# INTERGLOBE AVIATION: RISK TAKERS CAN BOARD THIS FLIGHT

**News / Airlines, Finance**

The initial public offer (IPO) by **InterGlobe Aviation** could have been an open-and-shut buying opportunity for investors. The company operates IndiGo Airlines — the country's largest and most profitable air carrier. The airline seems set to continue its strong growth in the high-potential Indian skies. Also, the asking price for the issue, while not cheap, seems justified. But these positives have been diluted by the interim dividend imbroglio that put the company's net worth in the negative territory. The risk quotient of the issue is now pegged higher.

**Robust business**

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In a difficult operating environment which has seen most airlines in the country struggle, IndiGo has been an outlier. Its superior operating and financial parameters has helped it remain consistently profitable — even in tough years such as 2012 and 2014. Between 2011 and 2015, the company's revenue grew at an annual average of 38 per cent to ?14,309 crore while profit grew at about 22 per cent to ?1,296 crore.

IndiGo's adherence to the low-cost carrier model with a single aircraft type (A320), no-frills offering, high aircraft utilisation and tight rein over costs (least in India and among the lowest in the world) have helped.

The growth looks set to continue. The current times are among the best for the sector in India — with strong passenger growth (20 per cent year-on-year during January to September 2015) and a 36 per cent year-on-year drop in the cost of aviation turbine fuel, the major airline expense.

IndiGo as the market leader is putting a lot of daylight between itself and the competition. Its market share in September 2015 was 36.5 per cent, much ahead of closest competitor Jet Airways' 22 per cent and nearly thrice its own share in 2009.

IndiGo grew profit nearly three-fold in 2015 and the recent June quarter profit is almost half that of the entire last year. Also, its operating margin at 37 per cent in the June quarter was much higher than the 27 per cent in 2015.

The company which currently has 97 aircraft placed large orders in 2011 (180 aircraft) and 2015 (250 aircraft) for the more fuel-efficient A320 NEOs, deliveries of which will run through the next decade. This should aid in cost control and help the airline maintain its pole position. Also, the asset-light sale-and-leaseback model for most of its aircraft means that the airline's fleet remains new, maintenance costs low and capex subdued.

Besides, the profit on the sale of aircraft adds to the bottomline and acts as a buffer in tough times. The company remains focused on its domestic operations which contribute about 90 per cent of revenue while also adding to its international footprint.

**Justified premium**

InterGlobe Aviation seems to have factored in the positives in the issue price. The price band of ?700-765 a share discounts the estimated 2016 fiscal earnings by 13-14 times, somewhat higher than the multiples of profitable international low-cost peers such as Southwest Airlines, EasyJet and Spirit Airlines. But given IndiGo's superior growth prospects, the premium does not seem out of place.

**Dividend dampener**

What spoilt the nicely stirring broth was the company's revelation in its red herring prospectus that its net worth as of June end was a negative ?139 crore. This incongruous state of affairs for the consistently profitable company was due to a large interim dividend (?1,003 crore) declared in the June quarter. The interim dividend was for the current fiscal 2015-16; the company declared the payout in the first quarter based on profits forecast for the entire year.

Terming the matter as a non-issue, the management pointed to the company's strong profits, implying that the negative net worth would have turned positive by now.

Yet, the development raises concerns that go beyond bad optics. In a sector as fickle as aviation,

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giving dividends to shareholders based on estimated profits seems aggressive. The front-ended dividend payout before the IPO suggests a hurry to reward the current owners as much as possible before inducting new shareholders. The ?1,003 crore dividend in the June quarter is just a tad lower than the entire fiscal 2014-15 dividend of ?1,080 crore (the highest in five fiscals) which was paid out in four instalments.

Next, despite good dividend payouts in earlier years, the company's net worth remained positive. This year though, it dipped into its reserves (and more) turning the net worth negative. The action raises disquiet — instances of companies reporting negative worth due to high dividend payouts are very rare.

Even if legally permissible, this does not reflect well on the company. This has increased the risk perception of the issue, making it suitable for those willing to take the not-so-nice with the good. After the issue, the promoters will hold about 85 per cent stake from 94 per cent currently. This will necessitate further dilution of promoter stake to 75 per cent over the next three years, as per SEBI regulations.

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