

India

Underweight *(no change)*

Highlighted Companies

InterGlobe Aviation Ltd

REDUCE, TP Rs1165, Rs1963 close

We estimate total traffic for Indian carriers in FY23F would be similar to FY20 due to our estimated 37% decline in domestic business travel over FY20-23F. We factor in a 7% decline in EBITDAR/ASK in FY23F (vs. FY20) due to downward pressure on tariff on account of weak industry volumes.

SpiceJet Ltd

REDUCE, TP Rs58, Rs74 close

We value the business at 6.8x FY23F EV/EBITDAR, at a 20% discount to our FY23F target multiple for IndiGo (8.5x) due to SpiceJet's relatively weak balance sheet and a tad lower than its 3-year median EV/EBITDAR of 7.5x.

Summary Valuation Metrics

| EV/EBITDA (x) | Mar-22F | Mar-23F |
|---------------------|---------|---------|
| InterGlobe Aviation | 44.2 | 15.6 |
| SpiceJet | 14.3 | 4.8 |
| EV/EBITDAR (x) | Mar-22F | Mar-23F |
| InterGlobe Aviation | 22.8 | 12.6 |
| SpiceJet | 10.1 | 6.1 |
| P/BV (x) | Mar-22F | Mar-23F |
| InterGlobe Aviation | (28.1) | (26.9) |
| SpiceJet | (0.7) | (0.5) |

Aviation - Overall

Air India sale: Competition in the sector to rise

- Tata Sons has acquired Air India (AI) at an attractive valuation.
- We believe debt reduction in AI and synergy benefits for Tata Group's aviation companies will increase competition in the sector.
- We maintain our Underweight rating on the sector and Reduce rating on IndiGo (TP Rs1,165) and SpiceJet (TP Rs58).

Key features of the deal for Air India's acquisition by Tata Sons

The bid of Tata Sons (Rs180bn Enterprise Value – EV) for acquisition of 100% stake in AI, 100% in Air India Express or AIXL (a low-cost carrier or LCC between India, the Middle East and SouthEast Asia) and 50% in a ground-handling company Air India SATS Airport Services (AISATS) has been approved by the Government of India. The transaction does not include assets of Rs147bn. (link to report on planned divestment of Air India, released in Feb 2020 – [How can a buyer turn Air India around?](#)) This report analyses the business of AI, likely impact of the acquisition on the sector and how a buyer can turn around AI.

Impact on Tata Sons' aviation business

(1) Attractive valuations: The deal EV is at a 35% discount to Mar 2019 book value of assets (Rs281bn). This EV implies that Tata Sons would take over Rs154bn of AI's debt, just 66% of the initial planned debt (Rs233bn) to be retained in AI and just 25% of AI's reported consolidated debt in Mar 2019. **(2) Debt reduction to reduce Cost/ Available Seat Km (CASK) by 10%:** High debt for AI+AIXL resulted in high ownership cost/ ASK (Rs1.35 vs. Rs0.77 for IndiGo in FY19). Debt reduction from Rs622bn to Rs154bn (as per transaction) will reduce interest by Rs37bn pa (Rs0.5/ ASK). Thus, CASK for AI+AIXL (Rs5 in FY19) is likely to reduce by ~10% to Rs4.5. IndiGo's CASK in FY19 was Rs3.6, but IndiGo has 13% more seats than AI as it is a LCC while AI is a Full Service Carrier (FSC). Adjusted for the same, CASK for IndiGo would rise to Rs4.1. **(3) Synergy likely to reduce overheads and ownership cost/ ASK:** Post acquisition of AI, Tata Group would have three airlines (Vistara, Air Asia India and Air India) with domestic market share at 7%, 7% and 9%, respectively (combined 23%). The synergy benefits could reduce its overheads/ASK. Further, the transaction could increase the group's Air traffic movement (ATM)/destination, improving its active hours and reducing its ownership cost/ATM. **(4) Restructuring of employee cost will be key to the plan:** We await clarity about Tata Sons' ability to reduce employee costs of AI as it has been ensured in the agreement that the interest of the employees and retired employees of AI would be taken care of. Salary and overheads /ASK of IndiGo (Rs0.6) is 53% lower than AI+AIXL (Rs1.3) in FY19.

Impact on IndiGo and SpiceJet

We believe this transaction would increase competition in Indian aviation by (a) reducing interest cost for AI, and (b) synergy benefits for Tata Sons (combined 23% market share) could reduce overheads and ownership cost/ASK. We maintain our Underweight rating on the sector and Reduce rating on IndiGo (TP Rs1,165) and SpiceJet (TP Rs58)

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Air India sale: Competition in the sector to rise

Salient features of the deal ➤

Air India Specific Alternative Mechanism (AISAM) approved the bid of M/s Talace (Rs180bn Enterprise Value – EV), a wholly-owned subsidiary of Tata Sons, for acquisition of 100% stake in Air India, 100% in Air India Express or AIXL (a low-cost carrier LCC between India, the Middle East and SouthEast Asia) and 50% in ground-handling company Air India SATS Airport Services (AISATS). The transaction does not include non-core assets including land and building (Rs147bn), which will be transferred to Gol's Air India Asset Holding (AIAHL).

Seven EOIs were received in Dec 2020, but five were disqualified. Request for Proposal (RFP) and draft Share Purchase Agreement (SPA) was issued in Mar 2021. The bid due date was extended to 15 Sep 2021 so that bidders could complete the due diligence. Two bids were received from Tata Sons (EV of Rs180bn) and Ajay Singh (EV of Rs151bn), both above the reserve price (Rs129bn). The next step is to issue a Letter of Intent (LoI) and sign the SPA. Certain conditions have to be satisfied by the bidder, AI and Gol. Transaction closure is expected by Dec 2021.

Link to our report on the planned divestment of Air India, released in Feb 2020. – [Aviation - How can a buyer turn Air India around?](#) We believe this report is relevant in analysing the business of Air India, likely impact of the acquisition on the sector and how a buyer can turn around Air India.

Figure 1: Key financials of Air India for FY19

| (Rs bn) | AI (S/A) | AIXL | Inter Company eliminations | AI + AIXL | | Difference |
|--------------------------|------------|-----------|----------------------------|------------|-----------------------------------|-------------|
| | | | | Derived | Adjusted for proposed transaction | |
| Equity | (295) | (8) | 8 | (311) | 49 | 360 |
| Debt | 606 | 27 | 12 | 622 | 233 | (389) |
| Total | 311 | 19 | | 311 | 281 | (30) |
| Non Current Assets | 261 | 29 | | 289 | 267 | (22) |
| Assets held for sale | 149 | - | | 149 | - | (149) |
| Investments | 9 | 0 | 8 | 2 | 2 | (0) |
| Deferred Tax asset | 28 | - | | 28 | 28 | - |
| Current Assets ex cash | 55 | 7 | 12 | 51 | 63 | 12 |
| Assets held for sale | 13 | 0 | | 13 | 0 | (13) |
| Cash | 9 | 1 | | 10 | 9 | (0) |
| less current liabilities | (212) | (18) | | (231) | (88) | 143 |
| Total | 311 | 19 | | 311 | 281 | (30) |

SOURCES: INCRED RESEARCH, COMPANY REPORTS

The process started in Jun 2017. The first round did not elicit any Expression of Interest (EOI). The process re-commenced on 27 Jan 2020 with issue of Preliminary Information Memorandum (PIM). The original construct in the Jan 2020 PIM was (i) fixed debt retained in AI (balance transferred to AIAHL), and (ii) certain liabilities (other than debt) retained in AI and AIXL equal to certain assets of AI and AIXL (excess liabilities transferred to AIAHL).

The timelines were extended due to the COVID-19 pandemic. Due to excessive debt, the bidding construct was revised in Oct 2020 to EV to allow bidders to resize the balance sheet. EV construct allowed bidders to bid on total (for equity and debt) with the minimum cash consideration being 15% for equity. As per both the original and revised construct, all non-core assets (land, buildings) are to be transferred to AIAHL and not a part of the transaction.

Impact on Tata Sons' aviation business ►

- **Attractive valuations:** The deal EV (Rs180bn) is at a 35% discount to book value of assets in Mar 2019 (Rs281bn). This EV implies that Tata Sons would take over Rs154bn of AI's debt, just 66% of the initial planned debt (Rs233bn) to be retained in AI and just 25% of AI's reported consolidated debt in Mar 2019.
- **Debt reduction to reduce Cost/Available Seat Km (CASK) by 10%:** High debt for AI+AIXL resulted in high ownership cost/ASK (Rs1.35 vs. Rs0.77 for IndiGo in FY19). Debt reduction from Rs622bn to Rs154bn (as per transaction) will reduce interest cost by Rs37bn pa (Rs0.5/ASK). Thus, CASK for AI+AIXL (Rs5 in FY19) is likely to reduce by ~10% to Rs4.5. IndiGo's CASK in FY19 was Rs3.6, but IndiGo has 13% more seats than AI as it is a LCC while AI is a Full Service Carrier (FSC). Adjusted for the same, CASK for IndiGo would rise to Rs4.1.
- **Synergy likely to reduce overheads and ownership cost/ ASK:** Post acquisition of AI, Tata Group would have three airlines (Vistara, Air Asia India and AI) with domestic market share at 7%, 7% and 9%, respectively (combined 23%). The synergy benefits could reduce its overheads/ASK. Further, the transaction could increase the group's air traffic movement (ATM)/destination, improving its active hours and reducing its ownership cost/ATM.
- **Restructuring of employee cost will be key to the plan:** We await clarity about Tata Sons' ability to reduce employee costs of AI as it has been ensured in the agreement that the interest of the employees and retired employees of AI would be taken care of. Tata Sons will have to retain all employees for one year. Thereafter, if anybody is to be retrenched, they will be offered a voluntary retirement scheme (VRS). The employees will be provided gratuity and provident fund. Post-retirement medical benefits for those who have retired or will retire in future will be protected. Salary and overheads/ASK of IndiGo (Rs0.6) is 53% lower than AI+AIXL (Rs1.3) in FY19.

Impact on IndiGo and SpiceJet: ►

We believe this transaction would increase competition in Indian aviation by (a) reducing interest cost for AI, and (b) synergy benefits for Tata Sons (combined 23% market share) could reduce overheads and ownership cost/ASK. **We maintain our Underweight rating on the sector and Reduce rating on IndiGo (TP Rs1,165) and SpiceJet (TP Rs58).**

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| | | | | | |
|---------------------|-----------|-----------|---------|----------|------------------|
| Score Range: | 90 - 100 | 80 – 89 | 70 - 79 | Below 70 | No Survey Result |
| Description: | Excellent | Very Good | Good | N/A | N/A |

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Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2020, Anti-Corruption 2020

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- CG Score 2020 from Thai Institute of Directors Association (IOD)

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Recommendation Framework

Stock Ratings

Definition:

- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
- Reduce** The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight** An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

- Overweight** An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral** A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight** An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.