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BJORKLUND FUND

February 16, 2018

Spirit Airlines, Inc.: (SAVE)

Theodore Wind

Sector: Industrials
Industry: Airlines
Current Price: $39.64
Target Price: $49.93

Spirit Airlines is an ultra-low cost airline with destinations in the United States, Canada, Mexico, Central and South America, and the Caribbean. Spirit is different from other major airlines because they allow the customer to choose exactly what they want to pay for in addition to the original ticket price. This includes baggage, seat preference, and food on-board the aircraft.

BUY

Current Price:	$39.64
Target Price:	$49.93
Market Cap:	$2.7B
Beta:	1.15
ROE:	26.5%
Profit Margin:	15.89%
Ke:	11.30%
ROIC:	14.88%
WACC:	9.10%
P/E:	11.72

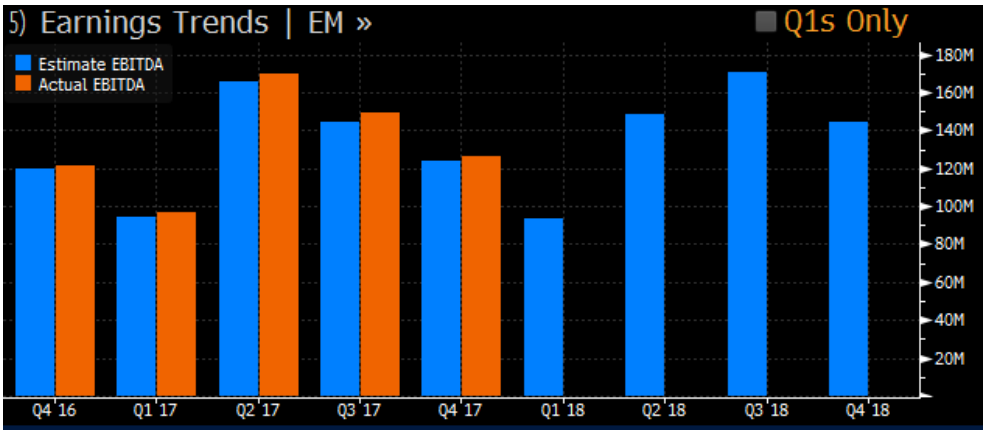
Catalysts:

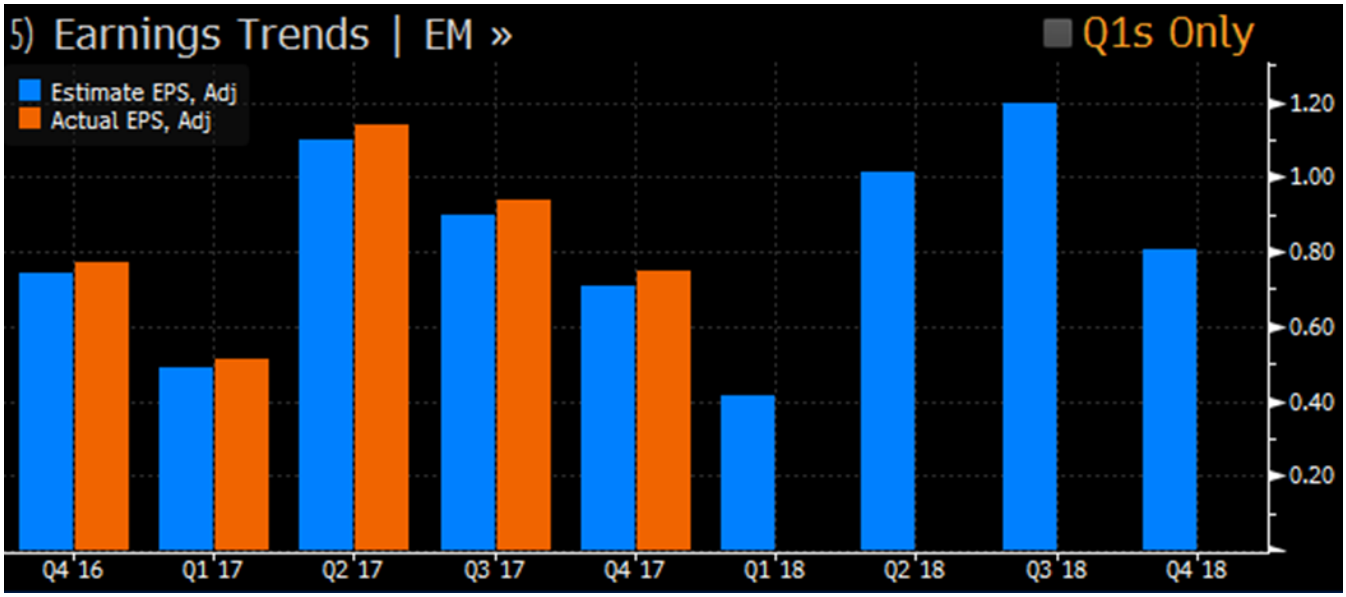
- Short Term (within the year): Quarters two and three are upcoming which are consistently their best quarters. As well as positive jobs report.
- Mid Term (1-2 years): Increasing number of airports serviced both domestically and internationally, as well as increasing size of their fleet.
- Long Term (3+): Increased consumer confidence in budget airlines along with millennials entering the workforce, who tend to be more price sensitive.

Thesis: Spirit Airlines is poised to become the leader in ultra-low cost airfare in North America due to their constant growth to different markets, as well as a growing demand for low-cost airfare. Spirit has outperformed analysts' revenue estimates three quarters in a row by an average of 0.2%. The airline industry is a seasonal industry, and that is no different for Spirit who sees their best quarters for revenue consistently being the second and third quarters each year. Therefore, now is the best time to buy Spirit as they are currently undervalued in the market because they are in the tail end of their slow period, and will draw more interest from investors as the airline industry picks up starting in quarter 2. Quarter 2 will have especially high revenues this year due to the early Easter holiday (April 1), as well as Spring Break revenue that falls mostly in quarter 2. Spirit Airlines growth strategy is to increase the size of their fleet, increase the number of destinations served, and increasing the size of the aircrafts as well as size of the aircrafts. Spirit Airlines is a currently a cheap stock that is backed by a solid company with both short and long-term growth potential.

Earnings Performance:

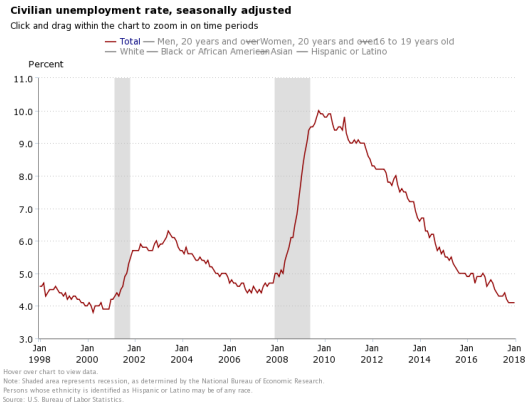
According to their CFO Ted Christie, Spirit Airlines had a year over year cost per available seat mile (CASM) reduction of 4.4% that helped them to beat analysts' estimates of EBITDA. Another positive for Spirit was their ancillary revenue increased 3.8% year over year, which is more important to Spirit than other airlines because their ancillary revenue accounts for about half of their total revenue. Spirit also plans to roll out further enhancements in 2017 that will allow them to further leverage their technology, improve their ability to both price, and merchandise their non-ticket products. This includes a plan to revise their app and launch a 2.0 version that is easier for customers to use and understand. This will help Spirit to deliver higher ancillary revenue per passenger in 2018. Their revenue per available seat mile (RASM) did decrease 1.8%. However, their performance during the peak periods was better than originally forecasted. The chart below shows the earnings trends over the last five quarters compared to analysts' estimates for EBITDA as well as projections for the next four quarters. The most noticeable thing to observe in this graph is the fact that Spirit has been able to outperform analysts' estimates for EBITDA 5 out of the last 5 quarters. This graph also clearly shows the seasonality that Spirit experiences as we are currently in the midst of quarter one, which is projected to be their poorest performing quarter. The earnings per share chart is also shown below. This shows that analysts consistently underestimate the EPS for Spirit. Spirit being able to consistently outperform analysts' estimates makes me believe that they understand how to manage their costs appropriately. This can be seen in their reduction in CASM over a year that was not the best for Spirit. I believe they are also able to generate more revenue than estimated because of their business plan that unbundles everything and forces the customer to pay extra for items that other airlines would normally include in the ticket price. Ancillary revenue is key to the success of Spirit Airlines. I believe Spirit is a cheap stock currently with a history of outperforming analysts' estimates and generating returns to investors.

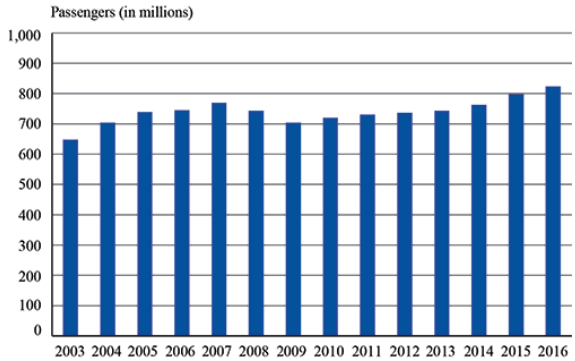




United States Economy:

Another major reason why Spirit Airlines will be successful is the recent jobs and wages report done by the United States Bureau of Labor Statistics. This recent report has unemployment approaching all-time lows along with an increase in wages. The civilian unemployment rate is shown in the picture below on the left. This is especially exciting news to the travel industry because that means more people have the disposable income to spend on airfare. Historically, the lower the unemployment the better the Airline industry performs. Spirit is also in a unique position to be successful because they are an ultra-low cost provider, this means they are able to reach a larger customer base as they are significantly more affordable then their other competitors. Another trend, shown in the graph below on the right, is the trend in airline passengers per year provided by the Bureau of Transportation Statistics. As you can see, there is an upward trend since 2013, with no signs of slowing down especially if the economy continues to do as well as it has been doing in recent months. These two economic factors will result in Spirit Airlines increasing the amount of passengers serviced and the demand for flights. These statistics are especially important as they are trying to increase the number of airports that they service. Increasing the amount of passengers will help to offset the costs associated with the aggressive growth plan that Spirit has outlined in recent company filings.

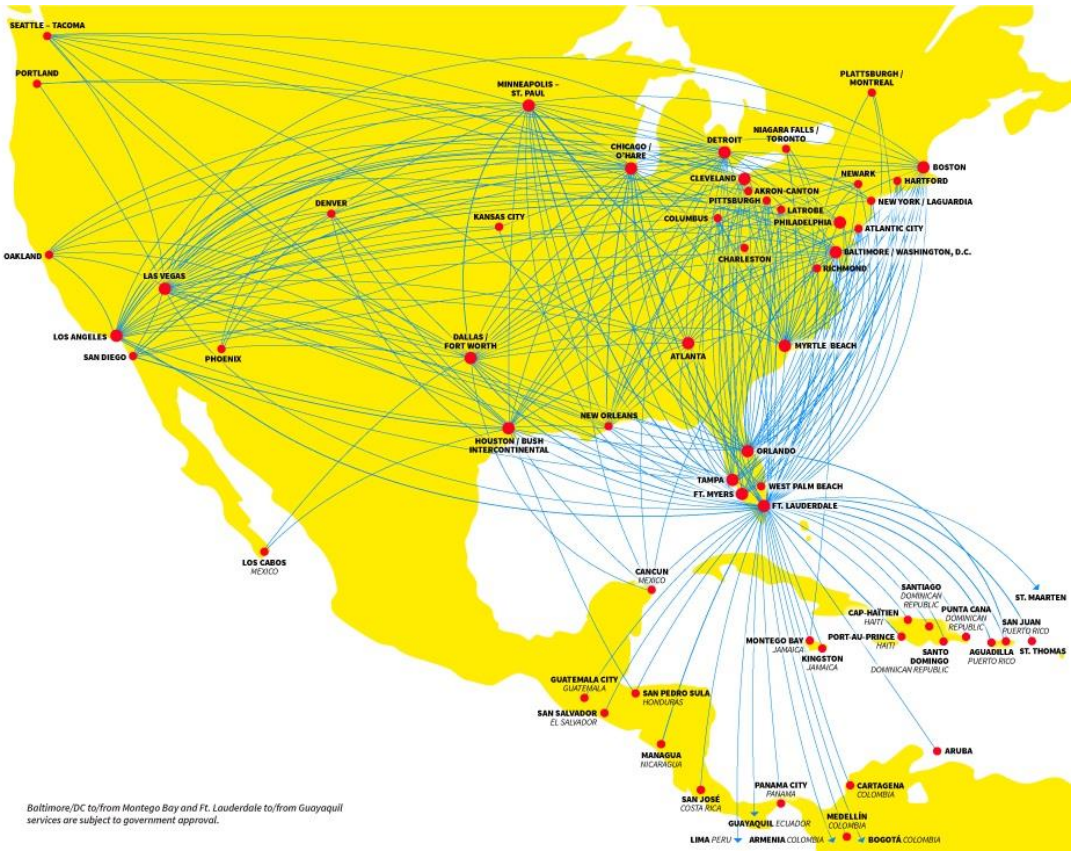




Growth Strategy:

Spirit Airlines has a very aggressive growth strategy over the next couple of years. Barring any catastrophic events such as major airline terrorist attacks, which would scare travelers away, I believe they will be able to fully implement this growth strategy. Their growth strategy includes adding more airlines to their fleet, increasing the size of airlines in their fleet, increase frequency of flights, and increase the number of destinations to which they fly. As far as an increased fleet, Spirit currently has an order placed with Airbus for nine A320neo's and five A320ceo's scheduled for delivery in 2019. This increases the size of their fleet tremendously in one year, and this also allows them to also increase the frequency of flights.

Another way Spirit plans to grow over the next year is to increase the number of destinations that they serve. In 2018, Spirit plans to add service to two international destinations that include Guayaquil, Ecuador and Cap-Haïtien, Haiti. This is important for Spirit because it shows they are a willing to expand beyond the United States to extend their brand. Additionally, Spirit announced services to start to Richmond, Virginia and Columbus, Ohio. This is in addition to adding Pittsburgh, Pennsylvania and Hartford, Connecticut in 2017. In addition to new locations of service, Spirit also announced an additional 24 routes that will be newly serviced in 2018. Below is a map showing the destinations and routes that Spirit now flies including the destinations and routes they have announced for 2018.



This aggressive growth strategy both domestically and abroad is critical for Spirit Airlines future growth and success. They are committed to becoming a leader in the airline industry by providing low cost flights across the United States, Central America, and the Caribbean. This allows us to get in now while the stock is cheap and reap the profits as Spirit Airlines network continues to grow along with their popularity.

Competitor Analysis:

	Name	Ticker	Mkt Cap	Rev - 1 Yr Gr:Y	OPM:Y	ROIC/WACC Ratio
	Median		4.63B	8.06%	16.19%	1.39
100)	SPIRIT AIRLINES INC	SAVE US	2.73B	14.03%	15.32%	1.63
101)	ALLEGIANT TRAVEL CO	ALGT US	2.70B	10.34%	17.45%	1.21
102)	JETBLUE AIRWAYS CORP	JBLU US	6.53B	5.78%	14.26%	-0.45
103)	SOUTHWEST AIRLINES CO	LUV US	34.45B	3.65%	17.06%	1.56

The above table shows how Spirit compares with the closest competitors. According to their most recent 10k filing they deem their biggest competitors to be Jet Blue Airways and Southwest Airlines based on route overlap. However, their closest competitor as far as an ultra-low cost airline with almost the same market cap is Allegiant Travel Corporation. They both have a very similar market cap of about 2.7 billion dollars. The first number I chose to look at was year over year revenue growth. I chose this metric because I believe that Spirit is a company in the growth phase, and the most important thing for them right now is gaining market share and popularity. Of the competitors I chose to look at they had the best year over year revenue growth at 14.03% compared to the competitor median of 8.06%. This is a positive because this means that their expansion to other destinations is paying off in terms of revenue, and justifies their continued expansion in 2018.

The next ratio I chose to look at was operating margin. When looking at this ratio Spirit was only able to outperform JetBlue at 15.32% for Spirit compared to 14.26% for Jet Blue. However, Allegiant and Southwest were able to maintain operating margins of about 17%. When diving into the income statement to understand why Spirit underperformed one major thing jumped out to me. Spirit paid approximately one hundred and fifty thousand dollars more for fuel in 2017 compared to 2016 and 2015. According to company filings this is because they get most of their fuel from the Gulf of Mexico, which was brutalized by hurricane Harvey in 2017. I believe this is contributing heavily to Spirit being undervalued at this time. While that region is often hit by hurricanes, few if any have ever been that severe in the region, so going forward I expect the amount paid for fuel to drop.

The third ratio I chose to compare was the ROIC/WACC ratio. This ratio tells investors whether or not the company is creating value. A number above one indicates that the company is creating value for investors, and a number below one indicates that the company is destroying value. According to the results Spirit Airlines is creating the most value for investors with a ROIC/WACC ratio of 1.63. The median of the competitors I chose was 1.39. Therefore, Spirit is definitely creating value for investors and further proves that they are currently undervalued in the market.

In summary when looking at Spirit's numbers compared to their competitors I believe that they are a solid company that is currently undervalued in the market. They are continuing to increase their revenue, and while that does not mean they are necessarily creating profits it is a positive sign for the company. I believe in the coming years their operating margin will improve because last year it was negatively impacted by one of the worst hurricanes in recent history. Finally, they are the best out their closest competitors at creating value for shareholders according to their ROIC/WACC ratio.

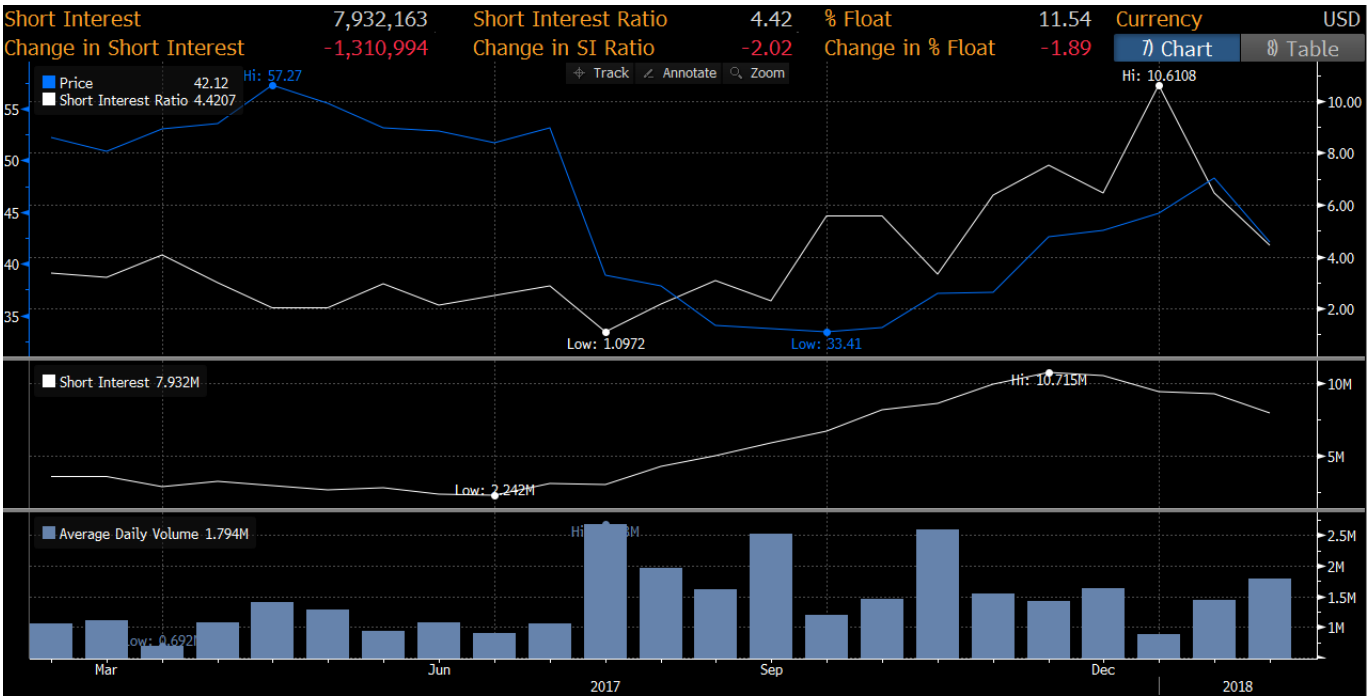
Stock Ownership/Short Interest:

To the right we can look at who owns the stock. The top holders are investment advisors followed by hedge fund managers. Having hedge fund managers as the second highest ownership group is a positive sign because they are the most aggressive investors with the highest expectations for returns over the short term especially. This helps to prove my theory that the stock is currently undervalued. I understand that they only own about 6%, but they must believe that Spirit is undervalued and due to break out for exceptional returns.

Top Ownership Type (%)

54) Ownership Type	02/11/18	Curr	Change
41) Investment Advisor	88.35	88.60	+0.25
42) Hedge Fund Manager	5.35	5.80	+0.45
43) Pension Fund	2.75	2.57	-0.18
44) Individual	0.75	0.67	-0.08
45) Insurance Company	0.70	0.62	-0.08
46) Bank	0.82	0.59	-0.23
47) Corporation	0.45	0.40	-0.05
48) Brokerage	0.37	0.34	-0.03
49) Sovereign Wealth Fund	0.29	0.25	-0.04

Below is the chart showing the change in short interest over the past year. It hit a low around July and then spiked all the way to almost 11 around January of this year. I believe this has to do with the seasonality of the airline industry as well as in July Spirit has problems with flight cancellations due to their pilot contracts. I believe this made investors believe the company was in trouble and the short position avalanched to its high. Spirit in January reached a tentative agreement with the pilot union for a five-year contract. I believe this news is why the short interest is now down to around four. This contract problem once again proves that Spirit had an outlier year in 2017 between Hurricane Harvey and the pilot dispute. Now is the time to take advantage of this mispricing because in 2018 and beyond Spirit is poised to take off.



Conclusion:

In conclusion, I believe Spirit is currently undervalued in the market and it would be a perfect time to add more shares to our portfolio. They are undervalued because of a series of unfortunate events that happened in 2017 that are not likely to happen again. First, was the devastation caused by hurricane Harvey. This not only did an incredible amount of damage to communities, but also caused Spirit to pay more for oil as they get most of their oil from the Gulf of Mexico. The second event, and I believe the one that scared most investors the most, in 2017 was the pilot contract dispute. This caused almost 800 flight delays and cancellations costing Spirit an estimated $45 million in revenue. Through my projections, I have their target price at $49.93, I believe this a very achievable number because Spirit is a solid company with favorable industry comparisons. They are not completely dependent on tickets sold for revenue as almost half of their revenue is ancillary from items such as baggage and preferred seating, just to name a few. In addition, Spirit Airlines has an aggressive growth strategy not only increasing their fleet, but also increasing their number of destinations served. This growth strategy is for both domestic and international locations, which is a big deal for Spirit especially because they receive a lot of revenue from spring break vacations, which are often to the Caribbean and Mexico. Now is the time to buy Spirit before investors realize how undervalued the stock is with their peak quarters coming up in 2018. They are due to have a great quarter two between an early Easter and Spring Break. Spirit Airlines is going to break out in 2018 and I believe we need to get in now to take advantage of this mispricing before the opportunity is gone.

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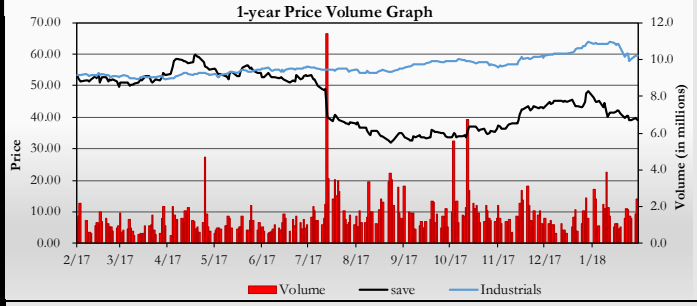
Spirit Airlines, Inc. (save)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Al Capone	Current Price:	$39.64	Intrinsic Value	$46.90	Target 1 year Return: 25%
2/16/2018	Divident Yield:	0.0%	Target Price	$49.55	Probability of Price Increase: 99.6%



Description

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

General Information

Sector	Industrials
Industry	Airlines
Last Guidance	February 12, 2018
Next earnings date	February 21, 2018

Market Assumptions

Estimated Equity Risk Premium	5.50%
Effective Tax rate	21%

Market Data

Market Capitalization	$2,703.96
Daily volume (mil)	1.17
Shares outstanding (mil)	68.21
Diluted shares outstanding (mil)	69.38
% shares held by institutions	109%
% shares held by investments Managers	91%
% shares held by hedge funds	10%
% shares held by insiders	0.52%
Short interest	11.63%
Days to cover short interest	5.39
52 week high	$60.28
52-week low	$30.32
Volatility	38.30%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2016	-0.03%	-33.90%
3/31/2017	-0.04%	-35.43%
6/30/2017	0.23%	-24.08%
9/30/2017	0.24%	-25.91%
12/31/2017	0.13%	-17.62%
Mean	**0.11%**	**-27.39%**
Standard error	1.0%	3.5%

Market and Credit Scores

Recommendation (STARS) Value--4
Recommendation (STARS) Description--Buy
Quality Ranking Value--NR
Quality Ranking Description--Not Ranked
Short Score--3
Market Signal Probability of Default % (Non-Ratings) -2.94%
CreditModel Score (Non-Ratings)--bb+

Industry and Segment Information

LTN Revenues by Geographic Segments	LTM Revenues by Business Segments
United States--92%	Provides Air Transportation for Passengers--100%
Latin America--8%	--
--	--
--	--
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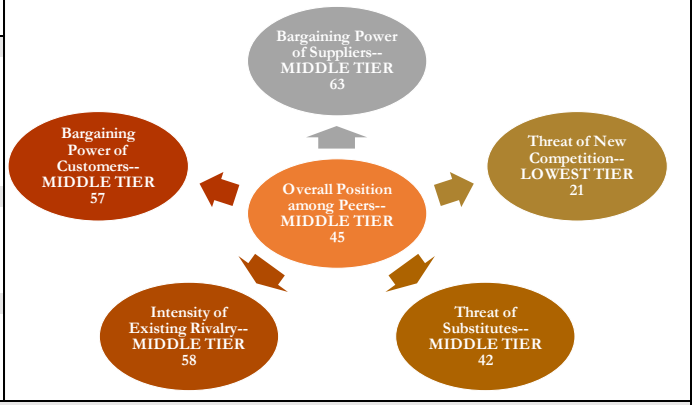
Peers

Hawaiian Holdings, Inc.	Southwest Airlines Co.
JetBlue Airways Corporation	American Airlines Group Inc.
Allegiant Travel Company	JetBlue Airways Corporation
SkyWest, Inc.	United Continental Holdings, Inc.
Alaska Air Group, Inc.	Delta Air Lines, Inc.

Management	Position	Total Compensations Growth	Stock Price Growth During Tenure
Fornaro, Robert	CEO & Director	726.97% per annum over 2y	-12.5% per annum over 2y
Christie, Edward	President, CFO & Director	-20.12% per annum over 4y	30.53% per annum over 4y
Bendoraitis, John	Chief Operating Officer and Senior Vice Preside	-15.64% per annum over 3y	13.35% per annum over 3y
Wiggins, Rocky	Chief Information Officer and Senior Vice Presi		0% per annum over 0y
Canfield, Thomas	Senior Vice President, General Counsel and Comp	14.22% per annum over 5y	8.21% per annum over 5y
McMenamy, Brian	VP, Controller & Principal Accounting Officer		

Porter's 5 forces (Scores are percentiles)



Profitability	save (LTM)	save Historical	Peers' Median (LTM)
Return on Capital (GAAP)	16.4%	26.28%	4.63%
Operating Margin	21%	18.79%	4.38%
Revenue/Capital (GAAP)	0.76	1.40	1.06
ROE (GAAP)	24.0%	29.6%	9.1%
Net margin	12.7%	11.5%	2.9%
Revenue/Book Value (GAAP)	1.90	2.57	3.13
Invested Funds	**save (LTM)**	**save Historical**	**Peers' Median (LTM)**
Cash/Capital	19.8%	35.1%	16.1%
NWC/Capital	-2.3%	-25.6%	-20.7%
Operating Assets/Capital	82.5%	90.5%	96.9%
Goodwill/Capital	0.0%	0.0%	7.7%
Capital Structure	**save (LTM)**	**save Historical**	**Peers' Median (LTM)**
Total Debt/Market Capitalization	0.61	0.57	0.64
Cost of Debt	4.6%	4.1%	4.3%
CGFS Rating (F-score, Z-score, and default Probability)	BB		
WACC	6.9%	8.8%	7.8%

Valuation

Forecast Assumptions	Explicit Period (12 years)	Continuing Period
Revenue Growth CAGR	6%	2%
Average Operating Margin	24%	27%
Average Net Margin	11%	11%
Growth in Capital CAGR	9%	2%
Growth in Claims CAGR	5%	2%
Average Return on Capital	8%	6%
Average Return on Equity	12%	6%
Average Cost of Capital	7%	8%
Average Cost of EquityKe	10%	10%