"IndiGo's First Quarter Fiscal 2018 Financial Results Conference Call"

July 31, 2017

MANAGEMENT: **ADITYA GHOSH – PRESIDENT& WHOLE TIME DIRECTOR**
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Operator: Good evening ladies and gentlemen and welcome to IndiGo's Conference Call to discuss the first quarter financial results for fiscal year 2018. My name is Zaid and I will be your moderator for this conference call. At this time, the participants are in a listen-only mode. A question-and-answer session will follow today's management discussion.

As a reminder, today's conference call is being recorded. I would now like to turn the call over to Mr. Ankur Goel, Associate Vice President of Treasury & Investor Relations for IndiGo.

Ankur Goel: Good Evening, everyone, and thank you for joining us for the First Quarter Fiscal 2018 Earnings Call.

I have with me our President and Whole Time Director -- Aditya Ghosh and our Chief Financial Officer – Rohit Philip.

Before we begin, please note that today's discussion may contain some statements on our business or financials which will be construed as forward-looking. Our actual results may be materially different from these forward-looking statements.

The information provided on this call is as of today's date and we undertake no obligation to update the information subsequently.

A transcript of today's call will also be archived on our website. We will upload the transcript of today's prepared remarks within an hour. However, the transcript of the Question and Answer session will be uploaded in a week's time.

With this, let me hand over the call to Aditya Ghosh.

Aditya Ghosh: Good evening everyone and thank you for joining us on this call. Our comments today will be somewhat longer than our past calls since there is a lot to discuss and a lot that we would like to update you on. However, we expect to complete the call including the question and answer session within one hour.

We announced our first quarter fiscal 2018 financial results today. We have reported our largest ever quarterly profit this quarter with a profit after tax of 8.1 billion rupees, an increase of 37.1% compared to the same period last year. Our after tax profit margin for the quarter was 14.1%. We added 4 aircraft during the quarter of which 3 were A320neos taking our total fleet count to 135 and our A320neo fleet count to 22. On the operational front, for the quarter, we were ranked No.1 in on-time performance and our technical dispatch reliability was 99.85% and flight cancellation rate was 1.2%.

Now, let me address the operational reliability issues around our A320neos. As you may recall, we had mentioned in a prior call that we are experiencing operational issues with the neo engines related to the premature degradation of the combustor chamber lining and the premature wear of the No. 3 bearing seal. As a result, we continue to have a high number of engine removals and sufficient spare engines have not been available. Regrettably, there have been days when we have had to ground as many as nine A320neos due to lack of spare engines. While we do receive certain compensation from Pratt and Whitney for these groundings, the operational disruptions are quite challenging and we are not happy with that situation. Based on what we know today, it may be another year or so before the design changes are implemented by Pratt and Whitney which should allow these engines to have the on-wing flight hours that we expect from them. Pratt and Whitney is a good partner and we have tremendous respect for their leadership team and have impressed upon them that they need to focus on increasing the number of spare engines that are available in the system. And, under the assumption that we receive sufficient number of spares, we hope to see significantly reduced operational disruptions within the next few months.

Now a brief update on our planned turboprop operations. During our last call, we announced our order of up to 50 ATR 72-600 aircraft. Documentation work with the aircraft and engine manufacturers continues towards finalization of the purchase agreements and currently our plan is to launch commercial operations by the end of this calendar year.

Earlier this month, on the July 6th, our founders, Mr. Bhatia and Mr. Gangwal at an analyst call, shared their views on the potential that exists in long-haul international flying in India and in that context, our specific interest in acquiring the international operations of Air India. We will wait to see how the Government would like to undertake the divestment of Air India and till such time that there is clarity, it does not help to speculate on different scenarios. Also, on this call, I will not repeat all the details of that call but would like to emphasize the following points.

One – we believe that there is a significant opportunity that exists in long haul international travel out of India. Today, a large number of people arrive or depart India on connecting international flights due to the lack of non-stop flights into and out of India and offering flights at lower fares would be an attractive value proposition for customers.

Two – IndiGo is uniquely placed to capitalize on this opportunity as over the last ten years, IndiGo has established a significant domestic presence and now has a little over 40% of the domestic market share. In doing so, we have also been able to build meaningful operations at all the large metropolitan cities of India. We would not be attempting to enter this long-haul international space but for the fact that we have this large domestic feed network.

Three – we recognize that this will present new challenges and complexities but we believe that the overall opportunity is very compelling and we will only go down this path if the business case is EPS accretive and creates shareholder value.

With this, let me hand over the call to Rohit for an overview of our financials.

Rohit Philip: Thank you, Aditya, and good evening everyone.

For the quarter ended June 2017, we reported a profit after tax of 8.1 billion rupees with an after tax profit margin of 14.1% compared to a profit after tax of 5.9 billion rupees with an after tax profit margin of 12.9% during the same period last year. Our profit after tax in the quarter was 37.1% higher than last year. As Aditya mentioned, this is our best ever quarterly profit. We reported an EBITDAR of 19.6 billion rupees with an EBITDAR margin of 34.1% compared to an EBITDAR of 15.5 billion rupees with an EBITDAR margin of 33.9% during the same period last year.

Our total capacity for the June quarter was 15.1 billion ASKs, an increase of 18.7% compared to the same period last year. This is lower than our previously guided number of 22% due to the grounding of some of our A320neos that Aditya talked about earlier and the delay in neo deliveries.

Our revenue from operations in the June quarter was 57.5 billion rupees, an increase of 25.6% over the same period last year. Our other income was 2.0 billion rupees for the quarter.

Our RASK for the quarter was 3.82 rupees, an increase of 5.5% from 3.62 rupees during the same quarter last year. This increase in RASK was driven by both an increase in our load factors and yields. Our load factors were up by 4.7 points to 88% and our yields were up by 2% to 3.83 rupees. The year-over-year RASK growth that we have seen this quarter is a much better performance than what we have seen over the past few quarters. It is important that I point out that in the June quarter of last year, we did not execute optimally on our RASK performance. We placed a bit too much emphasis on yields and were not matching competitors' fares. Consequently, we saw a decline in load factors and our RASK performance for the same quarter last year was adversely impacted. Now we have seen a year-over-year RASK improvement of 5.5% for the quarter in spite of capacity being up 18.7%. My point here is that this quarter's superior RASK performance does not necessarily portend the RASK performance for future quarters.

Our cost performance continues to be good. CASK excluding fuel was lower by 2.5% from 1.96 rupees in the prior quarter to 1.91 rupees in the current quarter. We reported a total CASK of 3.08 rupees for the quarter compared to 3.04 rupees last year. Our total CASK was higher by 1.3% in spite of a 15.8% increase in fuel prices.

In all our prior conference calls, we have not articulated the implications and pressures on RASK and CASK as a result of adding capacity at such a torrid rate. At IndiGo, for the last five years, our ASK or capacity has grown at a compound annual growth rate of 24.8%, or almost 25%, and for the same five years our RPK or traffic has grown at a compound annual growth rate of over 26%.

Let me try and attempt to explain the implications of growing an airline at 25% every year. When an airline grows its capacity at such a high rate, it tends to depress the RASK that it is able to generate every quarter due to the simple fact that new flights which were added during the quarter have yet to mature. This 25% capacity that was added during the quarter takes about six or more months before it establishes itself and takes hold in the market place. And, during that time, its RASK generation is sub-optimal. In other words, while the RASK of the new flights that were added during the same quarter last year have started to reach steady state maturity, the new flights added during the current quarter tend to be a drag on the system RASK.

And, there is another penalty associated with such rapid growth. There are significant costs that we incur due to our torrid growth rate of 25%. We incur material costs well before capacity additions have taken place – costs such as hiring and training of pilots, flight attendants, maintenance staff, ground staff, the opening of stations, etc. This also creates a drag on our true steady state cost structure.

So, this rapid annual growth rate of 25% at IndiGo tends to squeeze us on both the revenue side and on the cost side. Our point is that while we are somewhat satisfied with our overall profitability during this torrid growth phase, our true underlying profitability potential is suppressed due to the penalty on RASK and CASK. In years from now, this torrid growth rate will one day naturally slow down and that is when we believe that we expect to see a margin expansion due to improvements on our RASK, CASK and profitability.

Just so that there is no confusion and you do not misread my comments, we are in no way attempting to signal that we will be slowing down our growth rate in the near future. In fact, based on our current plans, market conditions and aircraft deliveries, we expect to keep growing at a compound annual growth rate of about 20% through fiscal 2020.

Another element that is impacting our profitability is the delay in A320neo deliveries. A320neos have not been delivered as per the plan with Airbus. By now we should have had 36 neos whereas we currently have 22 neos. To make up for this shortfall, we have had to go to the aircraft leasing market and enter in to short term leases of used A320s. Some of them with GE engines and some with IAE engines. These short term leases have an average duration of three years. However, they come at a higher operating cost for us due to higher maintenance costs because they are older aircraft and higher fuel burn relative to the neos. These higher costs are somewhat offset by lower lease rates since these are older aircraft. However, net-net the total cost to us of operating these used aircraft is higher than what we would have incurred relative to operating the A320neos. The only silver lining is that most of these used aircraft will be gone from our fleet within three years.

Moving to the balance sheet, we had total debt of 25.2 billion rupees at the end of the quarter. Our cash balance at the end of the quarter was 101.8 billion rupees, comprising of 51.9 billion rupees of free cash and 50.0 billion rupees of restricted cash.

I now would like to discuss the sale and leaseback model that we have historically been using to finance our aircraft. As Mr. Gangwal had mentioned during the analyst conference call on July 6th, going forward we anticipate reducing our use of short-term, sale and lease back model and gradually begin the process of owning aircraft with internal funds and maybe some debt.

Quite a few folks have not understood the pros and cons of the sale and lease back model that we have deployed to date and maybe because we have not elaborated on this issue. In fact, some of our competitors claim that our superior profitability is driven by the fact that we generate some of our profitability from being able to sell the aircraft at a price higher than what we purchased that aircraft for when we do a sale lease back. This is simply not correct.

Very simplistically and at a high level, the primary purpose of the short term, six-year, sale and lease back model that we had adopted was to be able to move the aircraft out of our fleet quickly once new technology aircraft came in to the market. The short-term six-year sale and lease back models were expensive since the lessors demanded a high lease rate because we were ending the leases in six years.

Now that we have the A320neo which delivers a 15% lower fuel burn and have a much lower risk of technological obsolescence, we may choose to operate these aircraft for a longer period than the six-year period we have historically used. Over the longer term, owning an aircraft tends to have a lower overall ownership cost than leased planes. Hence, the shift in our fleet acquisition strategy will allow us to reduce our operating costs which will result in higher profitability. Also, in the longer term, our ongoing cash flow from operations will become stronger as a result of the depreciation tax shield that we will get from the owned aircraft.

As we continue to evaluate the sale lease back model versus owning aircraft, we are also factoring in the implications of the new GST rules that went into effect earlier this month.

To put into perspective our lease vs buy thinking, let me just point out that many great airlines like Southwest, Ryan Air, etc. have a large number of owned aircraft and it has helped these carriers build a strong balance sheet.

As we embark on this journey of optimizing aircraft ownership costs, we will use some of our cash to purchase aircraft. So far, in determining the annual dividend, our board looked at the profits for the year, the cash needs to run the business and the prudent amount of cash that the company should maintain. Now, going forward, this use of cash to purchase aircraft will also be factored. The primary focus will always be to create long term shareholder value.

Now switching topics, we became a publicly listed company on 10th November 2015 and we are required by law to have a minimum public shareholding of at least 25% within the three year period post listing. We plan to seek approval of our shareholders to comply with this requirement in the upcoming Annual General Meeting which is expected in the last week of August. Also, the Board of Directors of IndiGo had recommended a dividend of 34 rupees per share for fiscal 2017. This will also be placed for approval in this Annual General Meeting and subject to us receiving the approval, the dividend will be paid shortly after that.

Before I close my remarks, let me give you our latest capacity guidance. We are expecting a capacity increase in terms of ASKs of 15% for the second quarter and 20% for the full year of fiscal 2018 which is lower than the guidance we had given earlier. The reduction in our capacity guidance is primarily because of the groundings we are currently experiencing on our neos as well as some delays in neo deliveries during the year.

That said, we expect that over the 3 year term for fiscal 2018 to fiscal 2020, our capacity will grow at a compound annual growth rate of about 20%.

The above prepared remarks transcript will be replaced with a full conference call transcript (including the Q&A portion)