Airline Industry- Developments in the industry

May 14, 2019 I Research

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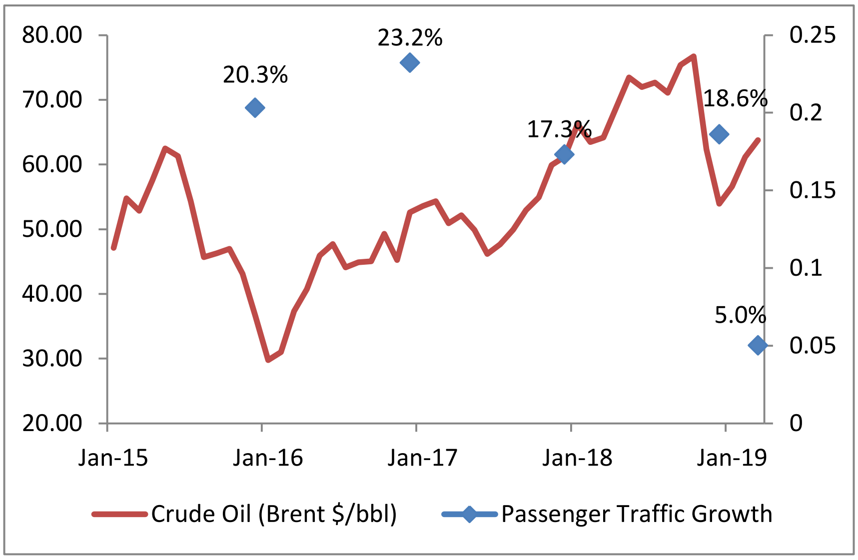
- Jet Airways is yet another addition to over half a dozen airlines globally, which either ceased operations or merged with other airlines in 2018 & 2019. This includes prominent names like WOW, Germania, Primera, Cobalt, Flybmi, Virgin America etc.
- Despite the impressive traffic growth and high capacity utilization, financial performance of Indian Airline companies has remained under pressure due to increased crude prices and currency volatility in FY18 and FY19. 2 out of the three listed domestic airlines have reported operating and net losses during 9M FY19 and the third reported operating profit but net losses during the same period.
- In order to capture market share, domestic airlines slashed fares on major routes. The fares were 1/3rd the fares charged by airlines in developed markets like The US and Europe on comparable routes.

Graph 1 Traffic Growth (Annual) & Average Crude Prices (Monthly)



Source: DGCA & World Bank

- **Excess taxation on ATF**: The difference in price of ATF for domestic and international players is a substantial 30-40%. Domestic airlines pay an average 1.35-1.4 times their international peers for aircraft turbine fuel (ATF) due to state level sales tax applicable on domestic airlines. Additionally, the pass-on of reduction in ATF prices in line with crude oil price movement is not dynamic. Collectively these factors contribute to higher share of fuel costs to revenue of domestic airlines at ~40%.

Passenger traffic

Domestic passenger growth has come at a much slower pace of less than 5% during the first quarter of the year 2019 versus 24.1% reported for the corresponding period during the previous year. Growth has been the silver lining for domestic airlines. International passenger traffic too witnessed a slowdown with a mix of factors impacting the industry, which included shutdown of airspace over Pakistan which led to considerable number of cancellations and rerouting of flights. Few international airlines had to temporarily shut-down their services to India.

Table 1 Passenger Traffic and Growth (Dom. & Int)

	2017	2018	Jan-Mar '18	Jan- Mar '19
Domestic Passenger	116,775,928	138,698,284	33,713,152	35,348,440
Growth % YOY	17.4%	18.8%	24.1%	4.9%
International Passenger	23,013,249	25,486,128	6,311,251	6,724,838
Growth % YOY	14.4%	10.7%	14.4%	6.6%

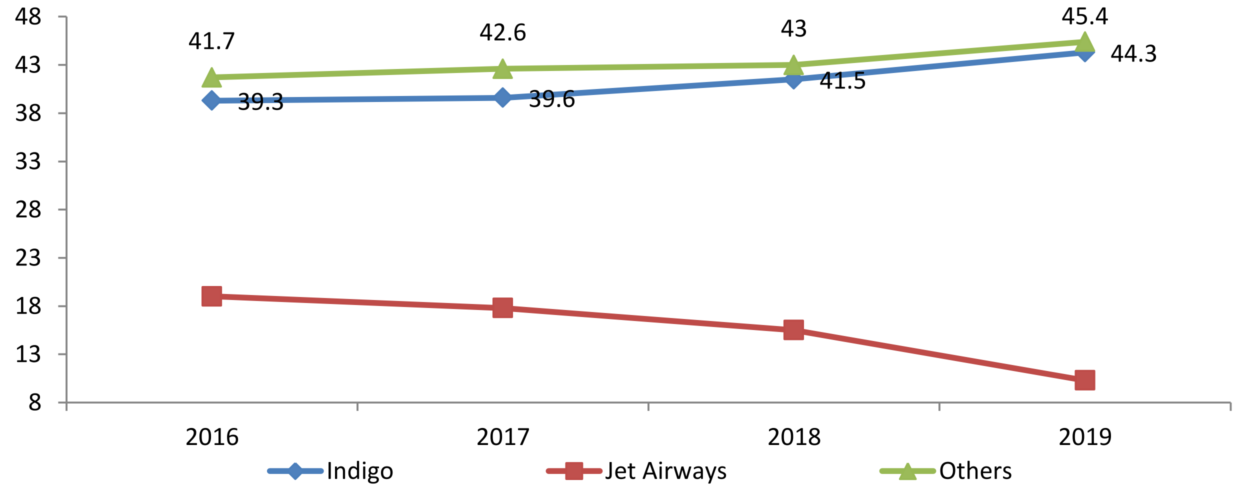
Source: DGCA

The high passenger traffic growth during 2016-18 coincided with very low airfares in the sector due to low crude oil prices, and intense competition. Favourable operating conditions ensured that airlines were able to maintain profitability despite the low passenger yields.

The low airfare scenario continued despite sharp recovery in crude oil prices post June 2016. It was only when crude-oil inched upwards of $60/bbl post December 2017 when the higher cost of ATF started hurting the airlines financially.

Market Share:

Graph 2 Market Share (%) of Airlines (Domestic)



Source: DGCA

Others include: Air India, Spicejet, GoAir, Vistara, Air Costa, Air Asia, Air Pegasus, Trujet and Air Carnival Jet Airways is inclusive of Jetlite.

Among the top 4 airlines, two are full-service airlines (Jet Airways & Air India) and two (Indigo & Spicejet) are no-frill/low cost carriers. Indigo has consistently maintained a market share of over 36% post 2015, and has further consolidated its position as a market leader with 44.3% share during the first quarter of 2019.

Air India and Spicejet have remained among the top 4 airlines with 12-15% market share over the last 3 years. Air India reported a dip from 14.6% in 2016 to 12.7% in March 2019. Spicejet's share remained range-bound between 12-14% and its overall share has risen between 2016 & 2019.

Jet Airways witnessed erosion in its market share from 19% in 2016 to 15.5% in 2018 and fell 10.3% during Q1 2019 before it ceased operations. Jet Airways has been offering competitive ticket prices across sectors and serving a large number of destinations both on domestic as well as international routes. Despite these measures, it has consistently lost market share to other airlines in the last 3 years. On the international routes, where Jet Airways had close to 1/3rd share among domestic airlines and 13.8% among all airlines, disruption in its operations is expected to benefit domestic airlines as well as international airlines especially on key routes like India-Europe-Americas, India-South East Asia and India-Middle-East.

Demand and Supply

There has been steady increase in Available Seat KM (ASK)/seat inventory at 14.7% and 18.5% in 2017 and 2018 respectively. UDAN scheme which targeted improving air-connectivity at affordable fares between metro and non-metro cities was among key drivers for seat inventory addition.

Table 2 Demand-Supply and Capacity Utilization

		2017	2018	Jan-Mar '19*
Available Seat KM - ASK('000)	**(D)**	129,130,130	153,044,356	39,448,345
	(I)	98,803,965	109,729,461	28,486,131
ASK Growth(D/I)		14.7%/11.6%	18.5%/11%	10.5%/7.5%
Rev. Passenger KM - RPK ('000)	**(D)**	111,117,283	132,398,012	34,368,088
	(I)	79,240,062	88,958,494	23,529,192
RPK Growth (D/I)		17.6%/14.0%	19.2%/10.9%	7.8%/6.8%
PLF (D/ I)		86.1%/80.2%	86.5%/81.1%	87.1%/82.6%

Source: DGCA * Data for Q1 of 2019 vs Q1 of 2018. D-Domestic, I- International

Demand during the same period remained robust. In terms of RPKs (Revenue Passenger KM), the industry witnessed robust growth of over 17.5% during 2017 and 19.2% in 2018. This in turn led to further improvement in Passenger load factor (PLF) for All-India airlines to 86.5% in 2018.

Both ASK and RPK growth has been muted during 2019 majorly as Jet Airways grounded it aircrafts due to non-payment to lessors. Additionally, other airlines too have reported grounding of aircrafts, though temporary; owing to technical snags and precautionary grounding of Boeing 737 Max aircrafts, non-availability of spare parts etc.

Financials:

The distinction between Low Cost Carriers (LCC) and Full-Service Carriers (FSC) has been constantly diminishing due to the low airfares. Few players chose to keep their fares proportionate to cost, but this resulted in lower market share and PLF for these players.

Key routes like Delhi-Mumbai, Mumbai-Bengaluru, Delhi-Bengaluru etc. witnessed heightened fare competition. Aggressive fares did help some players maintain their market share and led to near-saturation in PLF.

Publicly available data for listed companies and annual data for two airlines suggests that the overall industry had operating margin of 10-15% when crude oil prices remained at $30-45/bbl in 2015-16. The margins started contracting post last quarter of 2017, when crude oil prices recovered and remained at over $ 50/bbl.
For the 9M FY19, all Indian airlines made net losses. Apart from the crude-oil prices, factors like grounding of fleets due to technical snags added to the cost pressure which leads to cancellations and subsequent reduction in available seat inventory.

Airlines in the Americas have been able to maintain much stable margins with Low Cost Carriers maintaining 10-15% margins and FSCs maintaining 6-10% margins during 2018. Average fuel cost accounted for 18-22% and wages and salaries ~30-35% of operating revenue. In terms of fleet size, there are over 7,500 aircrafts operated in the US alone, which is 12-13 times the fleet size of the entire Indian airline sector.

Among the unlisted companies, financial result of two companies is provided in Table 3. Both the airlines are full-services carriers (FSC) offering value-added customer service and relaxed baggage carrying rules.

Table 3 Annual Results (Financials of unlisted Airlines Companies in India)

	Tata SIA (Vistara)			Air India		
(in ₹ cr)	**FY16**	**FY17**	**FY18**	**FY16**	**FY17**	**FY18**
Revenue	691.37	1389.92	2137.43	19992.33	21827.07	23003.67
Fuel Expenses#	38.8%	38.9%	38.8%	29.5%	29.3%	32.3%
Operating Profit	**-390.06**	**-501.98**	**-411.76**	**2584.42**	**1911.48**	**1104.87**
Operating Margin	-56.4%	-36.1%	-19.3%	12.9%	8.8%	4.8%
Interest Cost	0.72	0.73	1.75	4551.86	4445.29	4662.84
Net Profit	-400.91	-518.46	-431.09	-3836.78	-6281.54	-5337.74

Source: Ace-equity #- as a % of revenue

Air India's revenue has grown at 5.4% which is among the lowest in the industry. The airline has been operationally profitable at 4.8% in FY18 though it has contracted from ~13% in FY16. Air India's fuel costs as a percentage of revenue has been in the range of 29-33%. The huge interest cost has been weighing on its financial performance with an average annual interest outgo of ₹ 4,500 cr. The net losses stood at ₹ 3,336 cr, ₹ 6,281 cr and ₹ 5338 cr in FY16, FY17 & FY18 respectively. Air India is the second largest fleet operator with 163 aircrafts.

Tata SIA (Vistara) is a JV between Tata Group and Singapore Airlines has a market share of ~4% in terms of passengers carried in FY18. The company has been able to grow its revenue 3-fold between FY16 & 18. It has also been among the fastest growing large airline with ~23% growth in terms of number of passengers carried in FY19. It posted operating as well as net losses during its three year of operation. The operating losses have contracted from over -56% in FY16 to -19% in FY18. The company has near zero debt. Fuel accounts for ~38.8% of its total revenue and has been stable at that level indicating active management of costs and passing on the increase to the consumers. Vistara operates a fleet of 22 aircrafts.

Table 4a and 4b provides data of the 3 listed airlines - Interglobe (Indigo), Spicejet and Jet Airways.

Table 4 a Financials of Listed Airline Companies

	Interglobe			Spicejet		
(in ₹ cr)	FY17	FY18	9M19	FY17	FY18	9M19
Revenue	18,580.50	23,020.89	20,613.51	6,191.27	7,795.09	6,603.48
Fuel Expenses#	34.1%	33.7%	44.4%	30.1%	31.3%	39.8%
Operating Profit	3,007.74	3,976.64	151.6	685.92	919.69	-16.12
Operating Margin	16.2%	17.3%	0.7%	11.1%	11.8%	-0.2%
Interest Cost	406.15	413.09	376.38	95.14	121.84	103.44
Net Profit	1,659.19	2,242.37	-433.45	430.73	566.65	-372.36

#- as a % of revenue Source: Ace-equity

- Interglobe Aviation (Indigo) has been the only airline, reporting operating profit during the 9M FY19. It recorded ~24% growth in revenue in FY18 and ~ 20% growths during 9M FY19. Indigo operates the largest fleet among domestic airlines with 224 aircrafts and accounts for 40% of the total domestic airline fleet in India excluding Jet Airways which operated 119 aircrafts.

The two other listed airlines have posted operating and net losses with fuel expenses being the largest cost head ~40% as a percentage of revenue. Cost of fuel to revenue expanded by ~10% for all the airlines weighing heavily on their overall profitability.

- Jet Airways reported operating loss of ₹ 2,137 crore and net loss of ₹ 3,208 crore for 9MFY19. Competition with LCCs led to a considerable reduction in its passenger yields. These factors along with high debt posed challenge for the company to raise fresh funds for continuing operations.
- Operating loss of Spicejet came at a much lesser ₹ 16cr and net loss was of ₹ 372 cr during the 9M FY19. The airline had to ground Boeing 737 Max aircrafts in March 2019, but it the impact was temporary. The airline now operates close to 80 aircrafts excluding 13 Boeing Max planes.

Table 4b Financials of Listed Airline Companies

	Jet Airways		
(in ₹ cr)	FY17	FY18	9M19
Revenue	21552.35	23286.53	18,319.59
Fuel Expenses#	25.5%	29.9%	39.0%
Operating Profit	3004.31	695.81	-2,137.63
Operating Margin	13.9%	3.0%	-11.7%
Interest Cost	851.09	842.86	737.12
Net Profit	1482.52	-767.62	-3,208.23

Source: Ace-equity

The crude anomaly

- During FY19, the price of crude oil has decreased by 7.3% whereas the price of ATF during the same period has gone up by ~3%. This clearly indicates the entire benefit of reduction in crude prices is not passed on to the industry even though increase in prices is more dynamic. This despite the Government reducing excise duty on ATF by 3% from 14% to 11% in November 2018.

- Among the 4 metros, Delhi and Mumbai have the lowest ATF prices due to reduced sales tax imposed by the state government (~5% in case of Mumbai), whereas ATF price in Kolkata is highest- 10% higher difference over Delhi and Mumbai.

Table 5 Premium paid by Domestic Airlines for ATF

Period	ATF price for Domestic	ATF Price for International	Difference#
April 2019	₹ 63,448	$ 655	38%
Dec 2018	₹ 67,980	$ 684	42%
Sept 2018	₹ 69,161	$ 700	41%
June 2018	₹ 69,603	$ 720	38%
Mar 2018	₹ 60,738	$ 688	26%

Source: IOCL #1$ = ₹ 70, Lowest price among 4 metros considered

- The ratio of fuel expenses to revenue increased by 8-10 percentage points during the 9MFY19. Domestic airlines pay an average 35-40% higher price for ATF than international airlines. ATF prices are inclusive of 11% basic excise duty. An additional 5% basic customs duty and 11% additional customs duty is also applicable in case of imported ATF. An additional State level sales tax is levied (20-30%) with an exception of few states (Andhra Pradesh) and city specific relaxation as provided for by respective state governments. The state level taxes contribute to this difference in ATF prices for Domestic and International airlines. There is an urgent need to address this difference in price of ATF for domestic and international airlines as it gives an advantage to international airlines.

Concluding remarks

- We expect the fares across domestic routes to remain elevated at the current levels till July 2019. The fares on the international routes may moderate over the next two months as the inventory levels would gradually recover with more domestic airlines planning to ramp up their international operations across routes.
- Domestic passenger traffic growth during the year would moderate to lower double digits and higher single digits (8-12%), as fare prices remain high. With Jet Airways' entire fleet grounded post April 17th 2019, it would take considerable time for domestic airlines to make up for the extinguished seat inventory.
- With reduced competition and improved airfares, operating margins for airlines would improve during FY20. We do expect all airlines to report operating profits during FY20. Though the profitability would continuity to largely depend on the crude oil prices.

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