight various developments in the Aviation space that could lead to quicker recovery going forward. Nevertheless, we remain skeptical on valuations in this space (INDIGO has outperformed global peers by ~50% both on 6m and 1yr basis).
- Optimism over the vaccine could certainly result in increased flying confidence, leading to the quicker normalization of operations v/s earlier estimated. However, the same reason has also led to a spike in crude oil prices, which were previously subdued, somewhat easing the pain of airline companies in the current unprecedented times.
- We highlight that for every USD5/bbl change in crude oil prices, INDIGO's EPS changes by ~25/15% (given fuel constitutes 30–35% of sales) for FY22/23E.
- Our outlook for the sector remains Neutral.

### Change in expectations/assumptions in the space due to vaccine

- Given the recent positive developments around COVID vaccines globally, we expect sentiment in the Transportation and Tourism sectors (anticipated to be the most affected by COVID-19) to turn positive. Thus end-consumer confidence and demand would grow in these sectors.
- IATA recently upgraded its forecast for the global airline industry cash burn to end by the end of 2021, which was earlier anticipated until 2022. However, IATA continues to believe that the production and distribution challenges pertaining to a vaccine would result in prolonged recovery in the Aviation market.
- As per a [recent interview](#), the CEO of INDIGO stated that domestic capacity may reach ~80% of pre-COVID levels by end-Dec, while international capacity is still just ~20%; thus anticipating normalization to 100% in domestic capacity by early next year and in international capacity by the end of next year.

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- **We keep our model assumptions unchanged – which are apparently in line with IATA’s recent forecast – with INDIGO expected to reach pre-COVID ASK in 3QFY21. On the other hand, we believe RPK would still be down ~15% YoY in the same quarter on the back of lower PLFs.**

#### **Aviation in conjunction with hotels in India**

- As per a [recent report](#) by our team, **leisure travel has picked up at a faster pace post the relaxation in lockdown restrictions. However, people are traveling to nearby locations by their personal vehicles.**
- Although, two popular leisure destinations in India – Goa and Jaipur – saw average hotel occupancy rates of 26–27% in Sep’20 (v/s 61–66% a year ago).
- **Corporate travel (particularly large corporates) should remain under pressure in the near term; and virtual meetings may even replace a significant proportion of face-to-face meetings for a long time to come.**
- Common commentary across domestic hotel players in India is that: a) the customer mix has changed from quarantine guests to traditional guests, and b) some of the cost rationalization measures would remain once the COVID-19 pandemic ends.

#### **Outlook positive, but revival likely to countervail gains**

- **Optimism surrounding the COVID-19 vaccine presents scope for increased demand in the aviation space:**
  - Passengers’ confidence in flying would grow once again, with a boost in leisure travel domestically, if not abroad.
  - The re-opening of offices would require migrant employees to fly back to their job cities. However, established efficiency in WFH would further prolong this demand until vaccine shots are available to the masses.
  - Many companies are flying their labor/employees from native towns to the job city in current times. Such a development could be very constructive for a dynamic shift in demand in the post-COVID world. Having said that, this could be a one-time exercise.
  - MoCA has also recently raised the capacity cap on domestic operations to 80% from 70% earlier, which stands in place until the last week of Feb’21 or until further notice (along with domestic airfare caps).
- **Nevertheless, the various fringe benefits enjoyed by airline companies in current times would deplete with normalization in demand:**
  - Domestic passenger yield in India is up ~30-45% on a quarterly average basis in 3QFY21’td v/s 4QFY20 (pre-COVID quarter) – as facilitated by the fare bands imposed by MoCA. However, various industry experts believe the fare bands should be removed to let the industry grow organically.
  - India has a huge order book of >500 planes coming in over the next 3–4 years. And, with domestic air travel demand extremely elastic to railway journeys, airlines would have to compete on fares to fill their seats.
  - Earnings could see a drastic impact on currently enjoyed higher yields if fare bands are removed and competition prickles in.
  - Also, with revival in economic activity, any spike in crude oil prices from current levels would directly impact the earnings of airline companies.
  - If crude oil prices climb up, along with yields declining from current levels, it would lead to a double whammy impact on the stocks – which are currently trending at expensive valuations.

**Exhibit 1: Global airline industry price performance comparison**

| Region/Company    | Absolute Perf. (%) |       |       |       |
|-------------------|--------------------|-------|-------|-------|
|                   | 1M                 | 3M    | 6M    | 1YR   |
| <b>Global</b>     | 18.0               | 25.2  | 21.4  | -18.8 |
| Asia              | 17.6               | 24.7  | 18.2  | -8.3  |
| Americas          | 22.0               | 35.4  | 52.5  | -21.5 |
| Europe            | 16.2               | 18.3  | -3.8  | -36.1 |
| <b>Interglobe</b> | 6.8                | 33.6  | 72.0  | 29.2  |
| <b>SpiceJet</b>   | 96.9               | 106.9 | 104.9 | 2.4   |

Source: Bloomberg, MOFSL

**Exhibit 2: Domestic passenger data snapshot post the lifting of lockdowns**

| Monthly domestic passenger (as per daily data published by MoCA) |        |        |        |        |        |               |
|--|--------|--------|--------|--------|--------|---------------|
|  | Jun    | Jul    | Aug    | Sep    | Oct    | Nov           |
| <b>2019</b>  | 11.99  | 11.86  | 11.76  | 11.49  | 12.28  | <b>12.91</b>  |
| <b>2020</b>  | 1.98   | 2.11   | 2.83   | 3.94   | 5.27   | <b>6.32</b>   |
| <b>YoY (%)</b>   | -83.5% | -82.2% | -75.9% | -65.7% | -57.1% | <b>-51.1%</b> |

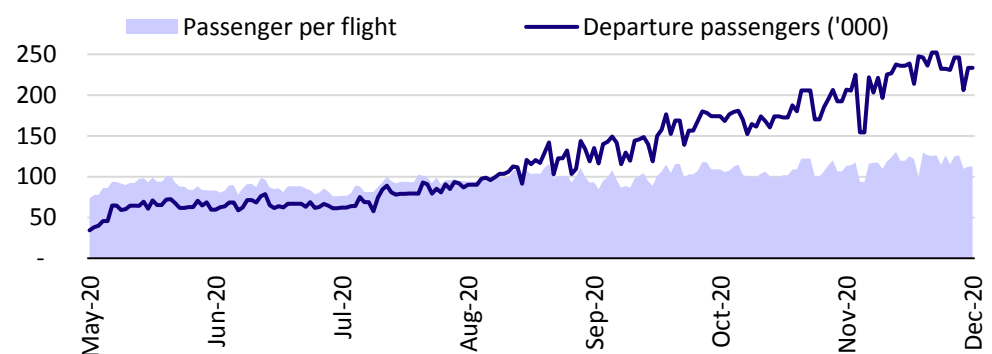
| Per day average basis  |        |        |        |          |          |          |
|------------------------|--------|--------|--------|----------|----------|----------|
|                        | Jun    | Jul    | Aug    | Sep      | Oct      | Nov      |
| <b>Average flights</b> | 722    | 785    | 927    | 1,310    | 1,588    | 1,811    |
| <b>Average pax</b>     | 64,771 | 67,062 | 90,779 | 1,29,086 | 1,69,140 | 2,10,551 |
| <b>Pax per flight</b>  | 90     | 85     | 97     | 99       | 107      | 115      |

Source: Ministry of Civil Aviation, MOFSL

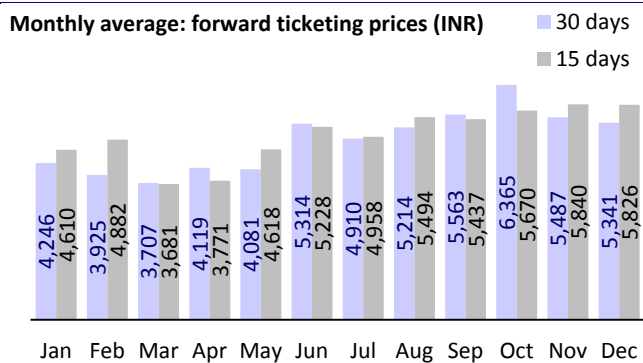
Domestic passenger data for Dec'20'td still stands at ~50% of pre-COVID levels.

Although, passengers per flight increased to 119 (v/s 115 in Nov'20); with average flights per day at 2,015 (v/s 1,811 in Nov).

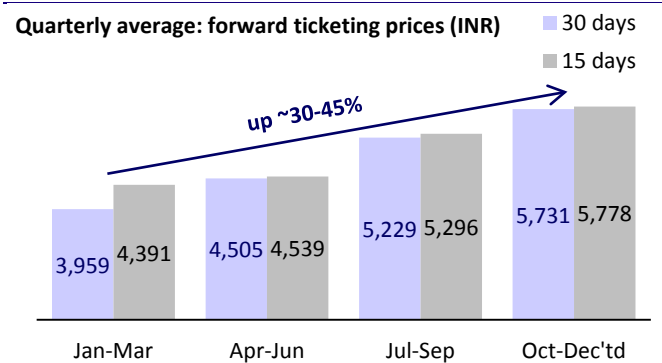
There is also an increase in the average daily passenger carried to 234,847 (up 12% MoM).

**Exhibit 3: Domestic passenger data in chart**

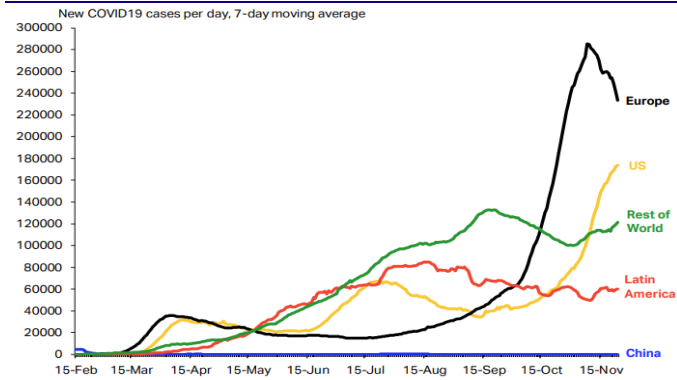
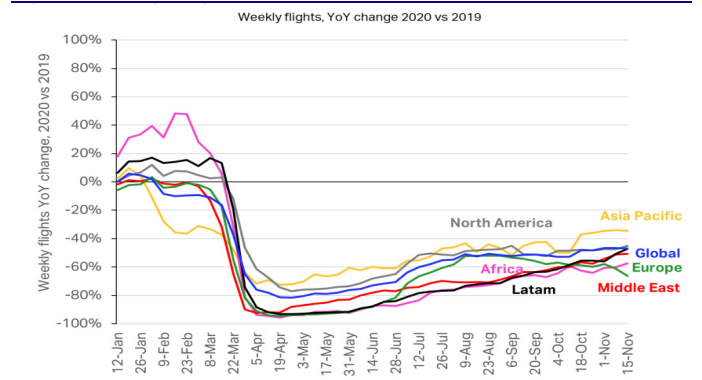
Source: Ministry of Civil Aviation, MOFSL

**Exhibit 4: India: yields have increased since June...**

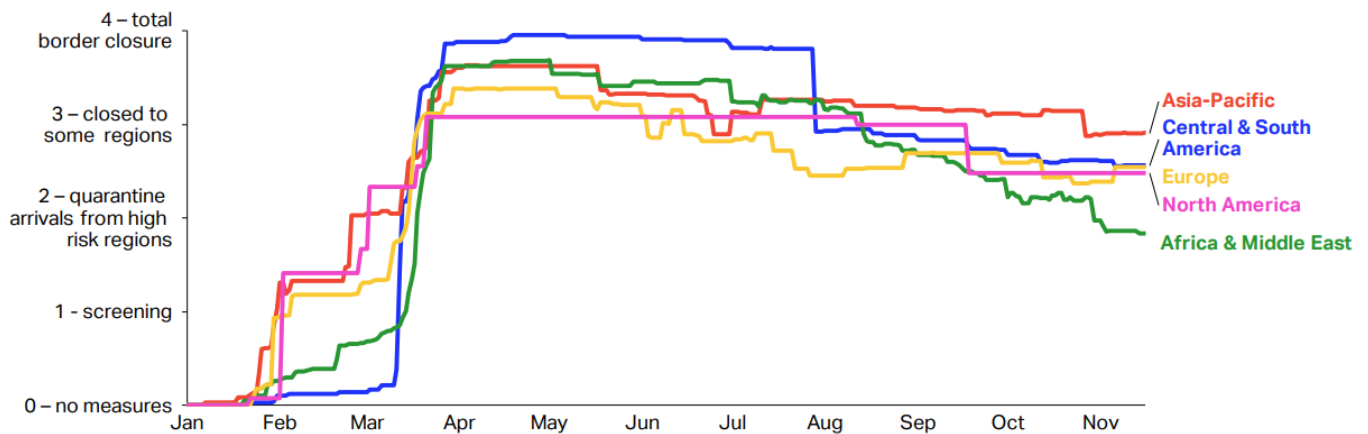
Source: Industry, MOFSL

**Exhibit 5: aided by airfare bands; up 30-45% v/s pre-COVID**

Source: Industry, MOFSL

**Exhibit 6: New COVID cases rising in the West recently...****Exhibit 7: ...resulting in a drop in weekly flight nos. in Europe****Exhibit 8: Restrictions imposed by various countries for international travel remain very high**

International travel stringency index weighted by population (Jan-Nov 2020)

**Exhibit 9: Global air passenger details – October 2020**

|                                | World share <sup>1</sup> | October 2020 (% year-on-year) |               |                         |                          | % year-to-date |               |                         |                          |
|--------------------------------|--------------------------|-------------------------------|---------------|-------------------------|--------------------------|----------------|---------------|-------------------------|--------------------------|
|                                |                          | RPK                           | ASK           | PLF (%-pt) <sup>2</sup> | PLF (level) <sup>3</sup> | RPK            | ASK           | PLF (%-pt) <sup>2</sup> | PLF (level) <sup>3</sup> |
| <b>TOTAL MARKET</b>            | <b>100.0%</b>            | <b>-70.6%</b>                 | <b>-59.9%</b> | <b>-21.8%</b>           | <b>60.2%</b>             | <b>-65.1%</b>  | <b>-56.4%</b> | <b>-16.7%</b>           | <b>66.1%</b>             |
| Africa                         | 2.1%                     | -76.3%                        | -65.6%        | -21.8%                  | 48.2%                    | -69.0%         | -62.2%        | -12.9%                  | 58.9%                    |
| Asia Pacific                   | 34.6%                    | -61.6%                        | -54.5%        | -12.7%                  | 68.7%                    | -61.8%         | -54.1%        | -13.8%                  | 68.1%                    |
| Europe                         | 26.8%                    | -77.6%                        | -65.1%        | -30.7%                  | 55.2%                    | -68.2%         | -60.8%        | -16.0%                  | 69.5%                    |
| Latin America                  | 5.1%                     | -68.0%                        | -63.9%        | -9.4%                   | 72.1%                    | -62.8%         | -59.2%        | -7.3%                   | 75.3%                    |
| Middle East                    | 9.1%                     | -85.5%                        | -72.4%        | -34.7%                  | 38.7%                    | -70.0%         | -62.3%        | -15.6%                  | 60.7%                    |
| North America                  | 22.3%                    | -70.1%                        | -55.1%        | -27.9%                  | 55.8%                    | -64.7%         | -50.5%        | -24.4%                  | 60.6%                    |
| <b>International</b>           | <b>63.8%</b>             | <b>-87.8%</b>                 | <b>-76.9%</b> | <b>-38.3%</b>           | <b>42.9%</b>             | <b>-73.6%</b>  | <b>-66.7%</b> | <b>-16.9%</b>           | <b>65.3%</b>             |
| Africa                         | 1.8%                     | -78.6%                        | -67.5%        | -23.8%                  | 45.5%                    | -70.1%         | -62.9%        | -13.7%                  | 57.6%                    |
| Asia Pacific                   | 19.1%                    | -95.6%                        | -88.5%        | -49.4%                  | 30.3%                    | -77.6%         | -71.6%        | -17.1%                  | 63.8%                    |
| Europe                         | 24.0%                    | -83.0%                        | -70.4%        | -36.7%                  | 49.5%                    | -71.8%         | -64.9%        | -17.0%                  | 68.9%                    |
| Latin America                  | 2.7%                     | -86.0%                        | -80.3%        | -23.5%                  | 57.7%                    | -70.7%         | -67.2%        | -8.9%                   | 74.1%                    |
| Middle East                    | 8.7%                     | -86.7%                        | -73.6%        | -36.6%                  | 37.0%                    | -70.6%         | -62.9%        | -15.9%                  | 60.5%                    |
| North America                  | 7.5%                     | -88.2%                        | -73.1%        | -46.2%                  | 36.2%                    | -74.4%         | -65.8%        | -21.2%                  | 63.0%                    |
| <b>Domestic</b>                | <b>36.2%</b>             | <b>-40.8%</b>                 | <b>-29.7%</b> | <b>-13.2%</b>           | <b>70.4%</b>             | <b>-50.1%</b>  | <b>-37.5%</b> | <b>-16.9%</b>           | <b>66.9%</b>             |
| Dom. Australia <sup>4</sup>    | 0.8%                     | -86.3%                        | -80.3%        | -25.7%                  | 58.0%                    | -69.4%         | -64.2%        | -11.8%                  | 68.5%                    |
| Domestic Brazil <sup>4</sup>   | 1.1%                     | -44.5%                        | -41.7%        | -4.1%                   | 79.9%                    | -52.3%         | -50.4%        | -3.1%                   | 79.5%                    |
| Dom. China P.R. <sup>4</sup>   | 9.8%                     | -1.4%                         | 7.6%          | -7.1%                   | 78.3%                    | -43.8%         | -32.1%        | -14.6%                  | 72.9%                    |
| Domestic Japan <sup>4</sup>    | 1.1%                     | -45.3%                        | -34.1%        | -13.1%                  | 64.5%                    | -56.3%         | -34.1%        | -24.6%                  | 50.3%                    |
| Dom. Russian Fed. <sup>4</sup> | 1.5%                     | -10.0%                        | 0.4%          | -8.7%                   | 76.0%                    | -24.5%         | -12.6%        | -11.4%                  | 72.6%                    |
| Domestic US <sup>4</sup>       | 14.0%                    | -60.7%                        | -45.3%        | -23.8%                  | 60.9%                    | -59.2%         | -41.6%        | -25.8%                  | 59.7%                    |

Source: IATA, MOFSL



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|----------------------------------|--|
| Investment Rating                | Expected return (over 12-month)  |
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