Group 5
Bill Beck – Luke McKee – Roah Sham – Grant Taylor

Allegiant Travel Company (ALGT)

KU SCHOOL OF BUSINESS
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Stock Data as of 3.06.2009 (USD)					
Ticker:	**ALGT**	AAI	JBLU	RYAAY	HA
Price (3/6/09):	33.44	2.89	2.96	22.40	2.51
Mkt Cap (M):	676.8	334.7	804.6	6625.7	129.3
EPS (FY2009):	2.84	1.05	0.58	0.53	1.22
F P/E (FY2009):	11.76	2.75	5.10	42.26	2.06
RASM (FY2008):	0.113	0.107	0.104	0.111	0.128
TEV/EBITDAR:	8.53	9.74	1.53	43.65	0.78
P/S (FY2008):	1.34	0.13	0.24	1.54	0.11
P/B (FY2008):	2.93	1.36	0.64	1.68	2.43

We recommend a **BUY** on Allegiant Travel Company.

Investment Thesis

- Allegiant operates a highly streamlined, no-frills business model that generates a high ROE of 15% and ROA of 8%. Both of these operating metrics are substantially higher than their closest competitors' returns.
- Allegiant's low cost airfares and vacation packages prove to be resilient in poor economic times, as their total revenue and net income have grown at 4-year CAGR rates of 40% and 48% respectively. These packages have a history of creating ancillary revenue, which gives Allegiant a competitive advantage over their business class focused rivals.
- Allegiant's use of low traffic airports reduces competition from larger airlines, while using low cost MD80 aircraft on non-stop flights. This cost-based business model has helped them corner a niche market, which has room for rapid growth despite economic hardship.

Company Overview

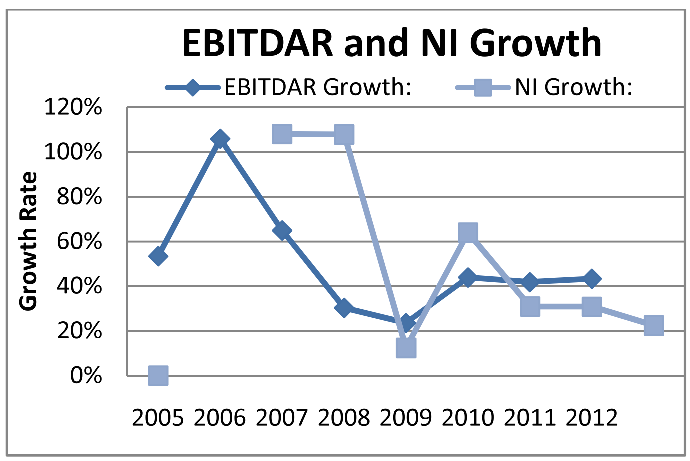
Allegiant Travel Company, founded in 1997,[1] is an airline and travel company that schedules flights out of small cities to leisure destinations in Nevada, Arizona, and Florida. This focus on small cities is a competitive advantage, because they aren't competing for space at high traffic airports. Through partnerships with major hotel chains, and the use of airports near small towns, Allegiant has been able to provide low airfares and hotel rates for various vacation destinations, such as Las Vegas, Orlando, and many other cities around North America. With use of their booking website or customer service hotline, customers can conveniently book their airfare, hotel, and car rental; or any combination of the three.

Along with their low costs and booking ease, Allegiant's business model centers on non-stop flights which are oriented towards leisure travelers. As part of their strategy to keep prices low, Allegiant only charges travelers for services that they use. The passengers are charged extra for any amenities they consume in flight, and pre-selected seats are extra as well. In order to maximize their revenue per flight, they strategically plan their routes and adjust the amount of flights to each destination based on demand and seasonality.[2]

Company Performance

Allegiant Travel Company has historically had a rapidly growing Net Income. Between 2005 and 2007, the company's Net Income doubled yearly, but the growth was much less in 2008 due in part to a high interest rate on income in 2007 that caused an abnormally large increase in the net income for that year. Lower rates in 2008 caused a net interest expense, which resulted in a historically small increase in income. If the interest rates are held constant in the future, we expect Allegiant's Net Income to continue increasing with a 4-year CAGR of 20%.

Historically EBITDAR for Allegiant has increased at a 5-year CAGR of 47%. In 2008, they purchased two of the aircrafts that they were leasing, so their rent expense was less than that of previous years, causing the EBITDAR growth rate to be less than the CAGR at 30%. As the company expands and adds more routes, we believe that the rent expense will start to grow again as more aircraft are leased for operations. Allegiant's 4-year expected CAGR through 2012 is 31%.



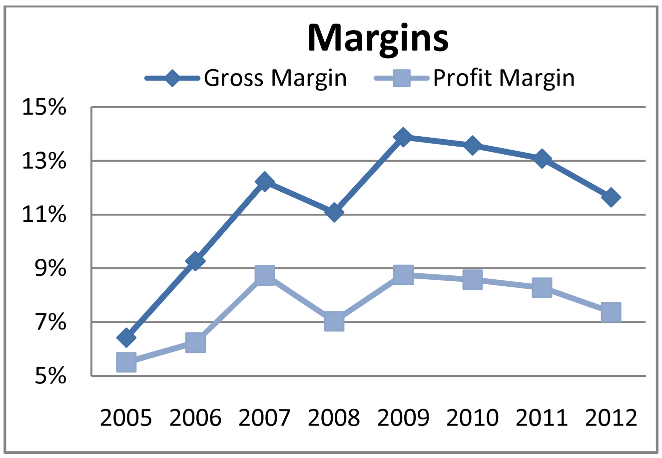
In the past, Allegiant has had volatile free cash flows. In recent history, their cash flows have been positive. In 2008, their free cash flows increased 72% over the previous year, despite the fact that they purchased two of the aircrafts that they were leasing. One reason that the cash flows increased so much that year was due to a reduced amount of cash taxes paid. They paid $4,623,000 in taxes in 2008, which is much less than their 36% tax rate. Before 2007, Allegiant had high

[1] http://www.allegiantair.com/aaAboutAllegiant.php,

[2] Allegiant Travel Company 10-K filed on 3/3/09, pg 1-4

free cash flows because they were a private company and were only subject to state and local taxes.[3] Looking forward, we expect a decrease in cash flows because of the initial increase in maintenance expense required on purchased aircraft, and a higher level of cash taxes paid. After the decrease in 2009, we expect the free cash flows to increase at a 4-year CAGR of 79%.

Allegiant has healthy gross and profit margins, and they are expected to remain high in the future. As depreciation increases in the future on aging aircraft, we expect their margins to drop slightly. Also, we expect the low fuel prices to increase in the future which will deteriorate some of their margins in the long run.



Las Vegas Revenues

Las Vegas is a major source of travel for Allegiant's business. Flights to Las Vegas are scheduled to make up one third of the company's capacity in 2009. The current economy has hurt the casino industry, but has not impacted Allegiant's business to the same extent. The casinos have cut prices on room rates by an average of 40% which has given incentive for customers to travel. Allegiant has made agreements with 61 hotels in Las Vegas to create flight packages that come with a room reservation. These room packages are a valuable source of ancillary revenue for the company. Allegiant has seen ancillary revenue grow 76% to $114 million in 2008. These revenue streams helped Allegiant to increase their RASM from 8.78 cents to 11.35 cents for 2008. Given the importance of ancillary revenue, and the recent increase in inbound flight volume, the downturn in the Las Vegas economy looks to create a competitive advantage for Allegiant, rather than becoming a liability.

[3] Allegiant Travel Company 10-k filed on 3/3/09, pg 41

Comparable Companies

Since Allegiant is a smaller company with limited cities of operation, the company cannot be compared to large international companies. To compare key ratios and statistics, we chose Ryanair, JetBlue Airways, AirTran, and Hawiaan Air as comparables.

Comparable Ratios

Comp	ROA	ROE	Gross Margin	Net Margin	EBITDAR Margin
AAI	-13.3%	-111.3%	-2.8%	-10.7%	0.4%
JBLU	-0.1%	-0.6%	3.2%	-0.2%	7.6%
RYAAY	-1.5%	-1.6%	2.2%	-1.4%	3.7%
HA	3.1%	53.6%	7.6%	2.4%	16.7%
AVERAGE	-2.9%	-15.0%	2.5%	-2.5%	7.1%
ALGT	8.4%	15.1%	11.1%	7.0%	16.2%

Allegiant maintains low aircraft rental obligations relative to its competition. In 2008, Allegiant spent 0.56% of its revenues on rental obligations, compared to the industry average of 5.82%. Their rental obligation is low because they own 36 of the 38 aircraft in their fleet, and those that are leased are low cost MD82 aircraft.[4]

Allegiant was one of the few small airlines to turn a profit in 2008. Relative to their comparables, Allegiant boasted the top Net Margin (7.03%), top Gross Margin (11.08%), top Return on Assets (8.35%), the second highest Return on Equity (15.14%), and the second highest EBITDAR Margin (16.18%). In addition, Allegiant maintained above average Revenue per Average Seat Mile ($0.1135), while showing growth in their Available Seat Miles (ASM) of 14.93% from 2007.[5]

For 2008, Allegiant created $1.73 EPS, which was far above the comparable average of $-0.24. Forward EPS projections suggest that Allegiant ($3.97) will outstrip the comparable average of $1.36 for 2009. Much of this success can be attributed to Allegiant's fourth quarter success, relative to the competition. For the fourth quarter, Allegiant reported an EPS of $0.88, whereas the comparables averaged $-0.11.[6] The relatively strong projections reflect Allegiant's strong financial health, ability to grow, and the poor fuel hedging practices of the comparables.

[4] Allegiant 2008 10-K, pg. 34

[5] Allegiant 2008 10-K, pg. 32

[6] Thomson One Analytics, 3/7/2009

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Relative Valuation

Outside of Allegiant, the only company to show positive 2008 EPS results was Ryanair, which is the best comparable in terms of business strategy. By using a 2008 P/E multiple, Allegiant (19.33) is undervalued relative to Ryanair (28.72). When comparing the company's, however, we found that the 2008 P/E ratios don't accurately represent airline industry's performance because of the large losses that airlines suffered during Q42008, which caused negative earnings in most cases. Ryanair maintained a higher Price/Sales ratio (1.54) than Allegiant (1.34). The most interesting contrast between the two was Allegiant's small TEV/EBITDAR multiple (8.53) relative to Ryanair's (43.61). This suggests that Allegiant outperformed Ryanair in 2008 and has better growth opportunity. When compared with the comparables' TEV/EBITDAR average of 14.21, Allegiant is undervalued by 125%. Allegiant did, however, have a high Price/Book ratio (2.89) relative to the entire comparable average (1.54).[7]

DCF Valuation

In our DCF model we are using EBITDAR rather than EBITDA since EBITDAR is better measurement of companies that have high rent or lease expenses. Based on the historical data, since 2004 Allegiant's CAGR for revenue and expense is about 40%. We assume both percentages should remain about the same because of the Small market Cap firm like Allegiant should have relatively high growth. The CAGR of depreciation is 60% and we assume that this would have the same rate in the future because they have a history of acquired many aircrafts in the past and have made plans to acquire more going forward. Capital expenditure is assumed to have a 30% growth rate in the future and cash taxes are expected to remain at 35% of operating income. These constants enabled us to predict the free cash flow.

For WACC we used 7.3% for their debt cost before tax, which is the average rate they pay for the bank notes. The beta for Allegiant is now 0.3, which will not be appropriate when forecasting the future price, so we decided to use the average beta of comparable companies which is 1.2. Assuming a market risk premium of 7%, we calculated a WACC to equal 10.36%. We used a conservative 2%-3% future growth rate for the terminal value.

As a result, we project intrinsic values of $83.69 & $92.56 for the 2% & 3% growth rates, respectively. Both of these values suggest Allegiant is undervalued by over 100% compared when to the 3/06/2009 closing price of $33.44. The following table shows more detailed information for the valuation.

DCF VALUATION		
Terminal Value Growth	2%	3%
Implied Equity Value	1,702,287	1,882,687
Shares Outstanding	20340	20340
Intrinsic Value per share	83.69	92.56
Current Price	33.44	33.44
Under (Over) Value	150.3%	176.8%
WACC	10.36%	

Wall Street Projections

The prevailing opinion amongst analysts is that Allegiant will outperform the industry average. Many of these strong endorsements came on the heels of Allegiant's announcement of better than expected earnings for the fourth quarter of 2008. Earnings per share for fourth quarter was $0.88, which was higher than the consensus analyst projection of $0.64.[8] These earnings also occurred during a quarter in which the economic downturn hammered industry rivals.

2009 analyst projections for Allegiant are strong across the board. The main factors cited were Allegiant's high operating margin of 23.4% for Q4 2008, the fact that many competitors hedged during high oil prices, and their focus on careful, methodical growth in their niche leisure market. Many of Allegiant's competitors hedged their fuel prices at around $100 a barrel (with the key exception being Ryanair), while Allegiant maintained their stance of paying market rates. 2009 projections for the price of oil are significantly lower than $100 a barrel. In addition, their small amount of long-term debt and healthy amounts of cash will enable Allegiant to invest in growth, while their competitors worry about defaulting. Consensus projections for 2009 EPS are $3.97.[9][10][11]

[7] Ryanair 20-F 2008, & Q3 2009 results

[8] Thomson One Analytics, 3/7/2009

[9] Avondale Partners: Allegiant analyst report Q4 2008

[10] Jesup & Lamont: Allegiant analyst report Q4 2008

[11] Bank of America Merrill Lynch: Allegiant analyst report Q4