Siena Market Line
18 February 2016

Spirit Airlines, Inc.

NASDAQ GS:SAVE

Analyst: Joseph Gonyeau
Sector: Services

BUY

Price Target: $57.64

Key Statistics as of 2/18/2016

Market Price:	$46.75
Industry:	Airlines
Market Cap:	$3,344.8M
52-Week Range:	$39.73 – 82.49
Beta:	0.97

Thesis Points:

- Has managed to undercut competitors by offering value flights.
- Record low oil prices have helped keep Spirit Airline's operating costs down.
- Q4 2015 Earnings signal strong financial and operational performance for the coming year.

Company Description:

Spirit Airlines, Inc. is an American low-cost carrier headquartered in Miramar, Florida. Spirit operates 385 daily flights throughout the U.S. as well as the Caribbean, Mexico, and Latin America, with major focus cities including For Lauderdale, Dallas, Detroit, Las Vegas, Chicago, Houston, and Atlantic City. Spirit Airlines basic service combines with a range of optional services for additional fees. Most of their revenue comes from ticket sales; however, a large portion of revenues come from non-ticket extras such as checked baggage. Their intensive focus on costs has enabled them to undercut many legacy airlines and increase their market share. Spirit Airlines has seen shares drop by around 45% over the last year due predominantly to price competition and uncertainty over the price of oil; however, a new CEO and very strong Q4 2015 results show that the stock is very bullish.

Thesis

Spirit Airlines, Inc. is one of the leaders in U.S. ultralow-cost airline carriers, having more than quadrupled their earnings since their initial 2011 initial public offering to $317 million last year. On top of this, revenue has double to $2.14 billion and they have also encouraged a U.S. imitator, Frontier Airlines. Although the stock price has tumbled as of late, Spirit Airlines is a value company that earned $4.38/share in 2015, which is a growth of 42.2% from 2014. Also, low fuel prices have helped Spirit Airlines decrease its biggest negative value driver, operating costs. With strong Q4 earnings, low operating costs, and a recent drop in price, now is the perfect time to enter a long-term position on a value creating company.

Industry Outlook

2015 was a record year for the air travel industry, due in large part to the decrease in the price of oil. Last year the airline industry saw a record year in profitability, with profits of $33 billion, and has been growing at a rate of 6-7% above the historic norm. As oil prices are expected to stay low, the airline industry could see a boost well into 2017, with expected industry profits of $36.3 billion in 2016. To make matters better, return on capital in the industry is reaching close to 8.6%, the best it has been in over a decade. The airline industry is rather cyclical and responsive to macroeconomic trends, and the current economic landscape is not entirely certain. With the FED recently increasing interest rates to a range of .25% to .5%, it seemed to be a sure sign that the economy has all but healed from the Great Recession. These rate hikes are not promising for the capital intensive airline industry, which relies heavily on debt financing for the purchase and maintenance of planes. Regardless, there is still an astonishing 3.8 billion anticipated airline passengers in 2016, placing Spirit Airlines and its low-cost strategy in a perfect position to navigate the market.

Business Model

Spirit Airlines operates an ultralow-cost business model, driven by a low-cost structure. This model allows Spirit Airlines to offer significantly cheaper airline tickets as opposed to its competitors, enabling it to achieve a relatively high profit margin. Their strategy revolves around unbundling traditional airline packages, removing things such as check-in baggage and advanced seat selection, and allowing its passengers to select and pay for only the services that they desire. The services aside from the base price of the ticket are ultimately recorded as non-ticket revenue. This strategy has proven to be successful thus far as they have been able to quickly increase their market share since 2011. Spirit Airlines targets price sensitive leisure travelers, who pay for their own travel. Its low fares attract travelers, and increase passenger volume, allowing them to also bolster non-ticket revenue on their flights. With passenger volume and non-ticket revenue increasing, Spirit Airlines is able to reduce its base fare even further, stimulating additional demand.

People

Spirit Airlines recently underwent a change in leadership, replacing their former CEO Ben Baldanza with Robert Fornaro. Fornaro is an industry veteran who has been a part of Spirit's board since 2014. Mr. Farnaro brings years of experience with him to his new leadership role, having previously held senior position at two large full-service airlines, and then as the CEO of AirTran Airways. Mr. Fornaro ultimately oversaw the sale of AirTran to the largely successful Southwest Airlines in 2011. His successful history with mergers and acquisitions could prove useful to shareholders in the event of future industry consolidation. During a recent interview, Mr. Fornaro explained his goals for the company, which included more transparency regarding prices and fees, reducing the number of daily hours that Spirit Airline's planes fly during peak periods, as well as dialing growth to a steady 15-20% per year.

Product Differentiation

As opposed to airlines such as Delta or American Airlines which focus on offering a more high-end passenger experience, Spirit Airlines offers its fairs below the rest of the market to attract cost conscious customers in underserved markets. These are price sensitive customers who may be travelling for either leisure, or to visit family and friends, and are flying for the destination, not the airline. By separating its base ticket fare form ancillary services such as check-in baggage, free drinks, and the option to choose seats, Spirit Airlines is able to allow customers to pay for what they need. This ultralow-cost business model can be expected to flourish in the United States, especially as not all are confident that the increase in interest rates truly signifies the return of the post-recession economy. As the airline industry is cyclical, Spirit Airlines can be expected to profit in the event of an economic downturn, as passengers seek to save on travel.

Corporate Responsibility

Under new CEO Robert Fornaro, Spirit Airlines Corporate responsibility revolves around transparency. Ultralow-cost airline carriers have often had the reputation of surprising passengers with expensive last minute charges, and have been among the nation's leaders in complaints. Fornaro hopes to change this reputation by making it very clear through the company website, and the websites that partner with Spirit Airlines, what passengers will and will not be charged for.

Financials

Although it posted strong earnings growth each quarter, 2015 was a difficult year for Spirit Airlines as it was forced to lower its margin guidance twice. As a result, its stock price plummeted nearly 50% during the year. However, strong Q4 results and a likely decrease in operating costs prove that Spirit Airlines is on an upswing in 2016. First, after their earnings report there was a notable increase in earnings per share to $4.38, up 42% from 2014. Spirit Airlines also posted a 37% YoY drop in fuel cost per gallon for Q4, and released positive guidance, anticipating 20% YoY average seat mile growth, as well as a continued decrease in fuel costs per gallon for 2016. Using the Proforma valuation, and the anticipated increase in revenues and decrease in operating costs, we were able to determine the fair price of Spirit Airlines to be $57.64. Revenue growth was adjusted from 8.2% to about 8.80% in 2016 based on Bloomberg estimates as well as the Q4 release and anticipated increase in average seat mile growth. Furthermore, growth was adjusted up to 17.91% in 2017, and down to 15.75% in 2018, before converging to 3%. I also rearranged the operating costs to revenue to reflect the decrease in oil price. We can expect operating costs to revenue to be around 66% in 2016, as the airline saves money on fuel; however, we can expect the percentage to increase to around 67% by 2018, and slowly converge to 74% by 2025, bit below their traditional operating costs to revenue. Also, the company bought back $99m in stock last year and still has $100m authorization to buy back more of its shares, showing that the company itself believes that it is undervalued. Finally, based on the UFCF and EVA valuation methods commonly used for capital intensive companies, Spirit Airlines is underpriced and poised to create substantial value in 2016, making now a perfect time to buy the company at a discount.

Conclusion

Spirit Airlines ultralow-cost business model provides significant profit margins for a company in a capital intensive industry, allowing it to undercut large competitors. As the price of oil remains low, profit margins will continue to grow and the airline industry as a whole will be on pace to set historic profitability records. Spirit Airlines is expecting to see a large decrease in operating costs to revenue, as well as a considerable increase in revenue as YoY average seat mile growth is expected to be around 20% in 2016. For these reasons, the price of Spirit Airlines is significantly undervalued, giving us the opportunity to buy a very bullish stock at a significant discount.

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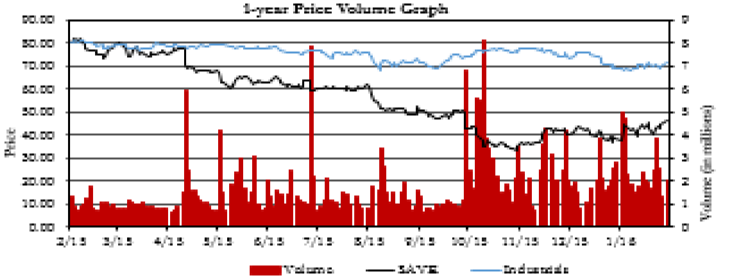
CENTER FOR GLOBAL FINANCIAL STUDIES

Spirit Airlines, Inc. (SAVE)					BULLISH
Analysis by P.C. Principal	Current Price:	$46.75	Intrinsic Value	$64.15	Target 1 year Return: 51.26%
2/19/2016	Divident Yield:	0.0%	Target Price	$70.71	Probability of Price Increase: 99.



Description

Spirit Airlines, Inc. provides low-fare airline services.

General Information

Sector	Industrials
Industry	Airlines
Last Guidance	November 3, 2015
Next earnings date	February 19, 2016
Estimated Country Risk Premium	6.00%
Effective Tax rate	40%
Effective Operating Tax rate	22%

Market Data

Market Capitalization	$3,344.81
Daily volume (mil)	1.16
Shares outstanding (mil)	71.55
Diluted shares outstanding (mil)	72.43
% shares held by institutions	64%
% shares held by investments Managers	81%
% shares held by hedge funds	13%
% shares held by insiders	0.42%
Short interest	6.50%
Days to cover short interest	2.16
52 week high	$83.45
52-week low	$32.73
Levered Beta	1.01
Volatility	0.00%

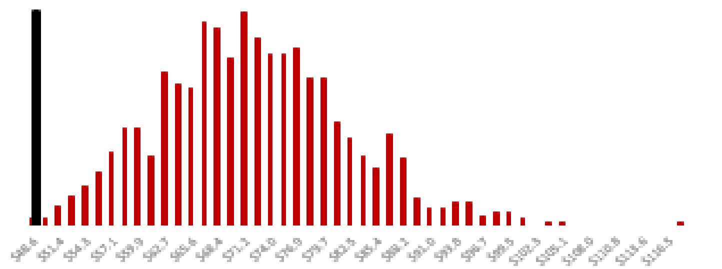
Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2014	-0.26%	-33.43%
3/31/2015	-0.37%	-31.01%
6/30/2015	0.03%	-22.33%
9/30/2015	0.52%	-22.25%
12/31/2015	-0.04%	-26.31%
Mean	-0.02%	-27.07%
Standard error	0.2%	2.3%

Peers

Virgin America Inc.
Hawaiian Holdings Inc.
Allegiant Travel Company
Alaska Air Group, Inc.
JetBlue Airways Corporation
Copa Holdings SA
SkyWest Inc.
Southwest Airlines Co.

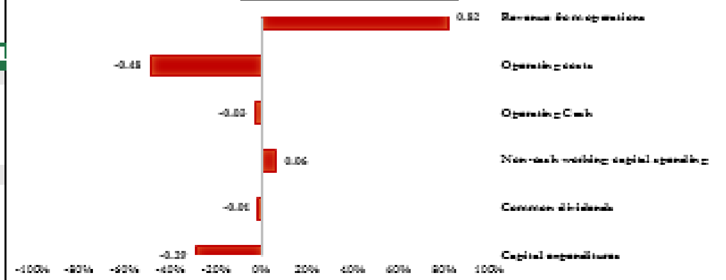
Target Price Distribution--Prob(Price Increase)= 100%



Management	Position	Total compensation growth	Total return to shareholders
Fornaro, Robert	Chief Executive Officer, Pre	N/M	0% per annum over 0y
Christie, Edward	Chief Financial Officer and	-24.74% per annum over 2y	106.46% per annum over 2y
Bendoraitis, John	Chief Operating Officer and	-17.99% per annum over 1y	66.44% per annum over 1y
Canfield, Thomas	Senior Vice President, Gener	27.3% per annum over 5y	N/M
Schroeter, Robert	Vice President of Consumer M	N/M	0% per annum over 0y
Stursky, Hilton	Chief Information Officer an	N/M	N/M

Profitability	SAVE (LTM)	SAVE (5 years historical ave	Industry (LTM)
ROIC	30.5%	20.02%	19.30%
NOPAT Margin	37%	19.19%	10.5%
Revenue/Invested Capital	0.83	1.04	1.83
ROE	39.8%	35.43%	26.76%
Adjusted net margin	35%	17.05%	9.9%
Revenue/Adjusted Book Value	1.13	2.08	2.71
Invested Funds	**SAVE (LTM)**	**SAVE (5 years historical ave**	**Industry (LTM)**
Total Cash/Total Capital	19.2%	21.5%	24%
Estimated Operating Cash/Total Capital	4.6%	7.1%	N/A
Non-cash working Capital/Total Capital	-4.6%	-7.1%	-34%
Invested Capital/Total Capital	85.4%	85.7%	93%
Capital Structure	**SAVE (LTM)**	**SAVE (5 years historical ave**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.92	0.58	0.45
Cost of Existing Debt	3.34%	3.52%	4.71%
Estimated Cost of new Borrowing	3.84%	4.03%	4.71%
CGFS Risk Rating	BB	B	BBB
Unlevered Beta (LTM)	0.84	1.09	0.71
WACC	7.31%	7.15%	6.59%

Sensitivity Analysis



Valuation

Period	Revenue growth	ROIC/WACC	Invested Capital	Net Claims	Price per share
Base Year			$1,100.95	$2,010.78	$51.86
12/31/2016	8.8%	1.97	$1,143.74	$2,181.29	$57.64
12/31/2017	17.9%	2.00	$1,415.93	$2,143.26	$63.69
12/31/2018	15.8%	1.99	$2,165.49	$2,316.50	$70.11
12/31/2019	8.6%	1.72	$2,586.94	$2,396.45	$76.96
12/31/2020	7.8%	1.55	$3,566.65	$2,284.73	$84.19
12/31/2021	7.0%	1.45	$4,238.87	$2,153.47	$91.69
12/31/2022	6.2%	1.35	$4,782.09	$1,999.91	$99.48
12/31/2023	5.4%	1.26	$5,607.30	$1,820.55	$107.55
12/31/2024	4.6%	1.17	$6,337.16	$1,611.97	$115.94
12/31/2025	3.8%	1.13	$6,877.35	$1,342.45	$124.67
Continuing Period	3.0%	1.08			