ICRA

INDIAN AVIATION INDUSTRY

Domestic air travel witnessed a sequential decline of ~7% mainly due to lean travel period during monsoon; international traffic for Indian carriers notably surpasses pre-Covid levels by ~25%

AUGUST 2022

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BUSINESS OUTLOOK: NEGATIVE

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ICRA expects a fast-paced recovery in domestic passenger traffic in FY2023, aided by normalcy 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 depreciation of the INR against the US$, in the backdrop of increased competitive intensity.

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 July 2022, domestic air passenger traffic was estimated at ~97 lakh, ~7% lower compared to 105.12 lakh in June 2022. However, it witnessed a YoY growth of ~94%, in comparison to the numbers in July 2021, following the disruption caused by the second wave of Covid-19. This was also ~18% lower compared to pre-Covid levels in July 2019. The airlines' capacity deployment in July 2022 was ~65% higher than July 2021. However, it was lower by ~11% than the pre-Covid levels. On a sequential basis, the number of departures in July 2022 declined by ~5%, given some impact of the cyclicality in passenger travel arising from a lean period during monsoon coupled with impact on leisure travel due to hardening of air travel fares. International passenger traffic continues to rise since the resumption of the scheduled international operations with effect from March 27, 2022. In July 2022, international passenger traffic for Indian carriers stood at ~22.8 lakh, thereby strongly surpassing pre-Covid levels of ~18.3 lakh by ~25%.

A steady rise in prices of aviation turbine fuel (ATF) and general inflationary environment continue to dampen the industry earnings, with ATF prices in August 2022 being higher by ~77% on a YoY basis. However, the same declined by ~12% sequentially. While airlines have been increasing yields, 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. Elevated ATF prices will continue to pose a major threat to earnings and liquidity profile of the airlines in the near to medium term. Also, the depreciation of the INR against the US$ (which adversely impacts lease rentals, maintenance cost and other overheads) will have a major bearing on the cost structure of airlines. This apart, likely near-term relaunch of Jet Airways and the entry of low-cost domestic carrier, Akasa Air, will further intensify the competition in the domestic aviation industry. The airlines' effort to maintain and/or grow their market share will limit their ability to expand margins in an elevated fuel cost environment.
- **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 have reported a net 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, the same has not been adequate to offset the impact of the sharp rise in ATF prices. In ICRA's view, air traffic yields (as measured by Passenger Revenues/Revenue Per Kilometre (RPK)) have increased by 25-30% over the pre-Covid levels on domestic routes. 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 following the significant reduction in Air India Limited's debt before the divestment by the Government of India. Overall, the industry will require an 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*

KEY UPDATES

Key Updates	ICRA Comments	Impact
Notification dated August 10, 2022, indicating removal of fare bands with effect from August 31, 2022	To ensure a curb on excessive fares, the Ministry of Civil Aviation (MoCA) has imposed a minimum and maximum band based on the flight's duration, with effect from May 25, 2020. The bands have been revised multiple times until now to factor in travel fare pricing. However, the MoCA has announced removal of these bands with effect from August 31, 2022	**Positive:** The removal of fare band restrictions will enable domestic airlines to pass on the escalated input costs by way of fare hikes. However, the flexibility for any sharp hikes in air fares will be limited, driven by intense competition and effort by airlines to maintain their market shares.

PASSENGER TRAFFIC

Domestic passenger traffic – ~97 lakh

Sequential decline of ~7%

YoY growth of ~94%

YoY decline (pre-Covid) of ~18%

International passenger traffic ~23 lakh

YoY growth (pre-Covid) of ~25%

CAPACITY DEPLOYMENT

Domestic capacity deployment – total ~78,614 departures

Sequential decline of ~5%

YoY growth of ~65%

YoY decline (pre-Covid) of ~11%

DOMESTIC PASSENGER LOAD FACTOR

Estimated PLF of ~78% against ~67% in July 2021 & ~86% in July 2019 (pre-Covid)

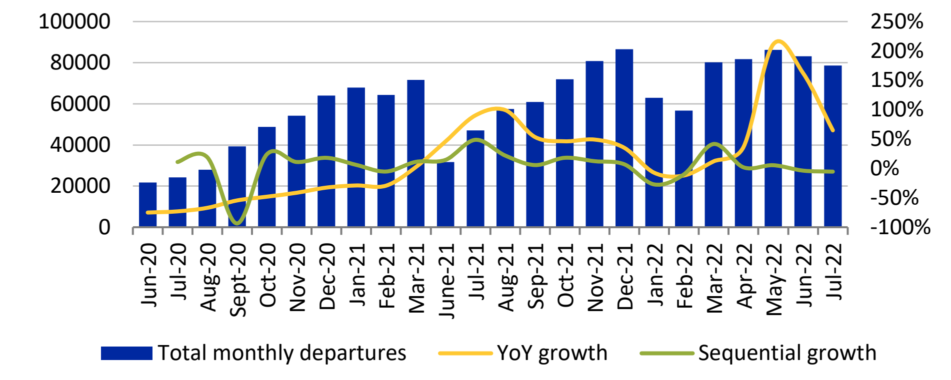
AVIATION TURBINE FUEL PRICES

Sequential decline of ~12% in August 2022 vis-à-vis mid-July 2022 and notable YoY increase of ~77% vis-à-vis August 2021

Domestic Passenger Traffic: Sequential Decline of ~7% in July 2022 and Lower by ~18% than the Pre-Covid Level i.e. July 2019

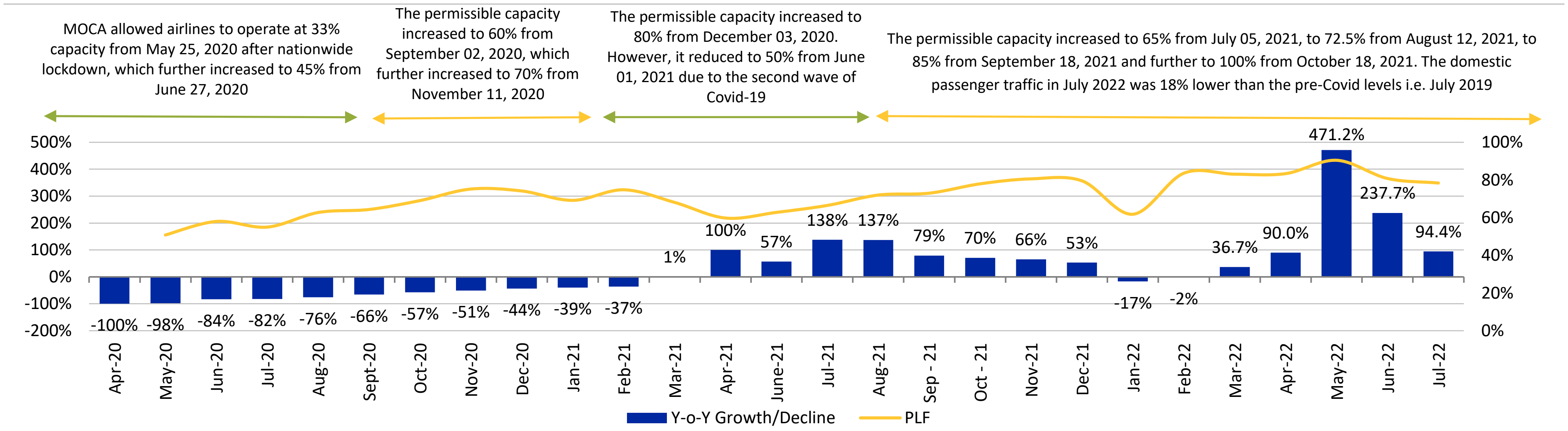
With the onset of Covid 2.0, the MoCA had reduced the permissible capacity deployment by airlines on domestic routes to 50% of pre-Covid levels with effect from June 01, 2021. The permissible capacity deployment was gradually increased to 65% from July 5, 2021, to 72.5% from August 12, 2021 and to 85% from September 18, 2021, before removing restrictions with effect from October 18, 2021. The capacity deployment for July 2022 was notably higher by 65% than July 2021 (78,614 departures in July 2022 against 47,692 departures in July 2021) due to significant decline in Covid-19 infections and near normalcy position seen in business operations. The number of departures in July 2022 were lower by ~5% on a sequential basis as well as lower by ~11% compared to departures of 88,200 in July 2019 (pre-Covid).

EXHIBIT 2: Trend in Capacity Deployment by Domestic Airlines



Source: MoCA, DGCA, ICRA Research

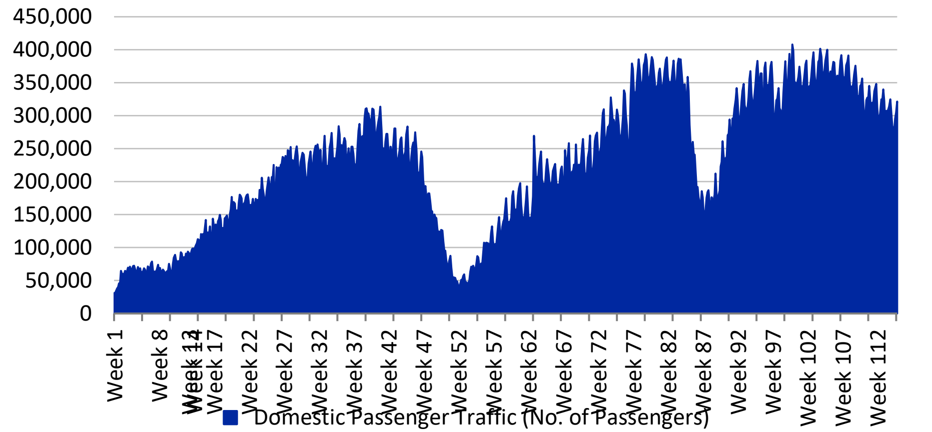
EXHIBIT 1: Domestic Passenger Growth & PLF



Source: MoCA, DGCA, ICRA Research

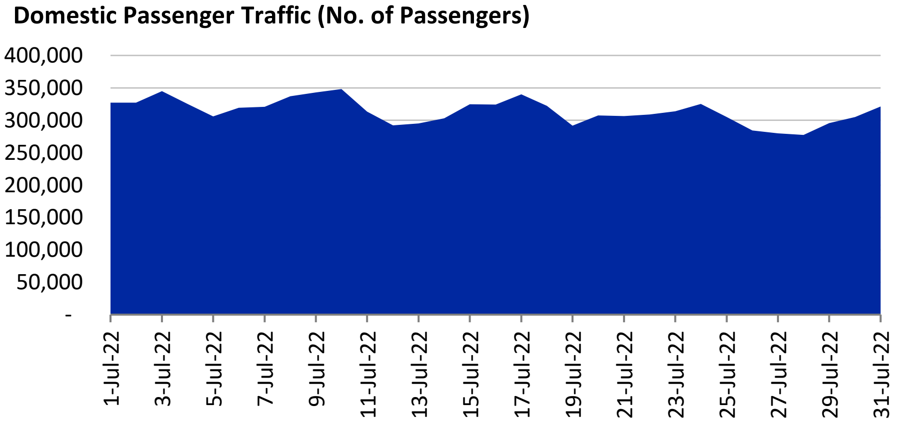
For July 2022, domestic passenger traffic stood at ~97 lakh, against ~50 lakh in July 2021, implying a significant growth of ~94% on a YoY basis. On a sequential basis, domestic passenger traffic declined by ~7% over ~105 lakh in June 2022 due to impact of the cyclicality in passenger travel arising from a lean period during monsoon monsoon coupled with impact on leisure travel due to hardening of air travel fares. 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 it crossed the mark again on May 15, 2022 with traffic at 401,357. In July 2022, the highest daily passenger traffic was witnessed on July 10, 2022 at 348,172. For July 2022, the average daily departures were at ~2,536, notably higher than the average daily departures of ~1,538 in July 2021, but low compared to ~2,771 in June 2022 and average daily departures of ~2,845 during July 2019. The average number of passengers per flight during July 2022 was at 124, largely similar at the average of 126 passengers per flight in June 2022, which was higher than the average of 105 passengers per flight in July 2021. The average number of passengers per flight was higher at ~135 during July 2019. **It is estimated that the domestic aviation industry operated at a passenger load factor (PLF) of ~78% in July 2022, against ~66% in July 2021 and ~86% in July 2019.**

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



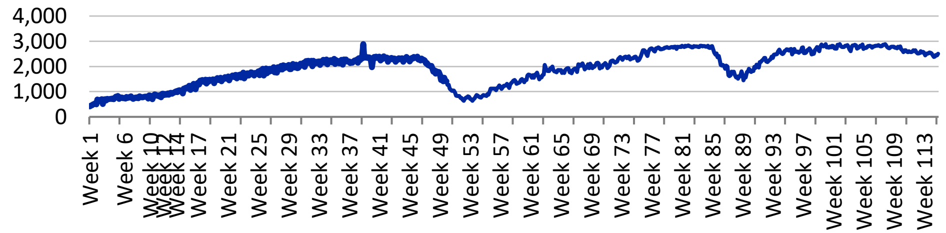
Source: MoCA, DGCA, ICRA Research

EXHIBIT 4: Daily Domestic Passenger Traffic in July 2022



Source: MoCA, DGCA, ICRA Research

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



Source: MoCA, DGCA, ICRA Research

To ensure a curb on excessive fares, the MoCA fixed a fare band with effect from May 25, 2020. However, the same will be removed from August 31, 2022. 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 as depicted in Exhibits 6 & 7.

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 bands. 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 the airlines to recoup a part of the increased ATF prices, thereby cushioning some of the airlines' losses. Further, effective September 18, 2021, the MoCA relaxed the fare band rules, wherein the fare restrictions in each of the bands are applicable only up to the next 15 days on a rolling basis, down from 30 days earlier. As per the recent announcement on August 10, 2022, the MoCA has indicated removal of these fare bands with effect from August 31, 2022.

In ICRA's view, the removal of fare restrictions is a positive move by the regulator towards market-driven pricing, as applicable during pre-Covid times, wherein the fares were determined by the actual supply-demand dynamics. However, there is uncertainty with respect to the movement in fares after August 31, 2022. While the restrictions on fares will be lifted, there are factors supporting both sides of the fare movement. The ongoing headwinds owing to higher ATF prices and INR depreciation (which adversely impacts lease rentals, maintenance cost and other overheads) will result in an increase in air fares; however, it will be limited by intense competition and endeavour of airlines to maintain and/or expand their market shares

With the resumption of scheduled international operations since March 27, 2022, international passenger traffic for Indian carriers is on a growth trajectory, and surged to ~22.8 lakh in July 2022, which also notably surpassed the international passenger traffic of ~18.3 lakh witnessed in July 2019. For April-July 2022, the growth in international passenger traffic for Indian carriers was ~25%, compared to the same period during pre-Covid. 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 Fares Since Operations Commenced From May 25, 2020, to Remain In Effect Till August 31, 2022

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	Effective from August 31, 2022
A	2,000	2,300	2,600	2,900	No Fare Restrictions applicable
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 Fares Since Operations Commenced From May 25, 2020, to Remain in Effect Till August 31, 2022

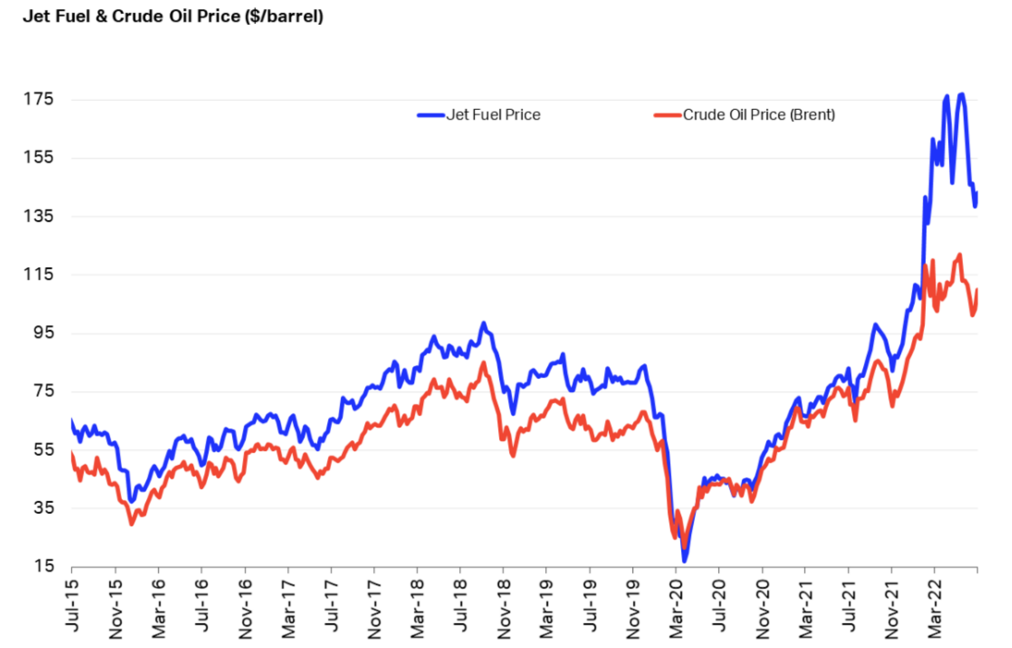
Class of Sectors*	May 25, 2020 - February 24, 2021	February 25, 2021 - May 31, 2021	June 01, 2021 – August 11, 2021	August 12, 2021 – October 31, 2021	Effective from August 31, 2022
A	6,000	7,800	7,800	8,800	No Fare Restrictions applicable
B	7,500	9,800	9,800	11,000	
C	9,000	11,700	11,700	13,200	
D	10,000	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 August 2022 Declined Sequentially By ~12%; Higher by ~77% On A YoY Basis

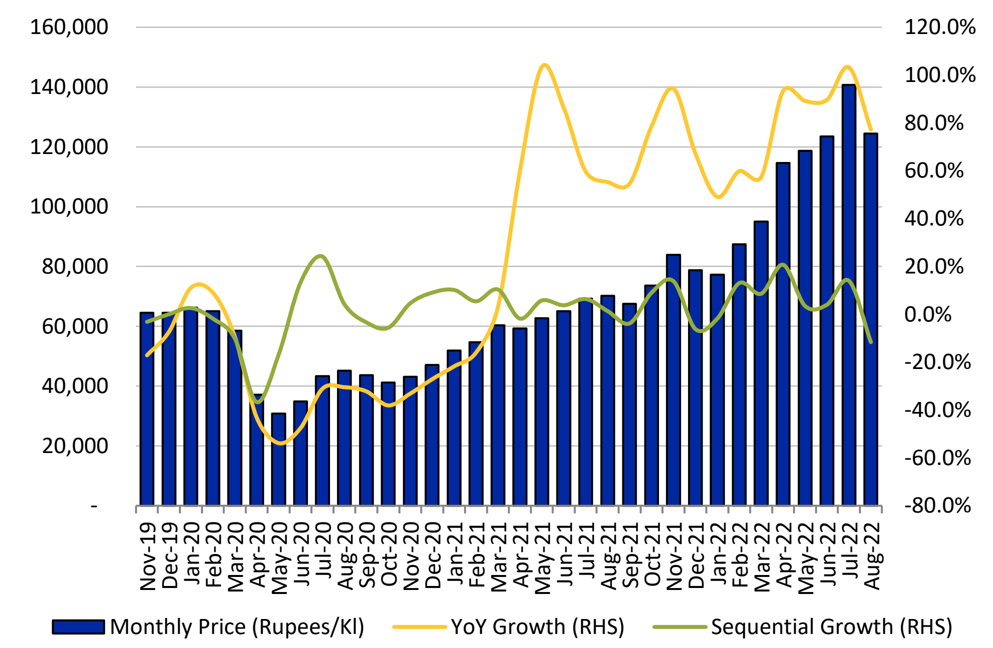
Following the pandemic, crude oil prices declined materially – reaching a low of ~US$ 19/ barrel in April 2020 (the sharpest decline since Q4 CY2018) – seeing a decline in ATF prices. However, crude oil prices increased gradually since then, and currently ranges at around ~US$ 93 / barrel. The increase in crude oil prices is attributable to the 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, 4.1% in June 2022 and 14% in Mid-July 2022. However, it declined by ~12% sequentially in August 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 August 2022, the prices were notably higher by ~77% 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)



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 August 17, 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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