

# Peru's first Low Cost Airline



Discover a Lost Empire

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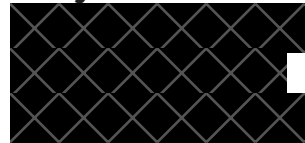
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## Investment Highlights

- Total estimated project investment US \$25 million
- Total Project Value - US \$116.2 million
- Internal Rate of Return Year 5 (COK of 20%) – 32.1%
- Payback Period (Nominal) – 3.46 years
- Annual Sales of US \$518 million by end of Year 5
- EBITDA of US \$74 million (13.9%) by end of Year 5
- Positive Cash Generation of US \$2.79 million by end of Year 2 growing to US \$71.87 million by end of Year 5.

## 1. Introduction

**a. The first authentic LCC in Peru. Phase 1, Year 1 – Arequipa:** this project aims to establish the first authentic Low Cost Carrier (LCC) in Peru – IncaJet - with a main base in the Southern city of Arequipa, the second largest city in the country and a major ground transportation hub for the South of Peru, Bolivia and Northern Chile. IncaJet’s initial main focus in Phase 1 will be to develop a route network comprising this geographical region.

**b. Phase 2, Year 2 – Cusco:** Phase 2 will see the development of an additional Route Centre in Cusco operating flights throughout the whole of Peru as well as international flights to Bolivia and Brazil.

**c. Phase 3, Year 3 – Chiclayo:** Phase 3 will see a further Route Centre established in the Northern port city of Chiclayo operating flights throughout Peru as well as international flights to Ecuador and Brazil.

Whilst not included in the initial current Financial Model, the project team believe that great potential exists in the medium and long term to develop IncaJet flights from Arequipa and Cusco to cities throughout South America, Central America and North America.

The development of new international airports at Chincheros, Cusco and La Joya, Arequipa during the next 3 years will allow IncaJet to operate long-haul flights to key cities including Buenos Aires, Rio de Janeiro, Sao Paulo, Mexico City and Miami. Furthermore, the construction of a second runway and a new air terminal at Lima Airport within the next three years will offer IncaJet the opportunity to establish a major route centre in the capital, subject to existing market conditions, when construction work has been completed.

**d. ‘Benchmarking’ Best Practice from Global LCCs:** IncaJet will adopt well-proven aspects of successful business strategies used by LCCs such as Southwest Airlines and Spirit Airlines in the USA, easyJet and Ryanair in Europe and Viva Columbia in South America, the latter being the only authentic LCC currently operating in the South American hemisphere.

Much of the day-to-day flight operations of IncaJet will be modelled on easyJet, one of the leading LCCs in the world with an acknowledged reputation for high standards of operational safety, customer satisfaction, competitive low one-way fares and consistently strong profitability. The IncaJet product offer will replicate easyJet’s ‘no frills’ approach and customers will pay individually for any services they require in addition to the basic ticket price.

**e. The LAN ‘Issue’:** a key part of the initial strategy is to avoid wherever possible head-to-head competition with market leader LAN, hence the decision to base the airline in Arequipa, South Peru and to develop Route Centres in Arequipa, Cusco and Chiclayo in Phases 1, 2 & 3 rather than Lima, LAN’s Peruvian hub.

**f. Exit Strategy for Investors:** Future opportunities exist for either an IPO or a Trade Sale.

#### g. Completed Actions:

- Flexible, comprehensive 5-year Financial Model
- Marketing and Commercial Strategy
- Meetings held with the Peruvian Transport Minister and the Head of the DGAC (FAA/EASA equivalent)
- Meetings held with senior politicians including the new Regional Governor of Arequipa, Miss Yamila Osorio.
- Meetings held with the senior management of AAP, the operating company of Arequipa Airport and all main airports in South Peru including Cusco
- Meetings held with senior management of third party ground handling/ engineering & maintenance companies
- Meetings held with senior management of Boeing

## 2. Positive South American and Peruvian Economic Trends

**a. Economic Growth & Inflation:** the economy of Andean South America enjoyed an annual growth rate of more than 5% per annum from 2005 to 2013 and whilst growth in Peru dipped from 6% in 2013 to 2.4% in 2014, The International Monetary Fund (IMF) forecasts positive growth of 2.8% in 2015, 3.5% in 2016 and for several years thereafter. Whilst inflation increased slightly to 3.2% in 2014, The IMF forecasts annual inflation of 3.5% in 2015 and 3% per annum for 2016 with a slight decrease in the medium term. Interest rates are currently 3.5% and not forecast to vary significantly in the short to medium term.

**b. Average and First Quartile Average Income:** the average income in Peru has risen strongly in recent years. More interesting is that the top 25% of the population's income is rising by 9% per annum and currently stands at \$12,000 per annum. This provides a domestic national passenger population of approximately 17m. In general those defined as middle class will grow by about 2m in the next few years. Such figures as these are strong indicators of potential airline travel growth.

## 3. Attractive underlying Market Resilience

**a. Potential Customer Base:** a potentially large customer base exists nationally and internationally which linked to positive economic growth and a growing middle class in the region provides a solid business base from which to grow IncaJet over the next five years.

**b. Key Target Market Segments:** the business strategy focuses on several key market segments namely the conversion of up to 10% of inter-regional coach passengers; regional international passengers between Peru, Chile, Bolivia, Brazil and Ecuador; global international passengers visiting Peru from North America, Europe, Asia and the remaining countries of South America.

**c. 'New travellers':** this is a sizeable market segment which has been successfully developed by easyJet in Europe as well as other major LCCs around the world, most recently by Viva Colombia in Colombia but also including Southwest Airlines, Spirit Airlines, easyJet and Ryanair in the USA and Europe.

## 4. Coach Transport Substitution

**a. Coach Passenger Substitution:** Peru has an extensive interprovincial and inter-regional coach network but no rail or motorway networks. Due to the terrain, these are unlikely to be developed in the near term. With a low one-way fares strategy – fares from US \$25 including tax - there is an excellent opportunity to persuade passengers to transfer from coach travel to IncaJet, especially as some routes take up to 18 hours by coach but only 1 hour by air. An example of this is Arequipa-Lima, a coach journey of 18 hours but just over an hour's flying time. Currently there are 122 coach services daily between Arequipa and Lima – over 6,000 available seats every day with occupancy rates in the high 90s %.

A 10% transfer of inter-regional coach passengers from regional hub catchment provinces would amount to over 870,000 potential air passengers in Year 1, 1.3 million in Year 2 and 1.8 million in Year 3. Our market research indicates that customers in this market segment will typically purchase on average 2 sectors per customer.

## 5. International Travel Demand

**a. 'Global' International Travellers to Peru:** Due to very high domestic fares charged to international visitors by the leading carriers LAN and Avianca – sometimes three times greater than those offered to local Peruvian air travellers – a significant majority of the 3.2 million international tourists to Peru in 2014 did not use air travel during their visit, typically 2 to 3 weeks duration.

However, IncaJet's non-discriminatory pricing plus its low one-way fares product will have a major impact on generating at least 20% passenger demand within this vital market segment. Based on primary and secondary market research, it is estimated that the average number of sectors purchased in this segment will be **4 sectors per customer**. A typical international tourist itinerary on IncaJet in Year 1 might be Lima – Cusco - La Paz – Arequipa - Lima.

An integral part of IncaJet's international strategy is to forge links where possible with airlines feeding the IncaJet network including 'Skyteam' member airlines – including Air Europa, Delta Air Lines, KLM-Air France, Aeromexico and Aerolineas Argentina - in Lima, Santa Cruz and La Paz Bolivia, Santiago Chile, Manaus Brazil and Quito and Guayaquil in Ecuador. The potential customers from these airlines will predominantly be from North and South America, Europe and Asia-Pacific.

Leading aircraft manufacturer Boeing forecasts an average annual growth of c. 6% in international air travel to and within South America over the next 10 years. Indeed, an increase in international capacity to South America, especially from North America, Europe and Asia-Pacific, plus a decrease in leisure travel fares is clear evidence of a significant international tourism stimulus. Furthermore, the new British Airways service commencing in May 2016 from London to Lima with four flights weekly by Boeing 777s is a strong indication of Peru's ever-growing international tourism potential.

**b. Regional International Travel – Chile, Bolivia, Brazil & Ecuador:** the project team also forecast significant national and international demand on IncaJet's regional international routes between Peru-Chile, Peru-Bolivia, Peru-Brazil and Peru-Ecuador. In the case of Peru-Chile routes, a significant number of high-earning Chilean passengers is forecast, especially motivated by the fact that goods and services in Peru are often less than half price compared to Chile. Our market research indicates that travellers in this regional international market segment will typically purchase **3 sectors per customer**.

## 6. Five Year Growth Plan

**a. Sales, Profits & Cash Generation:** the five the five year business plan shows sales increasing from USD \$80.6 million in Year 1 to USD \$518.0 million in Year 5. Profits before tax and depreciation increase to USD \$74.0 million by Year 5: cash generation increases from US \$2.79 million in Year 2 to US \$71.9 million by Year 5.

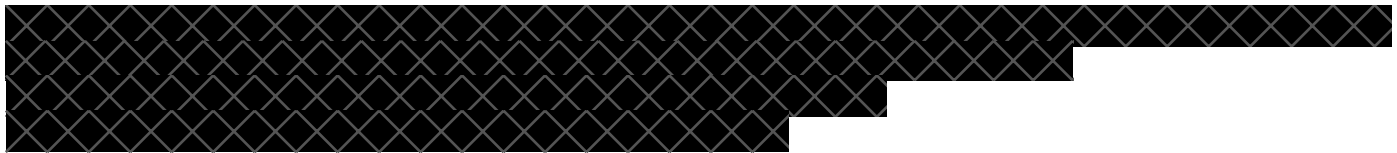
**b. Potential Passenger Numbers:** in Year 1, IncaJet aims to fulfil c. 1.1 million passenger-sectors and more than 6 million passenger-sectors by the end of Year 5. Extensive market research data is available to demonstrate 'demand' throughout various market segments. Most importantly, it should be kept in mind that the majority of IncaJet's regional and global international customers will be purchasing an average of 3 to 4 sectors per transaction.

## 7. Highly Experienced Management Team

**a. British & Peruvian team members:** the Proyectos Inca management team consists of a highly experienced British group of senior airline managers with extensive experience of establishing the Low Cost Carrier model, together with local Peruvian managers from Arequipa who know the environment well. Included in the UK team are a former CEO & Chairman of Airtours International PLC in addition to a former Director of easyJet who was a member of the senior management team from 1995-2005, the year of easyJet's first IPO.

**b. Mentoring:** it is an important aim of the project team to use their extensive senior management experience to closely mentor and establish a strong local Peruvian management team in the medium term.

## 8. Proyectos Inca Team – Career Highlights



**Kieron Heath (UK)** UK & Ireland Manager Delta Air Lines Inc; CEO Travel & Tourism Marketing Ltd; CEO Access! (International Travel and Tourism Marketing & PR)

**Jose Roca (Peru)** Marketing & IT Consultant

**Julio Gomez (Peru)** Finance & Management Consultant

## 9. VivaColombia – an authentic South American LCC Benchmark

**a. Viva Colombia's impressive growth in 2.5 years:** regional and international carriers in west coast South America currently follow a traditional 'legacy' or 'hybrid' airline model, with the exception of Viva Colombia, an authentic LCC which entered the Colombian market in May 2012 in competition with Avianca, LAN and COPA. Viva Colombia essentially emulates the European and US LCC models and despite intense competition, the carrier has captured 11% of the national domestic market within 2.5 years. In 2014, Viva's average Load factor was an impressive 89%!

**b. Viva Colombia: Proof that an LCC can compete against LAN and Avianca:** the project team believes that Viva Colombia's strong growth and development in Colombia against significant and well established competition – as in Peru - proves that IncaJet's LCC model can operate successfully in the South American environment. (NB Official Viva Colombia passenger, traffic and financial data is available)

**c. Viva Colombia International Flights:** Viva Colombia has recently commenced international flights and is the first South American LCC to offer low one-way fares between Colombia and Peru (Bogota-Lima). In Phase 1 IncaJet will be offering international services to Chile and Bolivia using the same Low Fares strategy.

## 10. Summary - Key features of IncaJet's strategy

- British senior airline executives developing the project and directing the company.
- State-of-the-art Computer Reservation System (CRS) and Revenue Management System
- Low one-way Fares from \$25 including tax
- 'No Frills' basic product plus Ancillaries Revenue Generation
- Highly efficient and cost-effective aircraft scheduling and crew utilisation
- High levels of global marketing and promotion
- Cost-saving Third Party outsourcing of labour-intensive functions such as ground handling and check-in



## Company Summary & Cash Flow

<b>COMPANY SUMMARY IN US \$</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>REVENUE</b>					
Scheduled (incl. TAX)	\$80,570,780	\$176,237,903	\$283,357,222	\$394,529,261	\$517,971,025
<b>TOTAL REVENUE (incl. Taxes)</b>	<b>\$80,570,780</b>	<b>\$176,237,903</b>	<b>\$283,357,222</b>	<b>\$394,529,261</b>	<b>\$517,971,025</b>
<b>COSTS</b>					
Total Selling Costs (including taxes)	\$23,222,775	\$49,781,212	\$75,030,578	\$101,146,440	\$128,501,689
Total Fuel	\$22,829,691	\$45,348,091	\$70,081,800	\$95,688,584	\$123,199,052
Other DOCs	\$18,857,789	\$36,999,844	\$56,950,300	\$77,738,792	\$100,105,123
<b>Total DOCs</b>	<b>\$64,910,255</b>	<b>\$132,129,148</b>	<b>\$202,062,679</b>	<b>\$274,573,816</b>	<b>\$351,805,864</b>
Fixed Costs	\$15,752,428	\$25,569,447	\$34,094,972	\$45,331,663	\$56,496,222
Ownership costs	\$8,190,000	\$15,750,000	\$23,310,000	\$30,870,000	\$37,800,000
<b>Total Fixed Costs</b>	<b>\$23,942,428</b>	<b>\$41,319,447</b>	<b>\$57,404,972</b>	<b>\$76,201,663</b>	<b>\$94,296,222</b>
<b>TOTAL COSTS (incl. Taxes)</b>	<b>\$88,852,683</b>	<b>\$173,448,594</b>	<b>\$259,467,651</b>	<b>\$350,775,479</b>	<b>\$446,102,086</b>
<b>EBITDA</b>	<b>-\$8,281,904</b>	<b>\$2,851,809</b>	<b>\$24,014,571</b>	<b>\$43,941,283</b>	<b>\$72,118,939</b>
<b>EBITDA %</b>	<b>-10.3%</b>	<b>1.6%</b>	<b>8.5%</b>	<b>11.1%</b>	<b>13.9%</b>
<b>LOAN INTEREST</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>PROFIT/LOSS (EBITDA)</b>	<b>-\$8,281,904</b>	<b>\$2,851,809</b>	<b>\$24,014,571</b>	<b>\$43,941,283</b>	<b>\$72,118,939</b>
<b>CASH FLOW</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Add back maintenance reserves	\$10,046,449	\$19,909,728	\$30,662,528	\$41,863,516	\$53,899,276
Less Maintenance spend	-\$10,046,449	-\$19,909,728	-\$30,662,528	-\$41,863,516	-\$53,899,276
Add back Insurance	\$2,130,413	\$4,215,590	\$6,423,962	\$9,067,039	\$14,687,890
Less insurance paid quarterly	-\$2,130,413	-\$4,215,590	-\$6,423,962	-\$9,067,039	-\$14,687,890
Add back Depreciation	\$490,500	\$490,500	\$490,500	\$3,000	\$3,000
Add Back Depreciation on additions	\$0	\$62,500	\$125,000	\$187,500	\$250,000
<b>START-UP WORKING CAPITAL - OPENING BALANCE</b>	<b>\$8,638,380</b>				
<b>TOTAL</b>	<b>\$846,976</b>	<b>\$3,404,809</b>	<b>\$24,630,071</b>	<b>\$44,131,783</b>	<b>\$72,371,939</b>



## Drivers

<b>INCAJET - DRIVERS</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Total Scheduled Passengers	1,070,974	2,277,706	3,582,486	4,802,531	6,071,313
Total Scheduled Revenue + Ancillaries (including Taxes)	\$80,570,780	\$176,237,903	\$283,357,222	\$394,529,261	\$517,971,025
Total Scheduled Revenue + Ancillaries (excluding Taxes)	\$63,286,179	\$138,804,403	\$226,605,941	\$316,973,326	\$418,059,155
Scheduled Revenue including Ancillaries per Sector	\$6,428	\$7,536	\$8,199	\$8,654	\$9,127
Scheduled Revenue including Ancillaries per Block Hour	\$5,099	\$5,790	\$6,314	\$6,664	\$7,028
Total Costs (including Taxes)	\$88,852,683	\$173,448,594	\$259,467,651	\$350,775,479	\$446,102,086
Total Costs (excluding Taxes)	\$71,568,082	\$136,015,094	\$202,716,371	\$273,219,543	\$346,190,216
Total Costs (excluding Taxes & Fuel)	\$48,738,391	\$90,667,003	\$132,634,570	\$177,530,960	\$222,991,165
Total Fuel Costsv	\$22,829,691	\$45,348,091	\$70,081,800	\$95,688,584	\$123,199,052
Costs per Sector	\$7,269	\$7,385	\$7,334	\$7,459	\$7,558
Costs per Block Hour	\$5,766	\$5,674	\$5,648	\$5,744	\$5,820
Total ASK (Available Seat Kilometer)	957,233,775	1,830,191,697	2,747,226,799	3,632,628,904	4,540,786,130
Total RPK (Revenue Passenger Kilometer)	698,780,656	1,519,059,108	2,390,087,315	3,196,713,436	4,041,299,656
Revenue per Passenger Kilometer (RPKs) - US cents (excluding Taxes)	9.06	9.14	9.48	9.92	10.34
Cost in US Cents per Available Seat Kilometer (CASKs) - incl. Fuel (excluding Taxes)	7.48	7.43	7.38	7.52	7.62
Cost in US Cents per Available Seat Kilometer (CASKs) - excluding Fuel (excluding Taxes)	5.09	4.95	4.83	4.89	4.91
Average Load Factor	73%	83%	87%	88%	89%
Break-Even Load factor (BELF)	83%	81%	78%	76%	74%
Average Revenue per Passenger incl. ancillary revenue (excluding tax)	\$59	\$61	\$63	\$66	\$69
Average Revenue per Passenger incl. ancillary revenue (including tax)	\$75	\$77	\$79	\$82	\$85
Number of Routes	14	31	52	52	52
Operating Profit per pax	-\$7.73	\$1.22	\$6.67	\$9.11	\$11.84
Contribution per pax	\$60.61	\$58.01	\$56.40	\$57.17	\$57.95
Fixed cost per pax	\$22.36	\$18.14	\$16.02	\$15.87	\$15.53
Change in Costs		90.0%	49.0%	34.8%	26.7%
Total Passengers	1,070,974	2,277,706	3,582,486	4,802,531	6,071,313
Change in Passengers		112.7%	57.3%	34.1%	26.4%
Change in CASK - Cents per Available Seat Kilometer		-0.6%	-0.7%	1.9%	1.4%

## Operating Data

<b>OPERATING DATA</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
	<b>Phase 1</b>	<b>Phases 1-2</b>	<b>Phases 1-3</b>	<b>Phases 1-3</b>	<b>Phases 1-3</b>
<b>FLEET - BOEING 737-700 (149 SEATS)</b>	3	6	9	12	15
<b>SECTORS/CYCLES</b>					
<b>Total Fleet annual sectors flown</b>	9,846	18,418	27,639	36,628	45,806
<b>Average Sectors daily per aircraft</b>	9.0	8.4	8.4	8.4	8.4
<b>BLOCK HOURS (BHs)</b>					
<b>Total Annual Block hours</b>	12,411	23,972	35,889	47,567	59,481
<b>Average Block Hours daily per aircraft</b>	11.3	10.9	10.9	10.9	10.9
<b>Average Block Hours per sector</b>	1.3	1.3	1.3	1.3	1.3
<b>FLIGHT HOURS (FHs)</b>					
<b>Total Annual Flight Hours</b>	10,147	19,568	29,364	38,919	48,667
<b>Average Flight Hours daily per aircraft</b>	9.3	8.9	8.9	8.9	8.9
<b>Average Flight Hours per sector</b>	1.0	1.1	1.1	1.1	1.1