



ICRA

INDIAN AVIATION INDUSTRY

Domestic air travel in June 2022 short by ~12% compared to pre-Covid levels; international traffic for Indian carriers surpasses pre-Covid levels by ~18%

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BUSINESS OUTLOOK: NEGATIVE



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ICRA expects a fast-paced recovery of domestic passenger traffic in FY2023, aided by normalcy seen in domestic operations and widening vaccination coverage. However, the earnings recovery for domestic airlines will be slow-paced due to sharp escalations seen in ATF prices and a depreciating rupee.

In the near term, the credit profile of Indian carriers will remain stressed until they are able to reduce their debt burden through a combination of improvement in operating performance and / or by way of equity infusion.

In June 2022, domestic air passenger traffic is estimated at ~105 lakh, ~13% lower compared to ~121 lakh in May 2022. However, it witnessed a YoY growth of 2.39 times, as passenger traffic was severely hit in June 2021, following the disruption caused by the second-wave of Covid-19 and only ~12% lower compared to pre-Covid levels. The airlines' capacity deployment in June 2022 was 1.62 times higher than June 2021. Further, capacity deployment in June 2022 was lower by ~4% than the pre-Covid levels. On a sequential basis, the number of departures in June 2022 declined by ~4%, given some impact of the cyclicity in passenger travel driven by reopening of schools post the summer vacation. International passenger traffic continues to rise since the resumption of scheduled international operations with effect from March 27, 2022. In June 2022, the international passenger traffic for Indian carriers was ~21.4 lakh, thereby surpassing pre-Covid levels of ~18.1 lakh by ~18%.

Steady rise in prices of aviation turbine fuel (ATF) and general inflationary environment continue to dampen the industry earnings, with prices in mid-June 2022 being higher by ~120% on a YoY basis, and ~15% sequentially, a direct result of increased crude oil prices due to the ongoing geo-political issues. The other issue which has been adding to the industry woes recently has been depreciation in rupee against dollar, given 35-50% of operating expenses of the airlines are denominated in US\$. While airlines have been increasing yields but the same has not been adequate to offset the impact of the rising ATF prices, in ICRA's view.

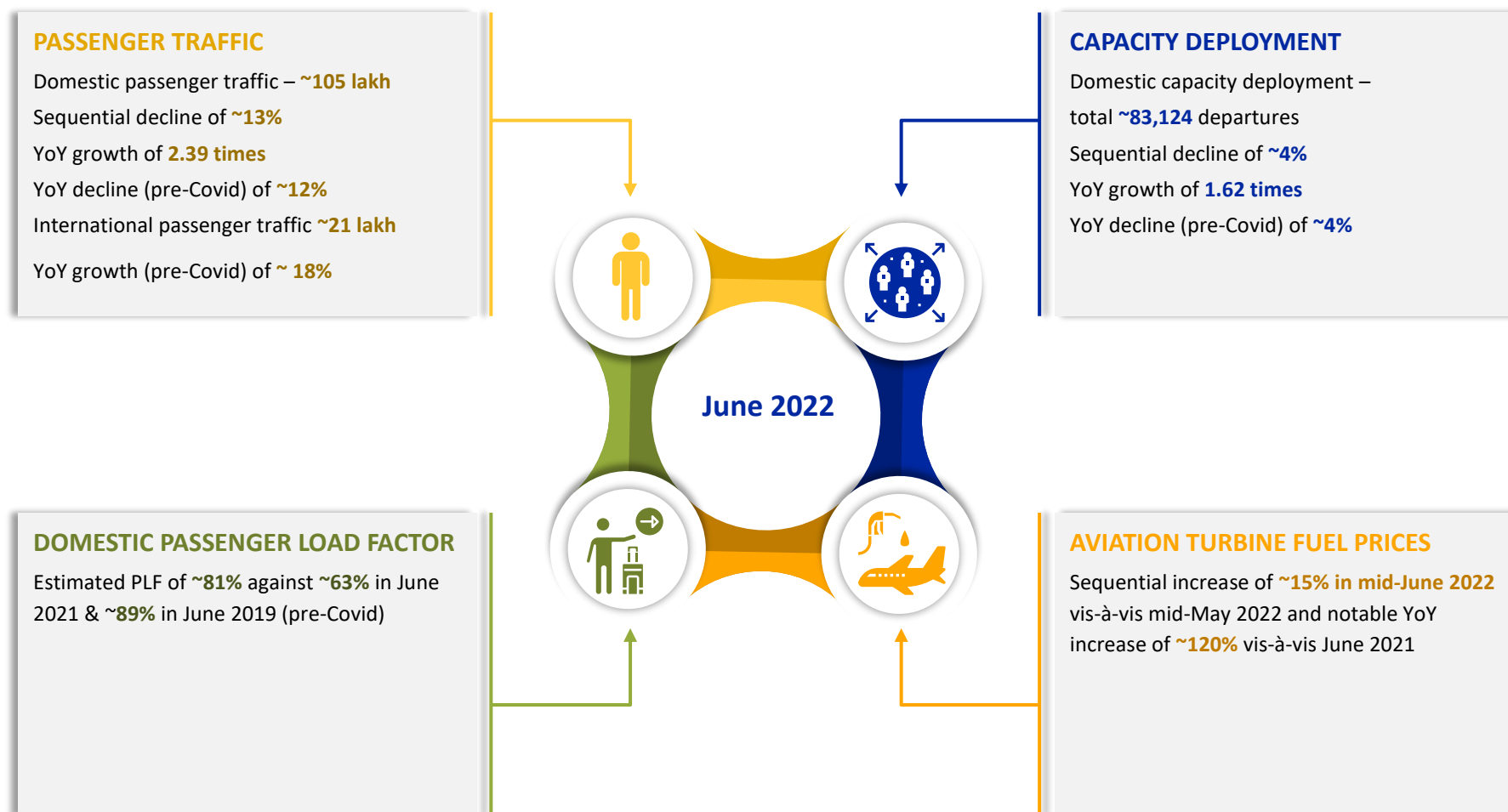
- **ICRA continues to maintain a Negative outlook on the Indian aviation industry** - The outlook reflects ICRA's view that the financial performance of Indian airlines is likely to remain under pressure in the near term, even as recovery in domestic passenger traffic has been healthy. Escalating ATF prices will continue to pose a major threat to earnings and liquidity profile of the airlines in the near to medium term. The same has been aggravated by depreciation of rupee against dollar, given ~35-50% of the airlines' operating expenses – including operating lease payments, fuel expenses and a significant portion of aircraft and engine maintenance expenses – are denominated in US\$. Hence every depreciation in rupee against the dollar adds to the operating cost of the airline.

Recovery in domestic passenger traffic to be fast paced in FY2023, driven by normalcy in domestic operations while the rising level of Covid infections in certain pockets will remain monitorable - A steady decline in Covid-19 infections from June 2021 onwards and easing restrictions by various state governments enabled the domestic passenger traffic to grow sequentially from July 2021 to December 2021. While in January 2022, it declined sequentially by a sharp ~43% due to the emergence of the new variant of Covid-19 and related restrictions, it improved sequentially by ~19% and ~37% in February 2022 and March 2022, respectively, due to the waning impact of the Omicron wave. On a YoY basis, domestic passenger traffic was notably higher by 2.39 times in June 2022 and it remained ~12% lower than the pre-Covid levels i.e. June 2019. On a sequential basis there was dip of 13% compared to May22, which can largely be attributed to cyclicity in demand, given reopening of schools in June post the summer vacation. Although recovery in passenger traffic is expected to be relatively fast paced in FY2023, aided by recovery in corporate travel and steady demand from leisure traffic,

an overhang of any further Covid wave looms on the sector in case the recent rise in Covid infections in certain pockets of the country spreads nationwide. Further, a sharp rise in air fares also remain a monitorable.

- **Earnings recovery in FY2023 is likely to be slow paced owing to escalating fuel prices** - The onset of Covid-19 3.0, along with continued high fuel prices, delayed the demand recovery in FY2022. Consequently, the industry is expected to report a loss of ~Rs. 250-260 billion in FY2022. Further, the recovery in industry earnings in FY2023 will also be gradual due to the steep increase in fuel prices. While the airlines have been steadily raising air fares but the same has not been adequate to offset the impact of the sharp rise in ATF prices. In ICRA's view, domestic air traffic yields (as measured by Passenger Revenues/Revenue Per Kilometre (RPK)) have increased by 18-20% over the past 12 months. ICRA expects the industry aggregate loss to moderate to ~Rs. 140-160 billion in FY2023 due to the expected recovery in passenger traffic and lower interest burden due to significant reduction in Air India Limited's debt before the divestment by the Government of India. Overall, the industry will require additional funding support of ~Rs. 200-220 billion over FY2022 to FY2024.
- **Select airlines face financial distress, stretched liquidity issues** - While some airlines have adequate liquidity and/or financial support from a strong parent, which is likely to help them sustain over the near term, for others, the credit metrics and liquidity profile have been under significant stress over the past few years. To ease liquidity pressures, most airlines had undertaken several cost rationalisation measures, including salary cuts for their employees, leave-without-pay options and laying off of pilots and crew members to cut costs during the pandemic. Some airlines have also sought a deferment in their lease rental payments to improve their liquidity positions. Others have also entered sale and lease back transactions to shore up liquidity in the near term. However, until profitability and cash inflows improve considerably, most airlines will require funding support to meet their expenses.

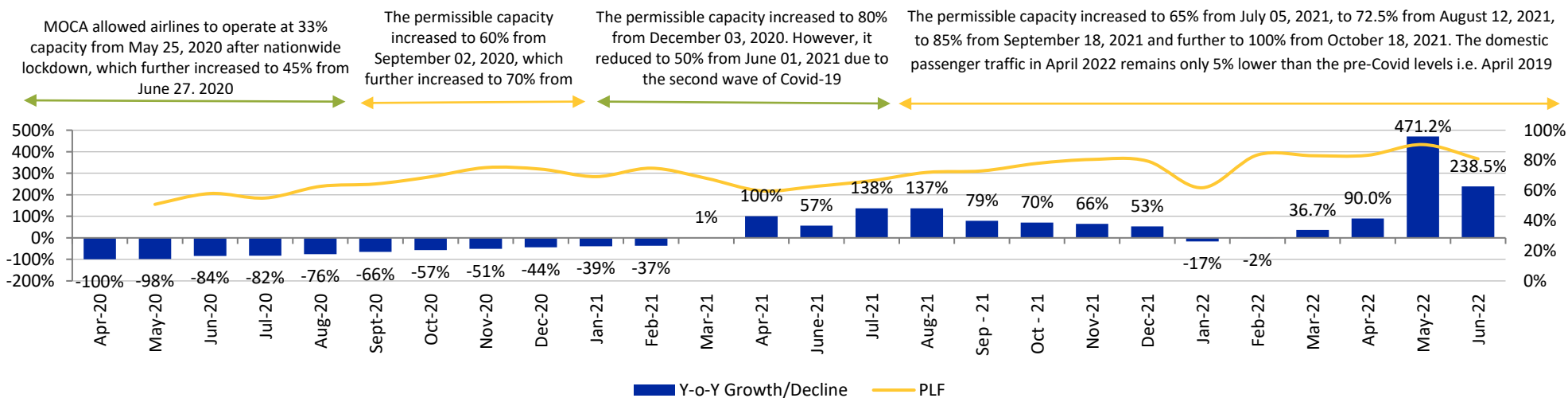
¹ Aggregate of Air Asia India Limited, Air India Limited, Go Airlines (India) Limited, Interglobe Aviation Limited, Tata SIA Airlines Limited and SpiceJet Limited; Excludes debt of Rs. 295 billion transferred from Air India Limited to a special purpose vehicle (SPV) with effect from October 01, 2019



DOMESTIC PASSENGER TRAFFIC: SEQUENTIAL DECLINE OF ~13% IN JUNE 2022 AND LOWER BY ~12% THAN THE PRE-COVID LEVEL I.E. JUNE 2019

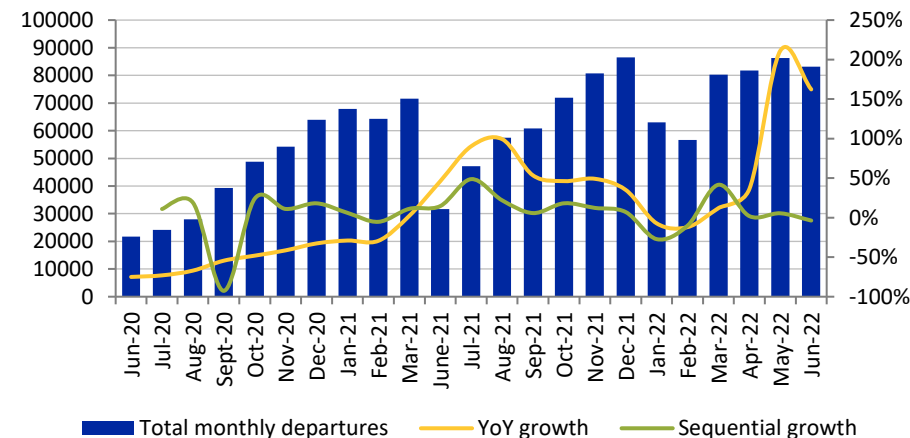
With the onset of Covid 2.0, the MoCA had reduced the permissible capacity deployment by airlines on domestic routes to 50% of pre-Covid levels with effect from June 01, 2021. The permissible capacity deployment was gradually increased to 65% from July 5, 2021 to 72.5% from August 12, 2021 and to 85% from September 18, 2021 before removing restrictions, with effect from October 18, 2021. The capacity deployment for June 2022 was notably higher by 1.63 times than June 2021 (83,124 departures in June 2022 against 31,693 departures in June 2021) due to significant decline in Covid-19 infections and near normalcy position seen in business operations as well as June 21 was impacted due to Covid 2.0. The number of departures in June 2022 were lower by ~4% on a sequential basis as well as lower by ~4% compared to departures of 86,456 in June 2019 (pre-Covid).

EXHIBIT 1: Domestic Passenger Growth & PLF



Source: MoCA, DGCA, ICRA Research

EXHIBIT 2: Trend in Capacity Deployment by Domestic Airlines

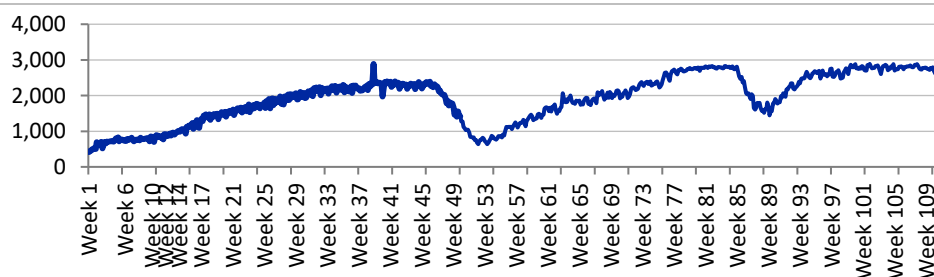


Source: MoCA, DGCA, ICRA Research

For June 2022, domestic passenger traffic stood at ~105 lakh, against ~31 lakh in June 2021, implying a significant growth of 2.39 times on a YoY basis. On a sequential basis, domestic passenger traffic declined by ~13% over ~121 lakh in May 2022. As seen in Exhibit 3, Since March 2021, given the resurgence of the second wave of the pandemic, daily passenger traffic was on a continuous decline, gradually declining to 70,098 on Day 372 (May 31, 2021). Later, with decline in daily infections, domestic passenger traffic witnessed a gradual improvement with a new peak of 393,245 on Day 545 (November 21, 2021). However, the rising trend in passenger traffic witnessed a reversal in January 2022 with the emergence of the new variant of Covid-19 and reactionary restrictions by a few states on air travel. With the waning Omicron wave, however, passenger traffic witnessed a sequential growth of ~20% in February 2022, ~39% in March 2022 and ~2% in April 2022. On April 17, 2022, domestic passenger traffic at 407,975 crossed the 4-lakh daily passenger mark for the first time since the start of the pandemic and again in May 2022, it crossed on May 15, 2022, at 401,357. In June 2022, the highest passenger mark was on June 05, 2022 at 391,796.

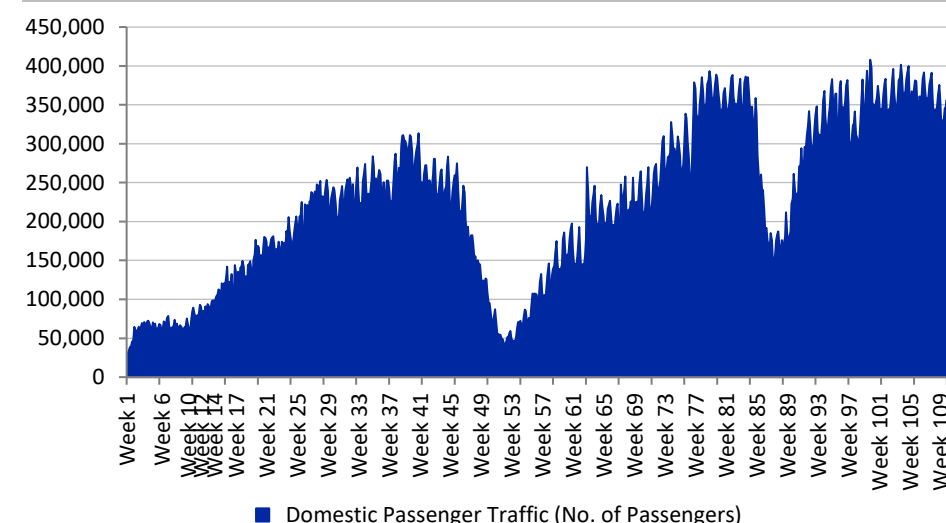
For June 2022, the average daily departures were at ~2,771, notably higher than the average daily departures of ~1056 in June 2021, but flattish compared to ~2,784 in May 2022 and average daily departures of ~2,789 during June 2019. The average number of passengers per flight during June 2022 was at 126, lower than the average of 140 passengers per flight in May 2022 and higher than average of 98 passengers per flight in June 2021. The average number of passengers per flight was higher at ~139 during June 2019. **It is estimated that the domestic aviation industry operated at a passenger load factor (PLF) of ~81% in June 2022, against ~63% in June 2021 and ~86% in June 2019.**

EXHIBIT 5: Domestic Daily Flight Departures since May 25, 2020



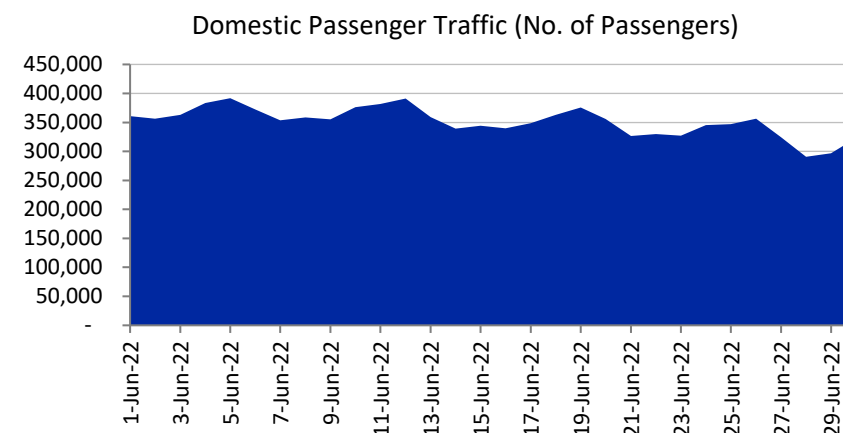
Source: MoCA, DGCA, ICRA Research

EXHIBIT 3: Daily Domestic Passenger Traffic since May 25, 2020



Source: MoCA, DGCA, ICRA Research

EXHIBIT 4: Daily Domestic Passenger Traffic in June 2022



Source: MoCA, DGCA, ICRA Research

To ensure a curb on excessive fares, the MoCA fixed a fare band which the airlines are expected to adhere to. The restrictions on capacity and the fare bands are not applicable in case of the Regional Connectivity Scheme (RCS) Udaan flights and for the business class. Furthermore, at least 40% of the tickets of a particular flight are to be sold for the fare less than the mid fare - between the minimum and the maximum fares given above.

The restrictions on fares, which were earlier valid till August 24, 2020, were extended till November 24, 2020 and further to February 24, 2021. However, on February 12, 2021, the MoCA allowed an increase of 10%-30% on the fare caps. While a 10% increase was allowed on the shortest route, the longer routes were allowed an increase of 30%. These restrictions were extended till May 31, 2021. Furthermore, on May 28, 2021, the MoCA allowed an increase of 13-15% on the lower air-fare band, with effect from June 01, 2021, while keeping the upper limits unchanged. The band was further increased by 10-13% on both the minimum and the maximum limits, with effect from August 12, 2021 on a 30-day rolling basis. This increase thus allowed airlines to recoup a part of the increased ATF prices, thereby cushioning some of the airlines' losses. However, effective September 18, 2021, the MoCA relaxed the fare cap rule wherein the fare caps in each of the bands shall be applicable up to the next 15 days on a rolling basis, down from 30 days earlier.

In ICRA's view, the reduction in fare cap roll-over period from 30 days to 15 days is a move towards market-driven pricing, as applicable during pre-Covid times, wherein the pricing was determined by the actual supply-demand dynamics and the actual PLF. There is uncertainty with respect to the movement in fares once the restrictions are lifted with factors supporting both sides. While low air fares suit the weak demand and excess capacity in the industry, higher fares are a necessity for the additional cost to be incurred by the airlines towards enhanced safety measures and sanitisation. It signifies a means of recouping the losses incurred due to the earlier suspension of operations, in addition to the increasing ATF prices.

While the scheduled international operations had ceased till March 27, 2022, the MoCA had permitted international operations under the Vande Bharat Mission (VBM) and the Air Transport Bubbles (ATB). With resumption of scheduled international operations since March 27, 2022, international passenger traffic for Indian carriers is on a growth trajectory, and surged to ~21.4 lakh in June 2022, which also notably surpassed the international passenger traffic of ~18.4 lakh witnessed in June 2019. For the first quarter Apr-Jun 2022, the growth in international passenger

traffic for Indian carriers compared to same period during pre-Covid levels was ~15%. Overall, the impact of the pandemic lasted longer on international travel than on domestic travel.

EXHIBIT 6: Changes in Fare Band for Domestic Operations (excluding Business Class) for Minimum Fare Since Operations Commenced from May 25, 2020

Class of Sectors*	May 25, 2020 - February 24, 2021	February 25, 2021 - May 31, 2021	June 01, 2021 - August 11, 2021	August 12, 2021 - October 31, 2021
A	2,000	2,300	2,600	2,900
B	2,500	2,900	3,300	3,700
C	3,000	3,500	4,000	4,500
D	3,500	4,100	4,700	5,300
E	4,500	5,300	6,100	6,700
F	5,500	6,400	7,400	8,300
G	6,500	7,600	8,700	9,800

EXHIBIT 7: Changes in Fare Band for Domestic Operations (excluding Business Class) for Maximum Fare Since Operations Commenced from May 25, 2020

Class of Sectors*	May 25, 2020 - February 24, 2021	February 25, 2021 - May 31, 2021	June 01, 2021 - August 11, 2021	August 12, 2021 - October 31, 2021
A	6,000	7,800	7,800	8,800
B	7,500	9,800	9,800	11,000
C	9,000	11,700	11,700	13,200
D	10,000	13,000	13,000	14,600
E	13,000	16,900	16,900	19,000
F	15,700	20,400	20,400	23,000
G	18,600	24,200	24,200	27,200

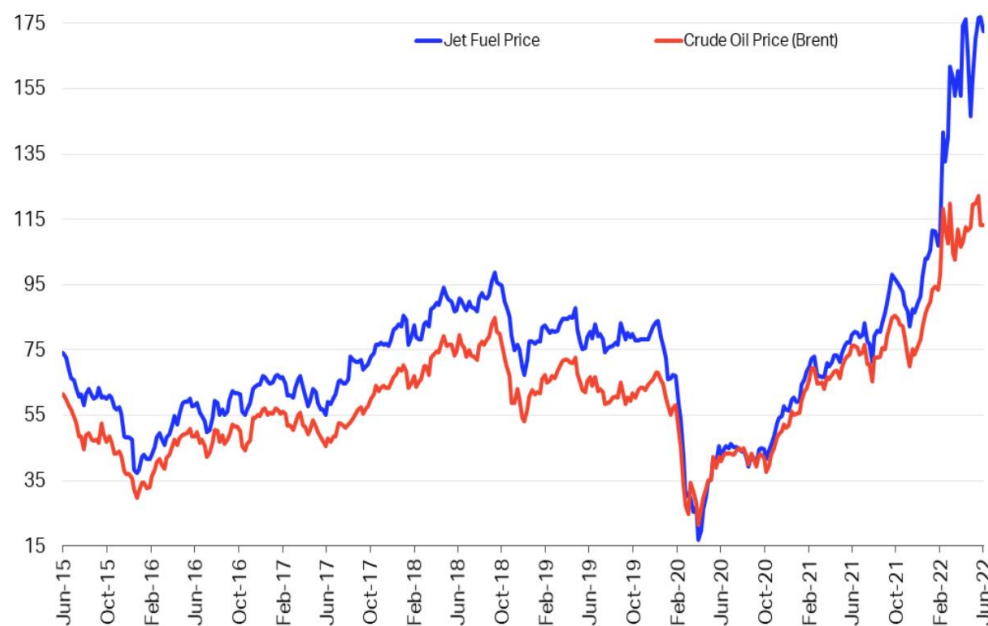
**Classified on the basis of approximate duration of flight; **Exclusive of applicable user development fee (UDF), passenger service fee (PSF) and goods & services tax (GST); Source: MoCA; Source: DGCA, ICRA Research*

ATF PRICES: PRICES IN MID-JUNE 2022 INCREASED SEQUENTIALLY BY ~15%; HIGHER BY ~120% ON A YOY BASIS

Following the pandemic, crude oil prices declined materially – reaching a low of ~US\$19/ barrel in April 2020 (the sharpest decline since Q4 CY2018) – seeing a decline in ATF prices. However, crude oil prices increased gradually since then, and currently ranges at around ~US\$105/ barrel. The recent increase in crude oil prices is attributable to the ongoing geo-political tension. Consequently, the ATF prices increased sequentially by 13.1% in February 2022, 8.6% in March 2022, 20.7% in April 2022, 3.5% in May 2022 and 14.8% in mid-June 2022. Until February 2021, ATF prices were lower on a YoY basis, while since March 2021, they have been substantially higher on a YoY basis. In mid-June 2022, the prices were notably higher by 120.4% on a YoY basis, given the elevated crude oil prices, due to geo-political issues.

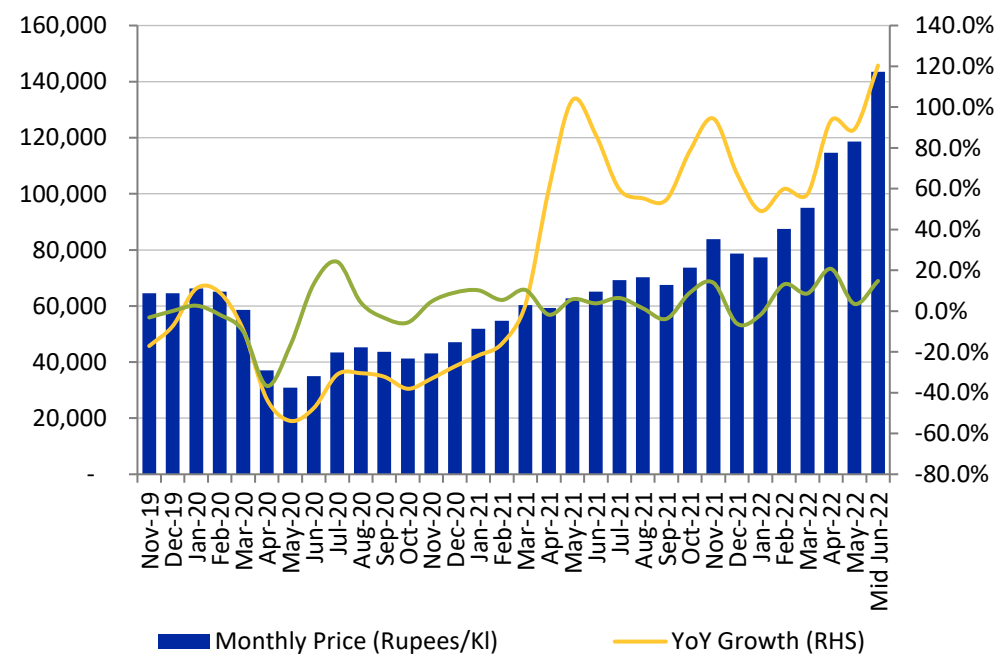
EXHIBIT 8: Movement in Crude Oil Price and Jet Fuel Price (Dollar/Barrel)

Jet Fuel & Crude Oil Price (\$/barrel)



Source: International Air Transport Association (IATA), ICRA Research

EXHIBIT 9: Movement in Jet Fuel Price



Source: Indian Oil Corporation Limited, ICRA Research

ICRA-RATED AIRLINE COMPANIES

EXHIBIT 10: Rating Distribution of ICRA-Rated Universe of Airline Companies as on July 11, 2022

Company Name	Rating Outstanding	Last Rating Action
Air India Express Limited	[ICRA]A4&	Rating placed on watch with developing implications
Interglobe Aviation Limited	[ICRA]A (Negative) / [ICRA]A1	Rating reaffirmed
Jet Airways (India) Limited	[ICRA]D / [ICRA]D ISSUER NOT COOPERATING	Rating continues to remain under 'Issuer Not Cooperating' category
Tata SIA Airlines Limited	[ICRA]A (Negative) / [ICRA]A1	Rating reaffirmed

Source: ICRA Research / *& - watch with developing implications



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ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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