EASYJET PLC

COMPANY REPORT

INDUSTRIALS

6 JANUARY 2017

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Resilience in a time of turbulence

- We initiate coverage of easyJet (EZJ) with a **BUY recommendation** and a **FY17 Price Target** of **GBP 14.48**
- Despite highly disruptive events during FY 2016 - terrorist actions, industrial strikes, Brexit -, easyJet continues to identify **opportunities for profitable growth** and to show **robust financial performance**
- easyJet has built a **privileged position** in the market of Low Cost Carriers – flying to a network of primary airports at convenient time slots – which is **difficult to replicate** and considered to be a major **competitive advantage** and source of **value**
- easyJet will has a **strong balance sheet**, which facilitates low funding costs and operational flexibility. It will be investing considerably in its fleet during the next six years, and is expected to further consolidate its position in the European short-haul segment and strengthen its share in its main markets
- The company has been delivering **consistent shareholder returns**: since 2011, when it started to pay a dividend, easyJet has steadily increased the payout ratio, reaching 50% in FY 2016. In total, easyJet has returned more than GBP 1 billion in dividends to shareholders **(+237% total shareholder return over five years** to September 2016)

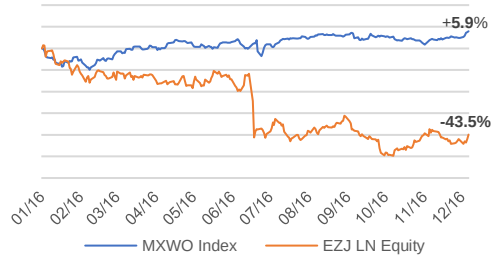
Company description

easyJet is a British Low Cost Company, the 2nd largest serving the European short-haul segment (by number of passengers). Based at the London Luton Airport, was founded in 1995 and holds today a 9.8% share of the intra-European aviation market, having carried in FY 2016 over 73 million passengers across its 803 routes, flying to 31 countries and serving a total of 132 airports.

Recommendation:	**BUY**
Vs Previous Recommendation	-
Price Target FY11:	**14.48 £**
Vs Previous Price Target	-
Price (as of 5-Jan-17)	**10.09 £**

52-week range (£)	8.73-17.62
Market Cap (£bn)	3.992
Outstanding Shares (m)	397.208

Source: Bloomberg



Source: Bloomberg

(Values in GBP millions)	2016	2017F	2018F
Revenues	4,669	4,769	5,463
EBITDAR	770	700	837
EBITDAR margin (%)	*16.5%*	*14.7%*	*15.3%*
Operating Costs	-4,171	-4,429	-5,062
EBIT	498	340	401
EBIT Margin (%)	*10.7%*	*7.1%*	*7.3%*
Net Profit	427	265	296
EPS (GBP)	1.74	0.67	0.75
P/E	5.8x	15.1x	13.5x
ROIC	17.2%	9.0%	7.3%

Source: Analyst Estimates

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Executive Summary

easyJet is today a key player among European passenger airlines, currently the second largest Low Cost Carrier serving the European short-haul market, with an estimated 9.8% share in terms of RPK. Its key assets are its strong network - with presence in the right markets and slots at slot-constrained primary airports -, its well-known brand, and its focus on cost savings, enabling structural cost advantages against the legacy and charter operators who are its major competitors in its markets.

easyJet is expected to consolidate its position in the European short-haul segment, increasing its market share in terms of RPKs from 9.8% in 2016 to 12.3% in 2022. The number of passengers is forecasted to grow at a CAGR of 6.9% during the period. To support this growth, easyJet will considerably invest in expanding its fleet, introducing Airbus' new generation, fuel-efficient short-haul aircrafts (the A320neo) that between 2018 and 2022 are estimated to deliver fuel savings of 2.85% per year vs the regular A320. easyJet's revenues are forecasted to grow at a CAGR of 6.2% between FY 2016 and FY 2022, with accentuated growth in FY 2018 and FY 2022. Operating costs before leasing, depreciation and amortization are expected to increase at a slightly lower CAGR (6.1%) over the same period, reaching GBP 5,550 in FY 2022.

Using a Discounted Cash Flow Model and a discount rate (WACC) of 4.7%, easyJet is valued at GBP 14.48 per share, above its current market value of GBP 10.05.

The European Airline Industry

Table 1 - Effects of the deregulation on routes and yields

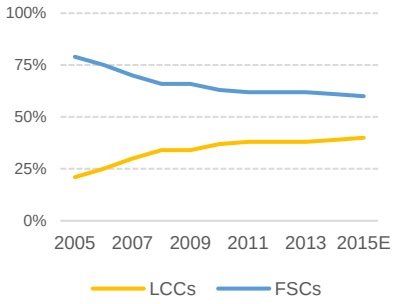
	1992	2000	*Var.*
# of EU domestic city-pair routes	813	910	*+11.9 %*
# of Intra-EU (international) city-pair routes	692	1202	*+73.7 %*
# of domestic routes w/ more than one carrier	106	199	*+87.7 %*
LCCs share of total Intra-EU ASKs	0.6%	12.9 %	*+12.3 ppts*
AEA Average Yield (cents/RPK, in USD at 2001 exchange rate)	14.48	14.63	*+1.0 %*
European Inflation (1992 = 100)	100	119	*+19.0 %*

Source: AEA, European Commission, ICAO

The deregulation of the European air transport market during the 1990's, and the creation of a single market for aviation, which removed all commercial restrictions[1] for all EU carriers, has resulted in a profound transformation of the European air transport industry. Lower fares (also with the emergence of the budget airlines), availability of new routes and airports, and improved safety and quality of service were, from a traveller's perspective, the main advantages that occurred with the liberalization of the market (Table 1).

The industry suffered some degree of consolidation in the past decade. The current top three Full Service Carriers (FSCs) – Lufthansa Group, IAG and Air France-KLM - are airlines that sought growth by a series of mergers and acquisitions[2], and their combined capacity share has increased from 21% to 31% between 2002 and 2014. Even so, the European market is still fragmented and FSCs remain structurally disadvantaged relatively to LCCs, that through the years have been able to take significant market share (c.a. 40% in 2015 - Figure 1) and to sustain, on average, higher operating margins (Figure 2).

Figure 1: FSCs vs LCCs market shares



Market shares in terms of available seat capacity for the European short-haul market.
Source: IATA, Financial Times

- Comparison with the US & other markets

Despite healthy traffic growth and relatively high load factors, European airlines' margins underperform against other geographic regions (Table 2). The USA is the region with the strongest financial performance, posting expected net post-tax profits of USD 22.9 billion in 2016.

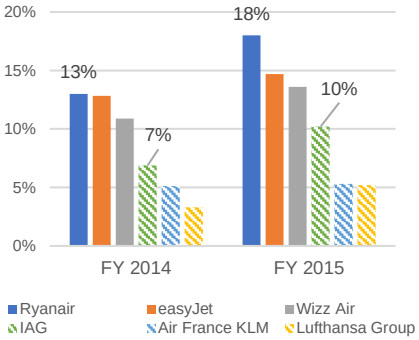
Table 2 – Global EBIT margin of commercial Airlines, by region

	World	Africa	Europe	Latin America	Middle East	Asia - Pacific	North America
2012	2.6%	-0.4%	**0.7%**	1.5%	3.0%	4.7%	3.4%
2013	3.5%	-0.5%	**2.0%**	2.2%	0.9%	2.9%	6.8%
2014	4.7%	-2.1%	**2.0%**	2.1%	1.2%	2.5%	11.1%
2015E	8.3%	-2.5%	**5.3%**	1.9%	2.5%	7.7%	14.7%
2016F	8.8%	-1.1%	**5.6%**	2.6%	2.8%	8.4%	15.4%

Source: IATA, ICAO

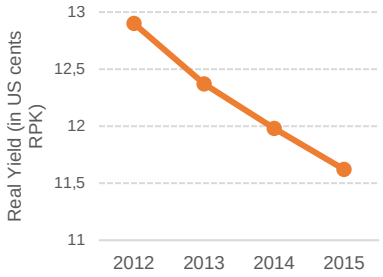
[1] For instance, previous restrictions on fares, on routes, on the number of flights, among others
[2] The Air France-KLM merger, in 2004, was the first major cross-border airline merger in several decades
Lufthansa acquired Swiss International airlines in 2005, Austrian Airlines in 2008 and the purchase of the remaining 55% stake in Brussels airlines has recently been approved by its supervisory board (September 2016). The objective of the latter is to expand Lufthansa's low-cost carrier Eurowings
In 2011, British Airways and Iberia merged, and formed the holding company IAG (international Airlines Group). In 2013, IAG acquired the Spanish LCC Vueling, and in 2015 acquired a majority stake in the Irish flag carrier Aer Lingus
All three groups have experienced negative growth in revenue in 2013-2014 and are going through a cost restructuring process

Figure 2:
Main carriers operating margins



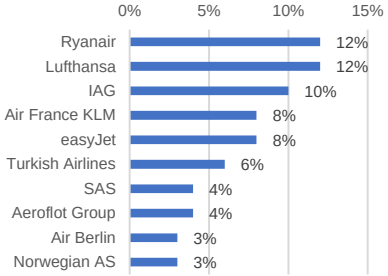
Source: Company's Annual Reports

Figure 3:
Real Yield Evolution



European Airlines, adjusted to 1,000 km
Source: Sabre, Embraer

Figure 4:
Top 10 airline groups by share of scheduled seats, winter 2016/2017



Source: CAPA

Europe's highly competitive environment and rigid regulatory framework are the main reasons for the comparatively lower yields and margins, that are further intensified by the market fragmentation and the large number of non-listed, small and unprofitable airlines, that also drag down the aggregate margin of the continent's airline industry.

The business model of FSCs and LCCs has been converging in the past few years, as a result of intense competition. The unit cost gap between legacy carriers and budget airlines has decreased 40% in the USA and 35% in Europe between 2005 and 2015, being smaller in the US than anywhere else[3]. This has enabled the emergence of "ultra-LCCs", airlines that deliver unit cost considerably lower than those of the incumbents[4], and that offer a lower fare base and collect the highest ancillary revenues. The eventual success of this business model may motivate other carriers to engage in more complex product and service mix unbundling.

Current Outlook

Since mid-2014, the global airline industry has benefitted from favourable economic drivers, namely increased passenger demand and falling jet-fuel prices. However, for European carriers, the benefits of low fuel prices have only recently begun to materialize, since most airlines had previously hedged their fuel costs at prices above market prices. In 2015, European airlines achieved a record average load factor of 81.7%, having generated net profits of USD 7.4 billion. The U.K.'s decision to leave the European Union (Brexit), instability in Turkey and episodes of terrorist attacks across Europe have negatively impacted the demand for air travel in 2016, and profits are expected to increase only slightly to USD 7.5 billion (+1.4%)[5].

In 2015, demand has increased more than supply – total RPK[6] growth totalled 5.0%, while ASK[7] grew only 3.8%[8]. Still, in the last 4 years, intense competition has depressed yields on 3.4% p.a on average (Figure 3). Average yields for flights within Europe have fallen 53% percent since 2000[9].

[3] Source: CAPA 2015, Embraer 2016
[4] Spirit Airlines, Frontier Airlines or Allegiant Air are examples of American ULCCs, that operate in the U.S. domestic market. In 2014, the ULCCs achieved 18% lower average unit costs than LCCs (Source: Alexander R. Bachwicha & Michael D. Wittman, MIT)
[5] Source: IATA
[6] Revenue Passenger Kilometres (RPK) measures an airline's traffic, and is commonly referred to as the "demand" for air transport services. It is calculated by multiplying the number of passengers by the number of kilometres they flew, or equivalently the Available Seat Kilometres (ASK) by the Load Factor
[7] Available Seat Kilometers (ASKs) is a measure of air travel supply, and is equal to the number of seats flown multiplied by the number of kilometers flown. It can also be seen as an airline's revenue-generating capacity, since it gives the total seat kilometers available for purchase
[8] Source: IATA
[9] Source: McKinsey, September 2016

In the winter season 2016/2017, total seat growth in Europe is set to reach 7% in intra-Europe routes, compared with 6% growth in winter 2015/2016. The top 5 airline groups by share of scheduled seats in the season are Ryanair, Lufthansa, IAG, Air France-KLM and easyJet (Figure 4).

The uncertainty of Brexit

Table 3 - European airlines share price movements

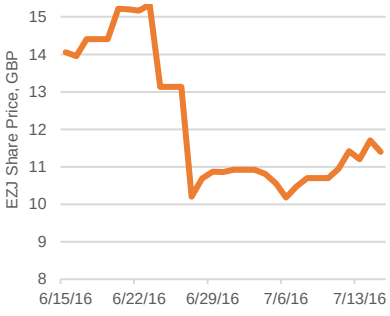
	Price change
Aegean	-12.7%
Air Berlin	-2.8%
Air France-KLM	-15.8%
Deutsche Lufthansa	-17.8%
easyJet	**-35.3%**
Finnair	-5.1%
Flybe	-23.5%
IAG	**-34.5%**
Norwegian AS	-21.3%
Ryanair	-21.6%
SAS	-7.4%
Wizz Air	-29.2%

Percentage change in price from the market close on the week of 23 to 27 June 2016
Source: CAPA

Reflecting the uncertainty surrounding the sector, European airlines' share prices have plunged in the week following the result of the referendum (Table 3). IAG (holding company of British Airways) and easyJet have been particularly affected (Figure 5). The true impact of the UK's decision to leave the European Union is still unclear, and may continue to be so for the next few years. In the near-term, uncertainty will cause businesses and households to delay their spending and investment decisions. In the near-medium term, the consequences of Brexit in

UK's air traffic will be closely tied to its impact on both the UK's economic activity and on the sterling (GBP) exchange rate. It is unknown the extent to which freedom of movement of people and goods will be affected, and the consequent impact on air traffic of both people and freight. Preliminary estimates by IATA suggest that the number of UK air passengers could be 3-5% lower by 2020 than in a non-Brexit scenario.

Figure 5: easyJet share price 15/06 to 15/07



Source: Bloomberg

Airlines from EU member states are entitled to operate anywhere within Europe's single aviation market, freely deciding on capacity, frequency and pricing. With Brexit, UK airlines no longer have access to such benefits, and must develop strategies that secure their rights to continue their operation in other EU countries. One option would be to participate in the European Common Aviation Area (ECAA) Agreement, that extends the liberalised aviation market to countries such as Norway, Iceland, Albania, Bosnia and Herzegovina or Croatia[10]. To enter the ECAA Agreement, countries must not only operate under EU aviation laws (which the UK currently does) but also must engage in a framework of economic cooperation (such as an European Union Association Agreement) with the EU. An alternative to the ECAA Agreement would be a bilateral agreement between the EU and the UK, such as the one of Switzerland[11], in which airlines of both parties would be granted free market access and UK would be tied to the EU's aviation laws. Other (less probable) options would be for the UK to establish bilateral agreements with each individual EU or ECAA country, or even to establish

[10] The ECAA covers 36 countries and 500 million people (Source: CAPA 2016)
[11] The Swiss-EU bilateral agreement was negotiated among seven other agreements that brought Switzerland to establish a degree of freedom of goods, services, capital and labor as in the rest of the EU. If any of the seven agreements is breached or terminated, so are all of them.

minority-owned affiliate airlines to operate within the EU (and EU carriers to set up subsidiaries to operate within the United Kingdom).

If pre-Brexit conditions cannot be replicated by the UK when negotiating its exit, there will be a reversal on the deregulation of the air transport market achieved during the 1990s, which may lead fares to increase in the UK[12].

Future Perspectives

- Long-haul

The emergence of low-cost, long-haul flights

There is currently a nascent market for low-cost, long-haul flights[13], of which FSCs are trying to conquer their share: Lufthansa's Eurowings started budgets flights to Cuba, Thailand and the Dominican Republic from Cologne, and is also consider flying from Munich; in the end of 2016, Air France-KLM said that was studying the possibility of low-cost flights to the US, even though no further details were disclosed; IAG announced intentions to start Barcelona-based low-cost flights to the US in June 2017, either through a whole new airline, or through its subsidiary Aer Lingus, and has not ruled out the possibility of the same strategy in the UK, offering a low-cost alternative to its transatlantic British Airways fares. Ryanair has also mentioned several times the possibility of moving to long-haul travel, but so far has not made any move in that direction.

Table 4 – Unit cost & Operating Margins of Gulf Carriers and European FSCs

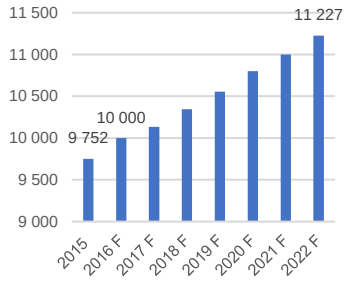
	Cost/ASK (USD)	Op. margin
Gulf Plus Carriers		
Emirates	0.060	9.8%
Ethiad	0.056	8.6%
Qatar Airlines	0.080	2.9%
Turkish Airlines	0.059	10.2%
Average	**0.065**	**7.9%**
European FSCs		
Deutsche Lufthansa	0.121	5.2%
Air France-KLM	0.095	5.3%
IAG	0.079	10.2%
Average	**0.098**	**6.9%**

Source: Company's Annual Reports (Emirates, Ethiad – FY16; Qatar Airlines, Turkish Airlines, Lufthansa, Air France-KLM & IAG –FY15)

The rise of the "Gulf Plus" airlines (the three big Middle East carriers Emirates, Etihad Airways, and Qatar Airways, plus Turkish Airlines), which are growing even faster than European budget airlines, poses a real threat to the long-haul market. These airlines benefit from several advantages over European carriers, provided by their local states, that include subsidies, modern airports, low airport and navigation charges, complementary infrastructure, and also no corporate taxes or social security charges. These conditions enable them to achieve higher average operating margins and lower unit costs (Table 4). On the past decade, these airlines went from serving 44 European airports to serving 81 and almost quadrupled the number of seats, from 7 million to 27 million. The Gulf Plus carriers tripled their market share on Europe–Asia routes, and average yields have fallen 22 percent[14]. The top three connecting airports for these routes are today Dubai, Doha and Istanbul, when in 2006 they were Frankfurt, Amsterdam and Paris.

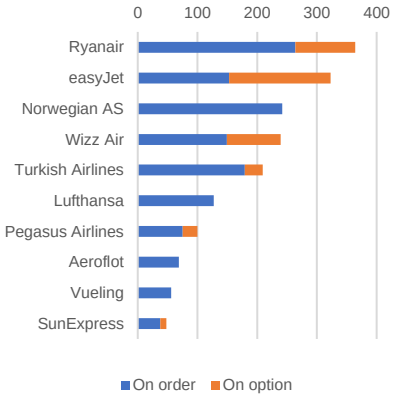
[12] Consultancy Oxera estimates this increase to be in the range of 15%-30%
[13] The LCC Norwegian Air Shuttle was the pioneer of the market, and currently offers London-New York one-way flights for as little as USD 69. It is already a significant competitor of British Airways on US routes out of London Gatwick. The Canadian WestJet Airlines and Iceland's WOW Air are also offering budget transatlantic flights.
[14] Source: McKinsey, IATA

Figure 6:
IFR Flight Movements ('000s)



Source: EUROCONTROL

Figure 7:
Top 10 European airlines by narrow body aircraft on order



As of July 2015.
Source: CAPA

- Short-haul (Intra-Europe)

The number of flights within the ESRA08[15] are expected to reach 10 million in 2016, a 1.5% increase over 2015, and from then to grow at a CAGR of 2.1% until 2022[16] (Figure 6). Boeing predicts that demand for intra-Europe air travel (RPKs) will grow at a pace of 3.2% p.a. until 2035.

During the next few years, FSC will continue to redirect short-haul travel to their LCC subsidiaries and flying the long-haul passengers through their hubs with connecting itineraries. The short-haul market business model will keep on converging into a "hybrid carrier" type of dynamic, which will combine traditional characteristics of LCCs – such as fares with unbundled fees for luggage, meals, and early boarding, and denser seating arrangements -, with features typically associated with FCSs, namely frequent flyer programs and flight connections[17]. Competition in this segment will intensify, particularly given that key LCCs (Ryanair, easyJet) have both declared aggressive fleet expansion plans. European narrow body aircrafts deliveries will surge between 2017 and 2023, dominated by budget airlines (Figure 7).

- Capacity constraints

By 2035, it is estimated that the number flights to/from/within Europe will reach 14.4 million, double the number of 2012. Growth will be higher in countries of Eastern Europe, and for flights to/from outside Europe rather than for intra-European routes. Capacity constraints will, however, limit air traffic growth. The forecasts point out that by 2035, airports won't be able to accommodate 1.9 million flights (12% of total demand)[18].

The 10 busiest airports in Europe in terms of number of passengers are depicted in Table 5. Of those, the European Commission forecasts that, by 2025, demand in London Heathrow (that already operates at 98% capacity), London Gatwick and Paris CDG will exceed capacity in most hours of the day[19]. Except for two large projects in Turkey and Italy[20], no other major airport developments are planned for the near future. Expansion projects currently under development include the Toulouse-Blagnac Airport in France (+4 million passengers p.a.), the London Luton

[15] ESRA08 – Eurocontrol Statistical Reference Area
[16] Source: European Commission Challenges of Growth 2013
[17] For instance, easyJet already offers flexible fares, a loyalty program and flies to an extensive network of primary airports during peak time slots
[18] EUROCONTROL, *"Challenges of Growth 2013"*
[19] Gatwick: assuming no new runway but increase of 2-3 movements/hour on current runway; Heathrow: assuming no third runway, or mixed mode, or relaxation of annual movement cap; Paris CGD: assuming increase from 114 to 120 movements/hour by 2015, but no further increase (e.g. fifth runway)
[20] A new airport in Istanbul is expected to begin operations by the end of 2018, serving 90 million passengers per year, and to become fully operational by 2028, with eventual annual capacity of 200 million passengers. In Italy, another airport is under construction in northern Italy and is expected to be operational in 2020, with a potential capacity of 100 million passengers per year

(+9 million passengers p.a.), and either the Heathrow or Gatwick[21] in the UK, and the Frankfurt International Airport (+4-9 million passengers p.a.) in Germany.

Table 5 – Busiest airports in Europe by number of passengers in 2015

Rank	Country	Airport	City	# passengers
1	United Kingdom	Heathrow	London	74 985 748
2	France	Charles de Gaulle	Paris	65 766 986
3	Turkey	Istanbul Atatürk	Istanbul	61 322 729
4	Germany	Frankfurt	Frankfurt	61 032 022
5	Netherlands	Amsterdam Schiphol	Amsterdam	58 285 118
6	Spain	Adolfo Suárez Madrid–Barajas	Madrid	46 824 838
7	Germany	Munich	Munich	40 981 522
8	Italy	Leonardo da Vinci–Fiumicino	Rome	40 463 208
9	United Kingdom	London-Gatwick	London	40 269 087
10	Spain	Barcelona El Prat	Barcelona	39 711 237

Source: Aviation Voice

- M&A activity

Consolidation has been a global trend and is likely to increase further

Industry consolidation, combined with the establishment of Chapter 11, has helped airlines' profitability in the USA. Over the past decade, mega-mergers have resulted in four large American airlines (American, United, Delta and Southwest), that combined are expected to control more than 80 percent of US commercial airline traffic in the near future[22]. Contrarily to the widespread idea that consolidation would lead to significant fare increases, it has been observed that average passenger fares have actually decreased since 2004, when adjusted for inflation, helped by the expansion of LCCs in domestic routes.

One major constraint of M&A activity in Europe is the political and regulatory framework, that has however showed some signs of improvement. In 2016, the European Commission announced it would relax its requirements on airlines foreign ownership, that is currently capped at 49%, through deals with individual countries. As such, and has it occurred in the US, further consolidation in the European airline industry is likely to happen, enabling carriers to build scale, reduce costs, increase flexibility and expand their networks to be able to capture additional business.

Macroeconomic scenario and forecasts

GDP Growth

[21] At the time of writing, the government has yet to decide whether to build a new runway at Heathrow Airport or at Gatwick
[22] Source: PwC "Aviation perspectives: The impact of mega-mergers: a new foundation for the US airline industry"

The European economy has recovered from the 2008 financial crisis, and is now growing at a moderate pace[23]. However, recovery has been slow compared to similar past events, and is expected to continue to be so in the next few years. The European Commission forecasts real GDP growth in the EU to reach 1.6% and 1.8% in 2017 and 2018, respectively, with the top performers in 2017 being Romania (5.2%), Ireland (4.1%), Malta (4.1%) and Luxembourg (3.6%). GDP growth is expected to stabilize at 1.8% in the longer term.

Air travel demand is closely tied to GDP growth – it was found that air travel demand income elasticity is consistently positive and greater than one, and that in developed countries it is situated in the range of 1.3-1.6, depending on the type of route (national/international and short-haul/long-haul)[24]. Short-haul travel is more commoditised and so income elasticity for long-distance flights is usually higher. Research also suggests that income elasticities tend to decrease as markets mature and as countries become richer (Table 6).

Table 6 - Income elasticity of passenger demand

	Route level	
	Short-haul	Medium-haul
US	1,8	1,9
Developed economies	1,5	1,6
Developing economies	2	2

	National level	
	Short-haul	Medium-haul
US	1,6	1,7
Developed economies	1,3	1,4
Developing economies	1,8	1,8

Source: IATA

Europe traffic grew at 5% percent in 2015, outpacing economic growth (GDP growth of 1.9%). The European aviation market is expected to grow during the next 20 years, with demand for Intra-Europe air travel (RPKs) growing at a CAGR of 3.3% per year until 2035.

Exchange rates

- GBP/EUR

Figure 8: GBP/EUR evolution Jun-Dec 2016

Source: Bloomberg

Following the UK's decision to leave the European Union, the pound touched a 31-year low of EUR 1.1723 on July 6th, and continued its negative trajectory until the 17th of October, when it hit EUR 1.1052 (Figure 8). A that time, investors were pessimistic about the sterling's evolution, with projections of low investment spending, low growth and high uncertainty. However, following on news that the UK Government would consider paying for full access to the EU's single market on December 1st, the pound surged against the euro, achieving its best level (EUR 1.1891) since the mid-September. For the future, analysts expect that the long-term equilibrium will see a recovery, always contingent on the political, economic and financial outlook during the Brexit negotiations period[25].

- GBP/USD

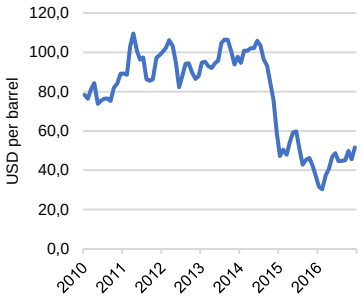
[23] Growth in the EU area in the first half of 2016 was even slightly stronger than in the US
[24] Demand income elasticity is defined as the sensitivity of demand for a good to changes in individual or aggregate income levels. Source: IATA
[25] This analysis was conducted in the 2nd of December 2016, before the Italian Referendum on proposed constitutional reforms and the UK Supreme Court hearing on Article 50 appeal

The outcome of the US elections, of which Donald Trump came out as the new President of the US, was unexpected for analysts and investors, and brought additional uncertainty for the US and the global markets in general. After the elections, the pound surged against the dollar[26], and recently rose to an eight-week high (USD 1.2591), following the hint of UK's intentions on securing its access to Europe's single market.

Fuel prices

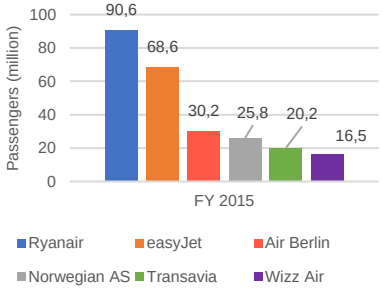
Fuel is one of the major cost driver of airlines. Since 2014, fuel prices have fallen by half (Figure 9), even though many airlines haven't been able to reap the full benefits of low fuel prices due to their hedging commitments. On November 30th, the members of OPEC met in Vienna and, for the first time since 2008, signed a deal to cut oil production by 1.2 million barrels a day, starting on January 2017, on the condition that non-OPEC countries (such as Russia) would also participate with a reduction of 0.6 million barrels/day. It is estimated that this reduction amounts to c.a. 2% of world production. This decision had an immediate impact on benchmark oil prices, that surged 10% to over USD 50 per barrel. The strength of the deal will depend on all the parties delivering on their commitment – historically, some countries have not cut production as they were supposed to, especially with low oil prices, and doubts on the soundness of this commitment may again lead to pressure on the market.

Figure 9:
Crude Oil Prices 2010-16



Source: U.S. Energy Information Administration

Figure 10:
Top European LCCs by number of passengers



Note: Ryanair's FY starts in April; easyJet's in October
Source: Company's Annual Reports

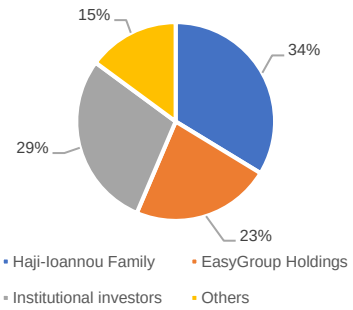
Company overview

easyJet is a British low-cost passenger airline, currently the second largest[27] serving the European short-haul market (Figure 10). Based at the London Luton Airport, the company was founded in 1995 and is today a key player among European passenger airlines, holding an estimated 9.8% share[28] of the intra-European market in terms of RPK. In FY 2016, easyJet carried over 73 million passengers across its 803 routes, flying to 31 countries and serving a total of 132 airports. easyJet's main markets are the United Kingdom, that in FY 2016 accounted for 48.0% of total revenues, Italy, France, Switzerland, Germany, Netherlands, Portugal and Spain.

[26] In the two weeks following Trump's election, USD 10.7 billion were pulled out by investors from US bond funds, the biggest exodus since 2013 (Bloomberg)
[27] In terms of passengers carried
[28] Analyst estimate

Shareholder structure

Figure 11: Shareholder Structure



Source: Bloomberg

easyJet plc is listed on the London Stcok Exchange, and is part of the FTSE 100 Index. Its largest shareholder is the founder of the company, the greek-cypriot Sir Stelios Haji-Ioannou and his family, holding a 33.7% stake in the company, followed by EasyGroup Holdings Ltd, the investment vehicle of EasyGroup Ltd[29] that holds a 22.7% stake. Institutional investors hold 28.7% of shares, and include Invesco Asset Management (10.0%), Standard Life Investments (4.1%) and BlackRock Investment Management (3.9%) (Figure 11).

- Dividend Policy

Since 2011, easyJet has paid out just over half its profit to shareholders (including special dividends). In 2016, the company announced intentions to raise the payout ratio from 40% to 50% of profit after tax, which clearly shows easyJet's confidence in the future success of the business. Thus, an ordinary dividend of GBp 53.8 (totalling GBP 214 million), will be proposed during the next Annual General Meeting.

Positioning & Strategy

*Table 7 - easyJet airports that are part of the top 30 European airports & respective morning peak utilisation**

London Gatwick	
Milan MXP	
London Luton	
Geneva	
Berlin SXF	
Paris CDG	
Manchester	
Edinburgh	
Paris Orly	
Lyon	
Amsterdam Schiphol	
Nice	
Lisbon	
Barcelona	

Full at peak times
Constrained at peak times
Less constrained at peak times

* *Based on theoretical max runway capacity at airport*
Source: easyJet

Being a budget airline, easyJet has adopted a simplified business model, that even though slightly diverges from the typical no-frills strategy followed by most LCCs, still focuses on maintaining a lean cost structure as to achieve a competitive advantage over FSCs. easyJet's strategy is based on three essential pillars:

1) Build strong number one and two network positions at leading airports

Unlike most LCCs, easyJet flies to a network of primary airports at convenient time slots (Table 7), a clear point-of-difference from the other Low Cost Carriers that enables it to capture both leisure and business travellers. 83% of easyJet's capacity is currently distributed in airports where it holds the number one or number two position by share[30]. To build on this, during FY 2017, the focus will be on protecting its number one positions in the UK and Switzerland, on strengthening its position in France, and on targeting specific market opportunities, such as city-based strategies in Germany, Italy or the Netherlands, by regularly reviewing and adapting its route network.

2) Leverage on data, digital & innovation

[29] EasyGroup is the holding company controlling the "easy" group of companies, and is privately owned by Sir Stelios Haji-Ioannou
[30] Company information

easyJet seeks to support its network and drive revenues by implementing an efficient digital strategy, leveraging on its advanced customer relationship management capabilities. The company invests highly on its digital platforms, currently comprised by three commercially mature channels: Corporate Website (350,000 visitors in FY 2016), Mobile App (168,000 visitors) and Global Distribution Systems (GDS)[31] aggregator. Mobile boarding passes are increasingly used (+63% y.o.y.), and 20% of all e-commerce bookings are now made on easyJet's mobile app[32] (+ 38% y.o.y). easyJet announced in 2015 that it will be "investing substantially" in its digital capability over the next three years, in an effort to develop support systems that will ultimately lead to the "first fully-integrated e-commerce platform in the airline industry". The front-end system is currently rolling out, and includes new live homepages, an innovative flight search functionality and a low-fare finder tool. The programme is expected to be completed by the first half of 2018. In October 2016, easyJet signed a five-year contract with the London-based start-up accelerator and incubator Founders Factory, becoming the sixth corporate backer of the incubator[33]. The partnership will support digital disruptors in the travel sector, enabling easyJet to have first-hand knowledge and privileged access to relevant sector innovations and technology.

- Yield management at easyJet

Contrarily to Ryanair, that follows an "load factor active/yield passive" strategy[34], easyJet uses an automated yield management system, designed specifically for and by the company, that attempts to maximize the revenue on each flight and ensures that the appropriate balance of passengers is met. Instead of segmenting its customers, easyJet segments its flights according to the route characteristics (business/leisure) and slot times (morning and evening/daytime flights). The yield management system recognizes the booking patterns that occur with each type of customer and sets fares accordingly. Between 2010 and 2014, this system helped boosting revenue per seat by 20%. In 2015, EasyJet appointed its first data scientist, Alberto Rey-Villaverde, to be in charge of "big data" and artificial intelligence (AI), with the objective of better predicting demand, decreasing delays and optimizing destinations and flight times.

- Drive passenger loyalty

[31] A GDS - Global Distribution System - is a worldwide computerized network containing travel related information (such as schedules, availability, fares and related services) that is used as a single point of access and enables transactions between travel providers and travel agents, online reservation sites and large corporations. LCCs adopted the GDS platforms as a way of reaching business travelers
[32] easyJet's mobile app has 4.5* on UK Apple app rating, while Ryanair has only 1.5*, and has been downloaded 18.3 million times during FY 2016 (+30% y.o.y.)
[33] The deal entails the investment in five early-stages start-ups each year, as well as the co-founding of two companies
[34] The maximization of load factor often drives fares to extremely low levels

In FY 2016, 74% of all seats were booked by returning customers. easyJet is focused on achieving higher levels of passenger loyalty, a major factor in creating long-term sustainable revenue, and to do so has launched in early 2016 its customer loyalty program "Flight Club", targeting high-value customers. Flight Club differs from the traditional frequent flyers' programs, often complex and expensive, and aims to offer member simple, but highly valued, benefits, such as free booking and name changes.

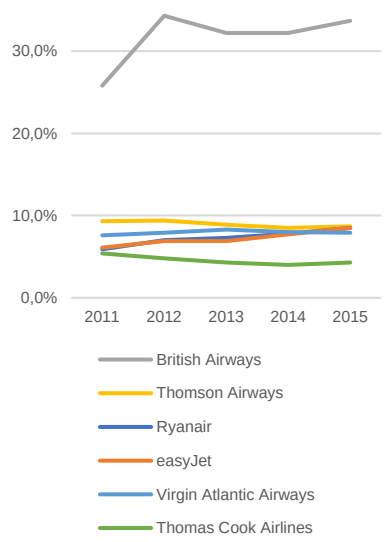
3) Maintain cost advantage

easyJet is committed to maintaining a structural cost advantage against other airlines, so that it can keep on developing its attractive portfolio of slots at slot-constrained primary airports, while keeping fares affordable. The company has set a target of flat unit cost performance between FY 2015 and FY 2019[35], to be achieved through efficient fleet management, high asset utilization, high seat density, high load factors and fixed costs as low as possible. Total cost per seat decreased from GBP 53.3 in FY 2015 to GBP 52.3 in FY 2016, a 2% improvement despite all disruptive events that took place during the year. A further analysis on easyJet's costs and fleet is available further on this Report.

easyJet's Main Markets

United Kingdom

Figure 12:
UK's Top 6 Airlines Market Shares by value of sales



Source: Passport Euromonitor International

easyJet has a 20% market share in the UK[36] (8.5% share by value of sales – Figure 12), being the largest LCC in the country. As of the end of FY 2016, the company had 140 aircrafts based in the UK (54.5% of its fleet), and this market accounted for 48.0% of its revenues. easyJet is the number one carrier by market share in most of its basis, including London Gatwick, London Luton, Bristol, Belfast and Edinburgh. London Gatwick is a particular valuable asset – it is the second busiest airport in the UK and the ninth in Europe[37], and easyJet has managed to secure a dominant position, currently flying 42% of the total number of passengers at the airport[38]. In 2016, easyJet increased capacity in the UK by 8%, mainly to grow in Luton, Bristol and Manchester; in 2017, it plans to grow capacity by 4.1 million seats.

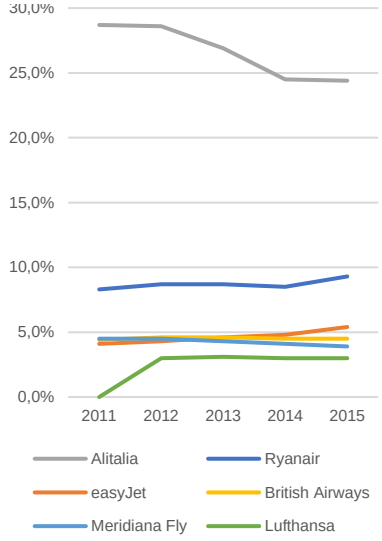
During 2015, Flybe, UK's regional low-cost airline, saw a 9% growth in the value of sales and a 10% growth in the number of passengers, making it the fastest

[35] At constant currency and before the effect of fuel and at normal levels of disruption
[36] Market share based on capacity. Company estimate based on OAG data
[37] By number of passengers
[38] Source: London Gatwick

growing airline in the UK. It currently serves a niche market – domestic flights to regional airports – and 80% of its routes are not offered by any other airline.

Brexit is today the major threat to growth faced by airlines operating in the UK, and a major source of uncertainty. Ryanair's CEO Michael O'Leary announced plans of expanding capacity in the UK, but would only go through with investment if stability conditions were to be guaranteed, which is currently not the certain[39].

Figure 13: Italy's Top 6 Airlines Market Shares by value of sales



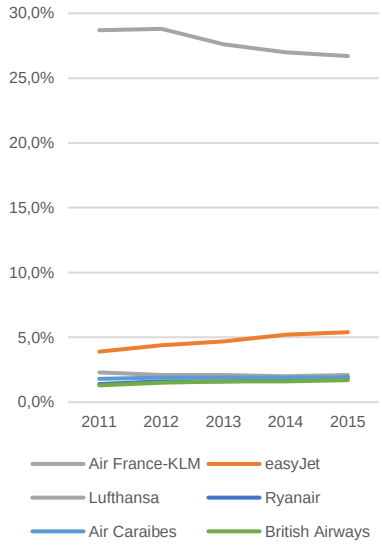
Source: Passport Euromonitor International

Italy

easyJet has a 12% market share in the Italy[40] (5.4% share by value of sales – Figure 13). As of the end of FY 2016, the company had 29 aircrafts based in the country (11.3% of its fleet). easyJet's most important airports in Italy are Milan Malpensa (2nd busiest airport in Italy by number of passengers) and the newly-opened Venice Marco Polo (5th busiest), where it holds a 19% and 23% market share, respectively. During 2016, it closed its Rome Fiumicino base, as it seen its profits decrease due to fierce competition and high airport charges. In 2016, easyJet increased capacity in 1% in Italy, adding capacity to Milan, Venice and Naples. In Italy, LCCs registered their best performance in 2015, flying a total of 43.3 million passengers (+6% y.o.y.). Ryanair was the top performer in terms of passengers carried, having flown a total of 15,600 million people (more 6,360 million than easyJet).

From the 1st of January 2016, a new tax was imposed on air travel – EUR 2.5 per passenger -, being highly criticized airlines and IATA, given that the revenues from the tax won't even be reinvested in the air transport sector.

Figure 14: France's Top 6 Airlines Market Shares by value of sales



Source: Passport Euromonitor International

France

easyJet has a 14% market share in the France[41] (5.4% share by value of sales – Figure 14), where it is the second largest budget airline. As of the end of FY 2016, the company had 28 aircrafts based in the country (10.9% of its fleet). It is the number one airline in Nice, and the second (after Air France) in the majority of the remaining airports where it operates. During FY 2016, easyJet increased capacity by 8%, and is expected to add a further 2.4 million seats in FY 2017, increasing capacity on its Charles de Gaulle base (the busiest airport in France by number of passengers) and strengthening the domestic network.

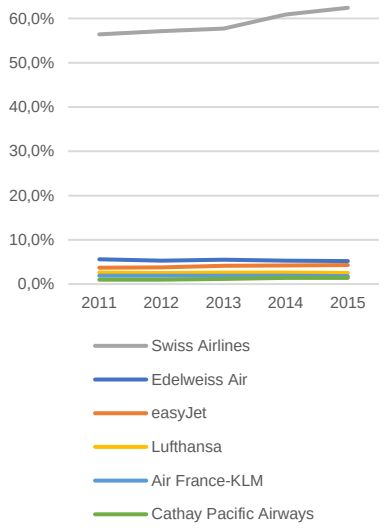
During 2015, the number of passengers carried increased 3%, which was a good result given the terrorist attacks that happened in the country. There is a highly

[39] O'Leary said *"I need to know by March next year [2017] what's going to happen in Britain in summer 2019. There isn't a politician who knows that."*
[40] Market share based on capacity. Company estimate based on OAG data
[41] Market share based on capacity. Company estimate based on OAG data

concentrated competitive environment in the market given the dominant position of Air France-KLM and its subsidiaries (34% of all passengers carried). There was also some interesting M&A activity in the country, with Air France's subsidiaries Brit Air, Regional and Airlinair consolidating into one single LCC, Hop!, with the objective of becoming a stronger competitor of easyJet and Ryanair, both domestically and internationally. With two main hubs in Paris and Lyon, Hop! aims to offer 500 daily flights to over 100 destinations, once fully operational.

France hasn't yet reached maturity in the domestic, short-haul segment, so there are still plenty of opportunities. Whilst in the past French carriers enjoyed more favourable conditions - new slots and lines seemed to be more easily attributed to French carriers than to foreign LCCs -, now the status quo seems about to change. Foreign airlines benefit from the exemption of the "Chirac tax" – a tax imposed on French companies to finance AIDS research -, and of the *Code de l'Aviation Civile* which is imposed on national airlinest by local authorities(while foreign airlines only have to follow the less constraining EASA code).

Figure 15: Switzerland's Top 6 Airlines Market Shares by value of sales



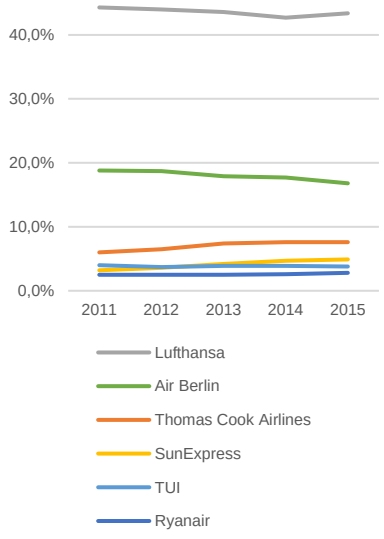
Source: Passport Euromonitor International

Switzerland

easyJet has a 24% market share in Switzerland[42] (4.3% share by value of sales – Figure 15), and is the second largest airline in the country. As of the end of FY 2016, the company had 22 Switzerland-based aircrafts (8.6% of its fleet). During the last fiscal year, the company increased capacity by 7%, to reinforce its number one position at both the Geneva and Basel airports, and is planning on adding 1.4 million seats to further strengthen its strategy.

Swiss International Airlines is the leading airline in Switzerland, enjoying a high level of popularity among domestic tourists. It is still perceived as the "national" company, even though it is now owned by Lufthansa. LCCs grew by 6% in 2015, while FSCs by only 2% in 2015.

Figure 16: Germany's Top 6 Airlines Market Shares by value of sales



Source: Passport Euromonitor International

Germany

easyJet has a 4% market share in Germany[43], and as of the end of FY 2016, the company had 13 aircrafts based in the country (5.1% of its fleet). It has a 13% market share in Berlin, and 9% in Hamburg.

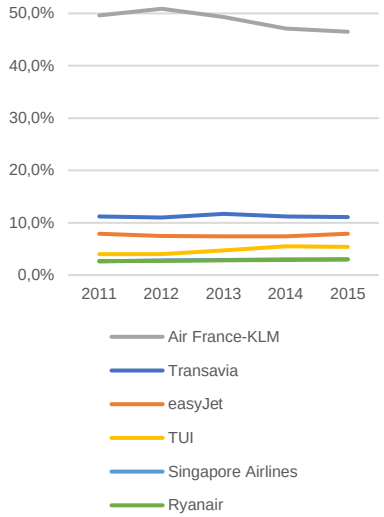
Germany is a very large and attractive market, worth EUR 22 billion in 2015. However, it is also very competitive – the leading players are the Lufthansa Group

[42] Market share based on capacity. Company estimate based on OAG data
[43] Market share based on capacity. Company estimate based on OAG data

and by Air Berlin (43% and 17% share by sales value, respectively), that have good reputation and are the preferred choice for the majority of Germans.

easyJet is planning on increasing capacity in Germany during FY 2017 by 0.6 million seats.

Figure 17: Netherland's Top 6 Airlines Market Shares by value of sales



Source: Passport Euromonitor International

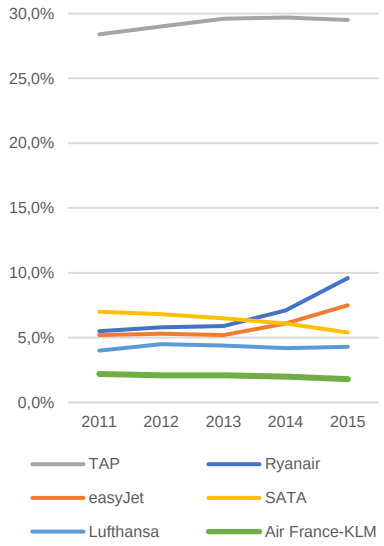
Netherlands

easyJet has a 10% market share in the Netherlands[44] (7.9% share by value of sales – Figure 17), being the second largest short-haul airline in the country.

After Flybe, easyJet had in 2015 the largest growth in sales value, following the opening its new base at the Schiphol airport and the 24% capacity increase in the country. Air France-KLM is the leading player, with its KLM Royal Dutch Airlines and Transavia brands. KLM also focuses on the development of technology and social media as a way of increasing ticket sales and complimentary services to customers[45].

Future perspectives indicate that Transavia is likely to struggle – even though it has a relatively strong position in the Netherlands, it will experience fierce competitions from other LCCs, such as easyJet and Ryanair that during 2015 opened bases in Schiphol. There are some rumours that Air France-KLM could face this competition by consolidating all Transavia activities by acquiring another player and thus enjoying economies of scale. Wizz Air, the Hungarian budget airline, would be the most likely candidate, but even so both LCCs together would still be smaller than easyJet or Ryanair, and would still have a higher cost base than them.

Figure 18: Portugal's Top 6 Airlines Market Shares by value of sales



Source: Passport Euromonitor International

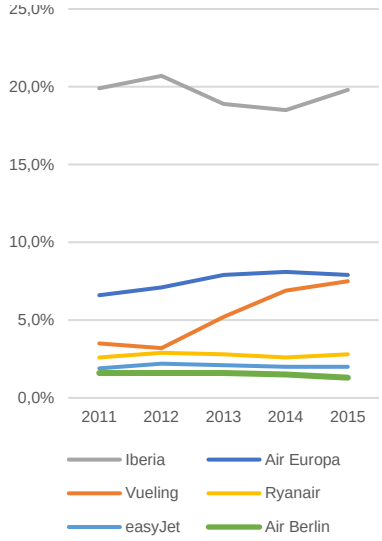
Portugal and Spain

easyJet has a 13% market share in Portugal[46] (7.5% share by value of sales – Figure 18) and 7% share in Spain (2.0% share by value of sales – Figure 19). As of the end of FY 2016, the company had 7 aircrafts based in Portugal and 3 in Spain, having increased capacity in these countries by 17% and 6%, respectively.

In Spain, besides easyJet, the two other top LCCs are Vueling and Ryanair, that enjoy market shares of 7.5% and 2.8%, respectively. In 2015, Monarch airlines changes its positioning and moved from a charter airline to a low-cost one, and is expected to undergo a smooth transition given that both business models are somewhat similar.

[44] Market share based on capacity. Company estimate based on OAG data
[45] The company actually employs 150 "social media agents", responsible for managing clients contacts through social media platforms such as Facebook, Instagram or Twitter
[46] Market share based on capacity. Company estimate based on OAG data

Figure 19:
Spain's Top 6 Airlines Market Shares by value of sales



Source: Passport Euromonitor International

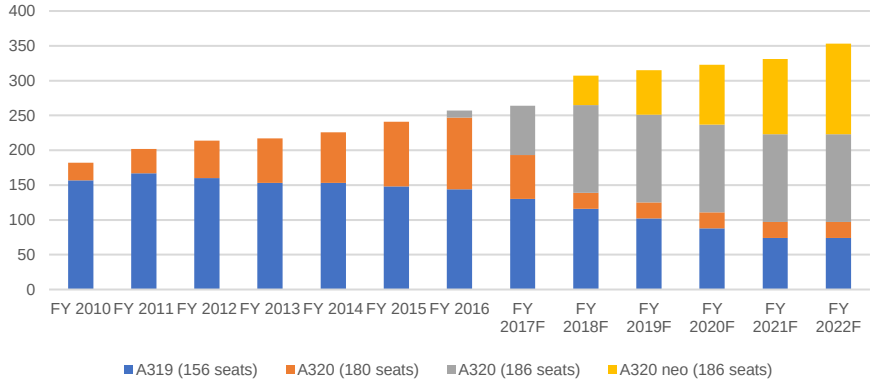
In Portugal, fierce competition has been undermining industry profits. In he past year, LCCs have fiercely competed for tourists and engaged in aggressive online promotion campaigns, that considerably dragged tickets prices down. With its aggressive campaigns and promotions, Ryanair was able to surpass the national carrier TAP in number of passengers carried in 2015.

Key Value Drivers

Fleet

easyJet operates a young fleet, constituted exclusively by Airbus A320-family aircrafts[47]. It's fleet management policy is based on flexibility, both in time and scale - contracts with suppliers are built in a way such that easyJet can defer new aircrafts orders and extend or terminate leases as it deems necessary. At the end of FY 2016, easyJet's fleet was comprised of 257 aircrafts, split between 156-seat A319s, 180-seat A320s and 186-seat A320s, representing a total of 39,325 seats available for passengers. easyJet has revealed intentions of aggressively expanding its fleet until FY 2022[48] (Figure 20): until the Summer of FY 2018, the 180-seat A320 will be up-gauged to fit 186 seats; between 2017 and 2022, it will acquire 166 aircrafts: 36 186-seat A320 and 110 A320neo. The A320neo are Airbus' new generation, fuel-efficient short-haul aircrafts, that between 2018 and 2022 are estimated to deliver fuel savings of c.a. GBP 180 million (average saving of 2.85% per year vs the regular A320). Some of the new aircraft will be for the replacement of the existing fleet as it ages - it is predicted that until FY 2022, 70 older A319 and 15 A320 will exit the fleet. easyJet has also issued a tender offer for the sale and leaseback of 25 aircrafts that is expected to occur during FY 2017.

Figure 20:
easyJet's fleet composition (historical & projected)

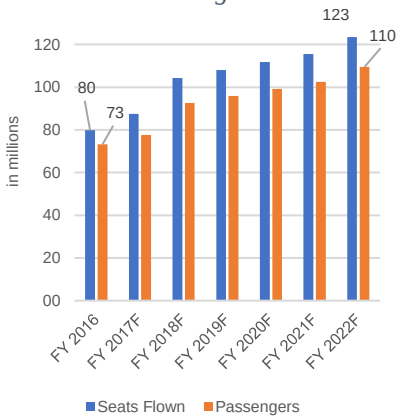


Source: Analyst estimates based on current outstanding contracts with Airbus

[47] Operating a fleet of only one or two types of aircrafts is a followed by LCCs. By operating a standardized fleet, airlines can achieve significant savings, though higher operational flexibility, lower training, engineering and maintenance costs, and though the higher discounts obtained by purchasing aircraft in bulk

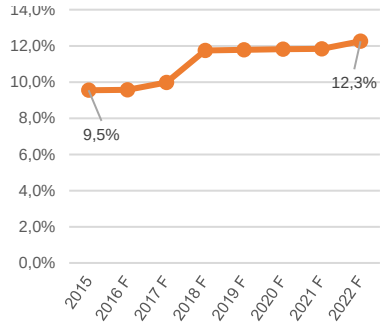
[48] Fleet expansion plans are analyst estimates, based on easyJet's public information and contractual commitments as of 30 September 2016

Figure 21: Projected Seats Flown and Number of Passengers



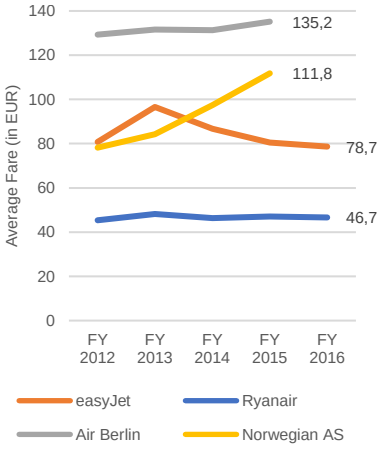
Source: Analyst estimates

Figure 22: Projected Market Share in terms of RPKs



Source: Analyst estimates

Figure 23: Average Passenger Fare



Source: Companies' Annual Reports

It is forecasted that easyJet will operate a fleet of 353 aircrafts by FY 2022, of which 260 (74%) will be owned, 88 will be under operating leases and 5 under financial leases. It was further assumed, based on historical information, that the average number of operated aircraft during the year was 93.5% of the total fleet.

Seats Flown and Number of Passengers

easyJet is expected to consolidate its position in the European short-haul segment and strengthen its share in its main markets. Seats flown[49] are forecasted to progress with fleet expansion, given that the average number of sectors per operated aircraft is expected to remain stable in the coming years (easyJet already has a high asset utilization – 11 block hours per day). Thus, seats flown are expected to increase at a CAGR of 7.5% until FY 2022, reaching 123.5 million in that year (Figure 21). It will be challenging for easyJet to sustain its high load factor, that has been above 88% in the last five fiscal years and reached a record high of 91.6% in FY 2016. Given easyJet's yield management strategy, that prioritizes maintaining high fares over high load factors, and its significant fleet expansion plans, it is reasonable to expect a slight decrease in last year's the load factor, that is thus assumed to remain at 90% levels until FY 2022. The number of passengers is forecasted to grow at a CAGR of 6.9% between FY 2017-22, reaching 109.5 million by the end of the period (Figure 21). The impact of Brexit was considered, and estimated to depress easyJet's number of passengers by 1.4% per year until FY 2020 vs a non-Brexit scenario. After FY 2022, passenger growth was forecasted taking into account the predicted growth rate of EU's GDP and the average income elasticity of passenger demand for developed economies. As such, the number of passengers is expected to increase by 2.9% per year after FY 2022, which is in line with Boeing's prediction of RPK growth (a proxy for air travel demand) of 3.2% per year until 2035. easyJet is expected to increase its market share in terms of RPKs, from 9.5% in 2015 to 12.3% in 2022 (Figure 22).

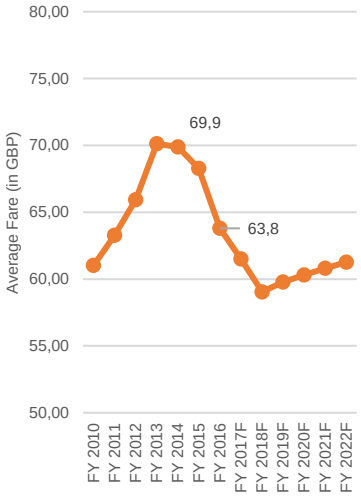
Average Passenger Fare

Because of its strategy of offering customers an attractive portfolio of primary airports and routes, of flying at convenient time slots, of targeting business passengers and of leveraging on its yield management capabilities, easyJet has been able to charge passengers an average fare relatively higher than its main competitor Ryanair (Figure 23). Even though airlines follow different pricing strategies, the average fare charged is generally closely linked to operating costs, distance travelled and market conditions, particularly supply and demand forces.

[49] Seats flown are a metric of passenger capacity, representing all seats available for passengers during the year

As such, an approach combining these three factors was used to forecast easyJet's average fare.

Figure 24: Historical and Projected Average Passenger Fare



Source: easyJet & Analyst estimates

- Average sector length was impacted in FY 2016 by -1.7%, when easyJet cancelled all its flights to in Sharm El Sheikh (Egypt) following the bombing of a Russian passenger airplane in October 2015. It is estimated that normal services will be resumed by the beginning of FY2018, and average sector length will return to FY 2015 levels (c.a. 1,118 km) and remain stable then on - easyJet operates in the short-haul segment, focusing on intra-Europe routes, and given the characteristics of its fleet - the A319 and A320 operate short to medium-haul routes -, stability of sector length is a robust assumption.
- Concerning supply of air travel, it is estimated that the number of IFR flights will grow at a CAGR of 1.9% per year. When regressing the average passenger fare, however, this factor was found non-significant, and even though its predicted growth is slightly higher than historical growth (CAGR FY2019-2015 of 0.60), this factor was not used as input in the regression.
- CASK[50] was the input used to measure operating costs, and is forecasted to decrease at a CAGR of 1.0% from FY 2016 to FY 2022.

easyJet's average passenger fare has decreased for three years in a row, from GBP 69.9 to GBP 63.9 (-9.0%). In Fiscal Years 2017 and 2018, significant unit cost reductions are expected to take place as he effects of fleet up-gauging start to materialize. Therefore, and taking into account easyJet's yield management strategy, growth in average passenger fare was capped at [-4%;+4%], reflecting the belief that not all cost savings will be transmitted to passengers and that the average passenger fare won't suffer major changes in the next few years, either positive or negative. As a result, average passenger fare is expected to decrease by 3.6% and 4.0% in FY 2017 and 2018, respectively, returning to positive growth in FY 2019 (Figure 24).

Key Cost Drivers

Fuel

Fuel cost typically accounts for roughly one third of airlines' total operating costs. Because it can be highly variable - fluctuating up to 40% y.o.y. -, airlines often

[50] CASK (Cost per Available Seat Kilometer) is a popular industry measure for unit cost. "Selling & Marketing Costs" and "Other Costs" were excluded as they were forecasted to grow proportionally with revenue

engage in hedging strategies to lock in fuel costs and reduce their exposure. easyJet hedges forward, on a rolling basis, between 65% and 85% of its anticipated fuel requirements for the following year, and between 45% and 65% of the following 12 months, in an attempt to "reduce short term earning volatility". easyJet's hedging position as of 30 September 2016 is depicted in Table 8. This conservative hedging policy has kept easyJet from fully enjoying the low fuel market prices – in FY 2016, the average market price of fuel was USD 415 per metric tonne (-32.9% y.o.y), but due to fuel and FX hedging commitments easyJet's effective fuel price decreased only 13.4%, from to GBP 553 in FY 2015 to GBP 479. In the years to come, fuel bill is estimated to increase at a CAGR of 2.6% p.a. (Figure 25), driven by the increase in traffic but reflecting increased fuel efficiency with the introduction of the A320neo aircrafts in the fleet.

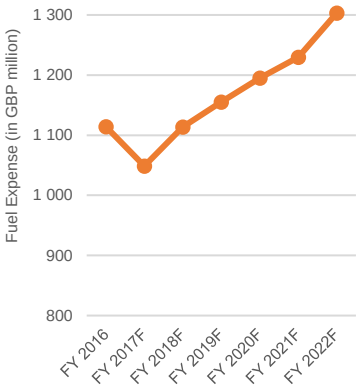
Table 8 – easyJet's fuel & FX hedging commitments

	Fuel requirement
Full year ending 30 September 20167	81%
Average rate ($/metric tonne or $/GBP)	617
Full year ending 30 September 2018	47%
Average rate ($/metric tonne or $/GBP)	510

	USD requirement
Full year ending 30 September 20167	74%
Average rate ($/metric tonne or $/GBP)	1,52
Full year ending 30 September 2018	50%
Average rate ($/metric tonne or $/GBP)	1,43

Source: easyJet's Annual Report

Figure 25: Projected Fuel Expense



Source: Analyst estimates

Airport charges & other operating expenses

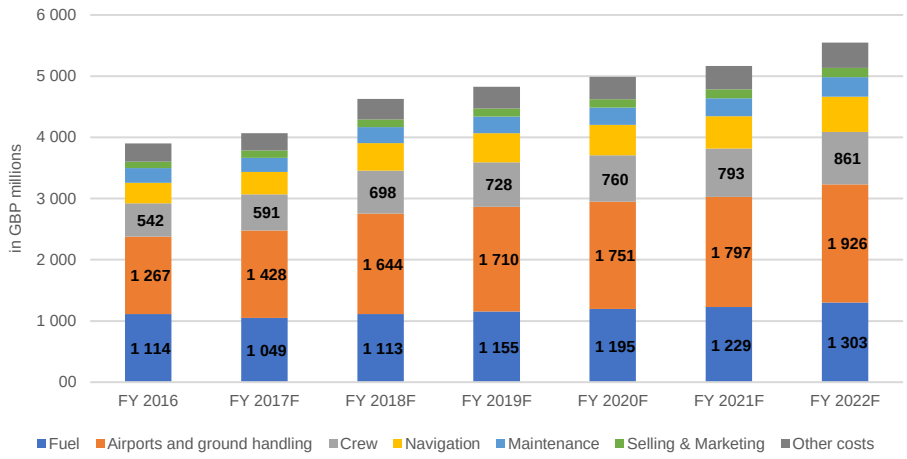
Airport charges and ground handling are easyJet's second largest expense after fuel. These include landing fees, passenger-related charges, parking fees, and many other payments airlines deliver to airports for the use of the facilities. Ground handling comprises the costs associated with providing ground staff, check-in staff, equipment, business lounges, office space and related facilities at each of the airports served by the airline. easyJet outsources much of these services, maintaining a minimum level of its own staff. It does not have connecting passengers or luggage, nor does it handles freight. easyJet tries to leverage its significant position in the airports and often establishes long-term deals with the airport owners and operators, as well as with ground handling contractors, benefitting from lower prices. Around 70% of easyJet's airport costs come from regulated airports where there have been above inflationary cost increases (particularly in Italy and London Gatwick). As easyJet will reinforce its strategy of flying to primary airports and routes, and as such is subject to the high prices charged by Europe's top airports that operate close to full capacity, it is estimated that this cost category will increase at a CAGR of 7.2% per year until FY 2022. Selling and marketing costs are also expected to suffer a significant increase in FY 2017 (+14.5%), reflecting easyJet's response to the uncertainty environment and decrease in consumer confidence caused by Brexit.

- Maintenance costs

Maintenance expenses relate to the cost of routine maintenance and spare parts. Leveraging its increasing scale, easyJet closed in 2015 an arrangement with AJW Group, that from October 2016 will be the airline's primary supplier of component

maintenance and will provide, store and distribute its spare parts. The contract is worth over £200 million annually, according to easyJet's COO Warwick Brady.

Figure 26:
Projected operating costs before leasing, depreciation and amortization



Source: Analyst estimates

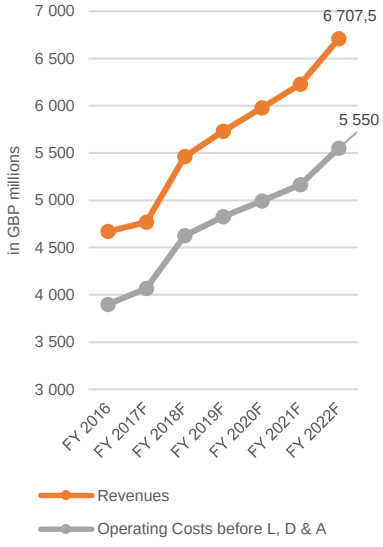
Forecast

Income Statement

The complete projected Income Statement is available in Appendix II.

easyJet's revenues are forecasted to grow at a CAGR of 6.2% between FY 2016 and FY 2022, with accentuated growth in FY 2018 and FY 2022. They are expected to reach GBP 6,707 million in FY 2022, and from then to evolve at a rate of c.a. 2.9% per year. Operating costs before leasing, depreciation and amortization are expected to increase at a slightly lower CAGR (6.1%) over the same period, reaching GBP 5,550 in FY 2022.

Figure 27:
Projected Revenues and Op. Costs before L, D & A



Source: Analyst estimates

- Depreciation and dry leasing

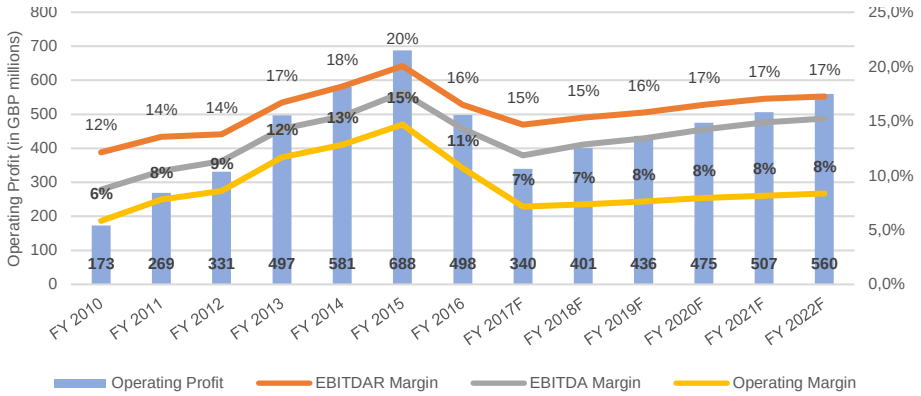
Depreciation is calculated on a straight-line basis over the expected useful life of the assets[51]; expected useful lives and residual values, when applicable, are reviewed annually. Depreciation costs are expected to increase with the acquisition of new aircraft and expansion of fleet. Dry leasing costs will jump 30% to GBP 134 million in FY 2017 due to the expected sale and leaseback transaction of 25 aircrafts. The fleet's ownership structure is expected to remain relatively constant until FY 2022 (74% owned aircraft / 26% leased), when easyJet will own 260 aircrafts and have 88 under operating leases.

[51] Expected useful life as of 30 September 2016: Aircrafts (23y), Aircraft spares (14y), Fixtures, fittings and equipment (3y), Computer hardware (5y)

- EBITDAR, EBITDA & Operating Profit

The evolution of easyJet's EBITDAR, EBITDA and Operating Margins are depicted in Figure 28. These indicators are expected to slightly underperform historical values, as the effects of intensified competition, lower load factors and average passenger fare materialize.

Figure 28:
Operating Profit & Margins



Source: Analyst estimates

Balance Sheet

The complete projected Balance Sheet is available in Appendix III.

- Property, Plant & Equipment

This caption comprises aircrafts and spares, leasehold improvements, computer hardware, and fixtures, fittings and equipment. The net book value of property, plant and equipment increased by GBP 375 million in FY 2016, mainly due to the addition of 20 aircrafts and pre-delivery payments relating to aircraft purchases. easyJet's projected fleet expansion will be the main driver of PP&E growth, that will almost double by FY 2022, reaching GBP 7,949 million in that year. easyJet only discloses the list price before escalation and discounts of the aircrafts it is committed to buy, which in the end of FY 2016 amounted to USD 14.8 billion. No airline actually pays "catalogue prices" – the aviation industry is famous for its "code of silence" when it comes to discounts given on aircraft purchases. These are known to substantially vary with volume, and estimates indicate that they can fluctuate between a range of 20% to 60%. Based on past easyJet's contracts with Airbus and on the company's disclosed CAPEX forecasts for the three next fiscal years, it was estimated that the discount given for the forthcoming acquisitions would be in of approximately 35%, which is in line with the above-mentioned range.

- Cash & Cash equivalents

easyJet's liquidity risk management defines a minimum liquidity[52] requirement of GBP 4 million per aircraft. This policy intends to ensure not only a sufficient availability of funding as required, but also to sustain the favourable credit rating it secured earlier in 2016. In FY 2016, this metric fell short from the objective (GBP 3.8 million per aircraft), and is expected to remain so in the coming years, but always above GBP 3 million. Liquidity is furthermore supported by a USD 500 million credit revolving facility (with no financial covenants), maturing in February 2021, that will help manage the impact of downturns in business or to face unexpected disruptive events.

- Borrowings

In February 2016, under the Euro Medium Term Note Programme, easyJet successfully raised a EUR 500 million bond, with a fixed annual coupon rate of 1.75%, securing a sector-leading credit rating: BBB+ Stable (S&P), Baa1 Stable (Moody's). easyJet has a strict capital management policy, intended to maximize shareholder returns, access to low cost of funding and operational flexibility. The company uses the gearing ratio[53] of debt to capital employed to manage capital risk, and a target of 15%-30% has been defined by the Board. Furthermore, it has also defined a maximum leverage of GBP 10 million net debt per aircraft. Including these targets in the estimates, until FY 2022, borrowings are expected to increase to finance the acquisition of aircrafts, and gearing will converge to the range of 45%-55%, which is still acceptable by the Board standards.

Valuation

A Discounted Cash Flow model was used for the valuation of easyJet. The company is expected to maintains a relatively stable debt-to-value ratio, targeting a dividend payout ratio and not a fixed dividend amount[54], and as such the DCF was deemed the best approach.

WACC

- Cost of Equity

[52] Liquidity is defined as cash and money market deposits (excluding restricted cash)
[53] Debt is defined as reported net debt plus 7x aircraft operating lease payments, less cash (incl. money market deposits but excluding restricted cash). Capital employed is shareholders' equity plus debt as previously defined.
[54] Meaning that the risk associated with interest tax shields equals the risk of operations

Table 9 – Comparable Companies & Beta Unlevered

	βu
1) European LCCs	
easyJet	0.162
Ryanair	0.493
Norwegian AS	0.865
2) European FSCs	
Lufthansa	0,739
Air France-KLM	0.394
IAG	0.579
SAS	0.864
Average	**0.575**

Source: Analyst estimates

Table 10 – Cost of Equity

Rf	1.44
MRP	6.00%
βe	0.624
Re	**5.18%**

Source: Analyst estimates

Table 11 - WACC

Re	5.18%
Rd	3.44%
Target D/EV	20%
WACC	**4.7%**

Source: Analyst estimates

The cost of equity was determined through the Capital Asset Pricing Model (CAPM), that builds on three factors: the risk-free rate, the market risk premium, and a company-specific risk adjustment. Even though ratings agencies downgraded UK's credit rating following the outcome of the Brexit referendum, the 10y Government Bonds were still assumed to be risk-free, and as such were used as proxy to obtain the risk-free rate, that equalled 1.44%[55]. The market risk premium was based on Damodaran's work, that estimated a MRP of 6.0% for mature markets. Finally, the MSCI World Index[56] was used to estimate easyJet's beta. The unlevered betas of 6 comparable companies[57] – 2 LCCs (Ryanair and Norwegian Air Shuttle) and 4 FSCs (Lufthansa, Air-France KLM, SAS and IAG) - were computed to arrive at the industry average unlevered beta, that was then relevered using the target debt-to-equity ratio. The resulting levered beta amounted to 0.638. Plugging all values into the CAPM equation, a cost of equity of 5.27% was reached.

- Cost of Debt

easyJet's bonds' yields cannot be used as a proxy for the cost of debt since they are callable bonds, and this approach can only be used with option-free bonds. As such, an alternative method was followed: the credit spread of easyJet was determined[58], and summed to the risk-free rate to get the cost of debt, that yielded 3.4%.

Given easyJet's above-mentioned capital structure guidelines and the capital structure of comparable companies, a target debt to value of 20% (and equivalently equity to value of 80%) was set, to arrive at a WACC of 4.7%.

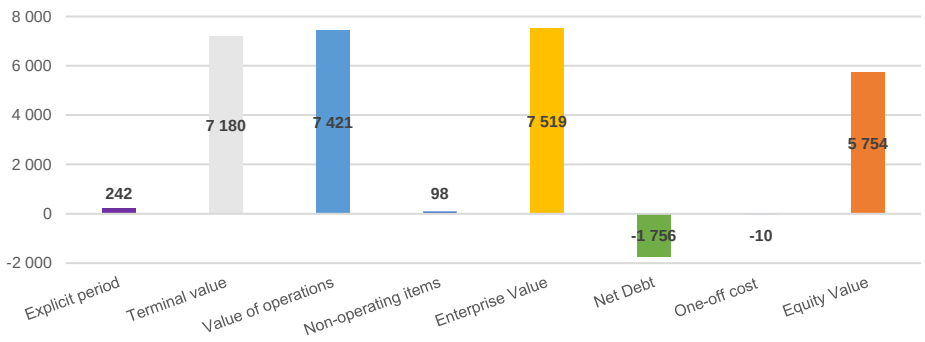
Enterprise Value, Equity Value & Target Price

easyJet's financial statements were explicitly forecasted for a period long enough for it to reach a steady state. The forecast was divided into two periods: a detailed forecast until FY 2022, with financial statements' captions linked to real variables such as capacity and passenger growth, and a simplified one, focusing on a few important variables, such as revenue growth and margins, until FY 2027. The continuing value was computed using McKinsey's recommended formula for DCF valuation. The liquidation value approach was not used, since it does not reflect the earning power of the assets, namely easyJet's fleet and intangibles (brand,

[55] To confirm the assumption, an alternative method was used: using the 10y German bonds and converting to GBP, a risk-free rate of 1.39% was obtained, which is in line with the 1,44%.
[56] Using 5 years of monthly returns in GBP
[57] Even though legacy carriers have higher fixed costs than LCCs, thus having, on average, higher unlevered betas, they were still included since the list of comparable European LCCs was limited and the effects of operational leverage are often neglected in practice
[58] Using the tables made available by Damodaran in his webpage

CRM). The exit multiple approach, even though it is simple and provides a quick estimation of continuing value, often leads to high imprecision, and as such it was also not used. Using the continuing value formula proposed by Koller, Goedhart and Wessels[59] , the perpetuity growth rate was set to 3.2% (steady state nominal growth of cash flows, assuming a 1.8% GDP growth rate in the European Union), and RONIC was set equal to WACC, since in the long-term competition effects will erode abnormal returns. easyJet's Enterprise Value amounts to GBP 7,519 million, of which 97% correspond to continuing value (GBP 7,180 million), which is deemed reasonable given easyJet's significant CAPEX investments for the next 7 years. Adjusting for Net Debt and for one-off costs[60], the Equity Value amounts to GBP 5,754 million. Dividing by the 397,208,133 shares outstanding, the resulting target price is of GBP 14,48.

Figure 29:
Value decomposition



Source: Analyst estimates

Sensitivity Analysis

In order to test the impact of changes in key assumptions of the model, a sensitivity analysis (Figure 30) was conducted on the following factors:

- Average Passenger Fare

The forecast of the average price charged for a flight ticket was based on a regression analysis and, as such, a 95% confidence interval was computed to assess the possible impact of changes in this input. A higher sensitivity to changes in CASK implies a lower valuation of easyJet's shares, from GBP 14.48 to GBP 14.10. Conversely, a lower sensitivity yields a higher valuation (GBP 15.47). This makes sense, given that significant cost savings (and thus lower CASK) is expected to occur in the next two years.

[59] Formula proposed in the book Valuation: Measuring and Managing the Value of Companies
[60] Because of Brexit, easyJet plans to establish an Air Operator Certificate (AOC) in another EU member state, to secure the flying rights of the 30% of its network that remains exclusively within and between EU states. This one-off cost is expected to total around £10 million

- Load Factor

Changing the Load Factor by 1%, easyJet's share price lies between GBP 12.37 and GBP 18.59. This metric has showed robust performance – it has been constantly increasing for over 5 years -, but it is unlikely that it will grow further, especially given easyJet's expansion plans. As such, it is expected that the Load Factor won't suffer significant changes in the future.

- Oil Prices

Even though fuel is one of the major cost driver of airlines, it may be passed onto customers by adjusting ticket prices. Given the already low fuel costs of the past two years and the recent OPEC decisions, the interval chosen for changes in this input was [-15%; +30%]. The resulting share price ranged between GBP15.54 and GBP 10.52.

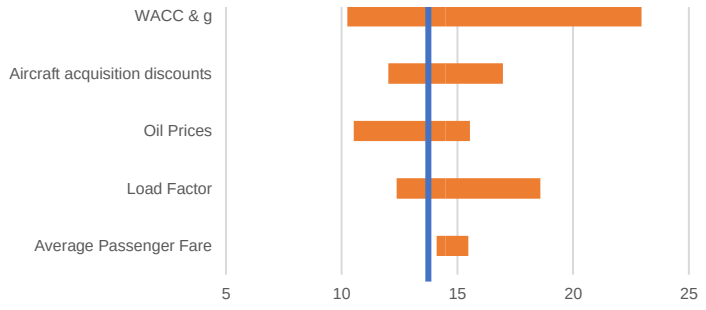
- Aircraft acquisition discounts

Discounts offered by aircraft manufacturers vary significantly. As such, an interval of [-10%;+10%] was computed, resulting in a share price in the range of GBP 12.01-16.97.

- WACC & g

First, it was assed which assumptions could lead to different WACC values. A preliminary sensitivity analysis on both the Equity Risk Premium and Beta Unlevered of the Industry was conducted. By choosing an interval of the ERP of 4,5%-6,5%, and computing the 95% Confidence Interval of the Industry Unlevered Beta, the WACC was concluded to vary between 2.72% and 6.63%. Combined with long-term growth changes of +/- 1%, easyJet's share price is set to vary between GBP 10.24 and GDP 22.95. This large interval can be explained by the fact that the standard error of the regression of the comparables return vs the MSCI World Index was very high, resulting in a large interval of possible WACC values.

Figure 30:
Sensitivity Analysis



Appendix

I. Key Operating Statistics

	FY 2016 09/30/2016	FY 2017F	FY 2018F	FY 2019F	FY 2020F	FY 2021F	FY 2022F
Total Fleet	257	264	307	315	323	331	353
Average number of aircraft operated during year	249	247	287	294	302	309	330
Seats Flown (million)	79,90	87,42	104,31	108,03	111,75	115,47	123,45
Passengers (million)	73,19	77,55	92,52	95,82	99,12	102,43	109,50
Average Passenger Fare (£)	63,79	61,50	59,04	59,79	60,29	60,80	61,25
Load factor (%)	91,6%	90,0%	90,0%	90,0%	90,0%	90,0%	90,0%
Available Seat Kilometers (ASKs) (millions)	2 087	2 087	2 087	2 087	2 087	2 087	2 087
Sectors	482 110	550 861	640 584	657 277	673 970	690 662	736 567
Average Sector Length (Km)	1 098	1 098	1 118	1 118	1 118	1 118	1 118
Revenue Passenger Kilometers (RPKs) (millions)	80 355	86 390	104 953	108 698	112 442	116 186	124 216

II. Income Statement

(£ million) 12 Months Ending	FY 2016 09/30/2016	FY 2017F	FY 2018F	FY 2019F	FY 2020F	FY 2021F	FY 2022F
Operating Revenue							
Seat Revenue	4 587	4 695	5 375	5 635	5 881	6 127	6 599
Non-Seat Revenue	82	74	88	94	96	101	109
Total Operating Revenue	**4 669**	**4 769**	**5 463**	**5 729**	**5 976**	**6 227**	**6 707**
g	*0%*	*2%*	*15%*	*5%*	*4%*	*4%*	*8%*
Operating costs							
Fuel	-1 114	-1 049	-1 113	-1 155	-1 195	-1 229	-1 303
Airports and ground handling	-1 267	-1 428	-1 644	-1 710	-1 751	-1 797	-1 926
Crew	-542	-591	-698	-728	-760	-793	-861
Navigation	-336	-367	-452	-475	-500	-526	-573
Maintenance	-237	-231	-259	-271	-282	-295	-320
Selling and marketing	-107	-120	-124	-132	-137	-143	-154
Other costs	-296	-284	-335	-355	-365	-383	-413
Operating costs before leasing, depreciation and amortization	**-3 899**	**-4 069**	**-4 626**	**-4 825**	**-4 990**	**-5 166**	**-5 550**
g	*4%*	*4%*	*14%*	*4%*	*3%*	*4%*	*7%*
EBITDAR	**770**	**700**	**837**	**904**	**986**	**1 062**	**1 157**
EBITDAR Margin	*16%*	*15%*	*15%*	*16%*	*17%*	*17%*	*17%*
Aircraft Dry Leasing	-103	-134	-136	-136	-135	-135	-135
EBITDA	**667**	**566**	**702**	**769**	**851**	**926**	**1 022**
EBITDA Margin	*14%*	*12%*	*13%*	*13%*	*14%*	*15%*	*15%*
Depreciation	-157	-226	-301	-332	-376	-420	-463
Amortisation of intangible assets	-12	0	0	0	0	0	0
Loss/profit on disposal of assets held for sale	0	0	0	0	0	0	0
Total Operating Expenses	**-4 171**	**-4 429**	**-5 062**	**-5 293**	**-5 502**	**-5 721**	**-6 148**
g	*4%*	*6%*	*14%*	*5%*	*4%*	*4%*	*7%*
Operating Profit (EBIT)	**498**	**340**	**401**	**436**	**475**	**507**	**560**
Operating Margin	*11%*	*7%*	*7%*	*8%*	*8%*	*8%*	*8%*
Net finance charges	**-3**	**-9**	**-31**	**-41**	**-48**	**-53**	**-58**
Profit Before Tax (EBT)	**495**	**331**	**370**	**395**	**427**	**453**	**501**
Tax charge (credit)	-68	-66	-74	-79	-85	-91	-100
Profit for the year	**427**	**265**	**296**	**316**	**342**	**363**	**401**
g	*-22%*	*-38%*	*12%*	*7%*	*8%*	*6%*	*11%*
Total comprehensive income for the year	**690**	**265**	**296**	**316**	**342**	**363**	**401**

III. Balance Sheet

(£ million) 12 Months Ending	FY 2016F 09/30/2016	FY 2017F	FY 2018F	FY 2019F	FY 2020F	FY 2021F	FY 2022F
Non-current assets							
Goodwill	365	365	365	365	365	365	365
Other intangible assets	152	148	143	138	133	129	124
Property, plant and equipment	3 252	5 086	6 046	6 736	7 373	7 959	7 949
Derivative financial instruments	154	154	154	154	154	154	154
Restricted cash	7	6	6	5	6	6	6
Other non-current assets	121	140	151	158	169	173	187
Total non-current assets	**4 051**	**5 899**	**6 865**	**7 557**	**8 200**	**8 785**	**8 785**
Current assets							
Assets held for sale	0	0	0	0	0	0	0
Trade and other receivables	217	214	246	261	270	282	304
Derivative financial instruments	268	268	268	268	268	268	268
Restricted cash	0	6	6	5	6	6	6
Money market deposits	255	255	255	255	255	255	255
Cash and cash equivalents	714	537	666	690	714	738	804
Total current assets	**1 454**	**1 280**	**1 441**	**1 479**	**1 513**	**1 548**	**1 636**
Total assets	**5 505**	**7 178**	**8 306**	**9 036**	**9 713**	**10 334**	**10 421**
Current liabilities							
Trade and other payables	564	567	640	677	693	718	772
Unearned revenue	568	604	693	716	754	785	844
Borrowings	92	74	73	55	47	42	46
Derivative financial instruments	275	275	275	275	275	275	275
Current tax payable	21	27	26	32	32	35	38
Provisions for liabilities and charges	53	144	159	181	198	213	234
Total current liabilities	**1 573**	**1 691**	**1 866**	**1 936**	**2 000**	**2 067**	**2 208**
Non-current liabilities							
Borrowings	664	2 123	2 865	3 344	3 746	4 085	3 788
Derivative financial instruments	49	49	49	49	49	49	49
Non-current deferred income	35	29	23	17	12	6	0
Provisions for liabilities and charges	235	293	355	381	421	459	497
Deferred tax	237	237	237	237	237	237	237
Total non-current liabilities	**1 220**	**2 732**	**3 529**	**4 029**	**4 465**	**4 835**	**4 571**
Total liabilities	**2 793**	**4 423**	**5 395**	**5 965**	**6 465**	**6 903**	**6 779**
Shareholders' equity							
Share capital	108	108	108	108	108	108	108
Share premium	659	659	659	659	659	659	659
Hedging reserve	24	24	24	24	24	24	24
Translation reserve	1	1	1	1	1	1	1
Retained earnings	1 920	1 963	2 119	2 279	2 455	2 639	2 850
Total shareholders' equity	**2 712**	**2 756**	**2 911**	**3 071**	**3 247**	**3 431**	**3 643**
Total liabilities + shareholders' equity	**5 505**	**7 178**	**8 306**	**9 036**	**9 713**	**10 334**	**10 421**

Disclosures and Disclaimer

Research Recommendations

Buy	Expected total return (including dividends) of more than 15% over a 12-month period.
Hold	Expected total return (including dividends) between 0% and 15% over a 12-month period.
Sell	Expected negative total return (including dividends) over a 12-month period.

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