

Stormy flight

Covid-19 to crimp airline margins despite lower crude prices this fiscal

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Wings clipped in the near term

Curtailed mobility of people due to the Covid-19 pandemic and related restrictions will shrink India's air passenger traffic in both domestic and international sectors by 40-45% and 60-65%, respectively, this fiscal.

The demand destruction can be gauged from the fact that even after resumption of domestic air services, the load factor is hovering at 50-60%, with primarily unidirectional flow of traffic, limited largely to essential travel and those returning to their home cities/ countries.

In the milieu, Indian carriers are expected to log operating losses this fiscal despite lower crude oil prices. And with the Covid-19 pandemic still raging in much of the world, a revival to pre-pandemic levels appears unlikely even next fiscal.

This is a serious jolt to the Indian domestic air travel industry that had logged double-digit growth in seven of the past ten fiscals before its fortunes took a turn for the worse with the bankruptcy and grounding of a couple of major carriers.

Domestic air passenger traffic to rewind to fiscal 2016 level...

The number of domestic air passengers is expected to be 78-83 million this fiscal, similar to fiscal 2016.

In the first quarter, passenger demand was weak as air services, grounded since March 25, resumed only on May 25, and with capacity limitations in place. Domestic demand is likely to be subdued in the seasonally weak second quarter as well. But, the third and fourth quarters are expected to see increased travel owing to the festive season, although it will still be lower on-year.

Interestingly, the fares, capped by the government, are higher on-year today. However, as airlines look to stimulate demand with the onset of the festive season amid the expected removal of the fare cap from end-August, ticket prices on domestic routes are expected to come off from the third quarter and will on average be lower on-year this fiscal.







...could revive next fiscal subject to pandemic control

Looking into fiscal 2022, CRISIL Research does not see the traffic situation improving unless the pandemic is brought under control.

We see two scenarios here:

- In scenario 1, or S1, where there is control or cure, domestic passenger traffic in the fiscal is projected at 122-130 million, which is near the fiscal 2018 level, as people take to the skies again, with visiting friends and relatives (VFR) and business traffic leading the travel itinerary. However, some share of business traffic is expected to be lost permanently owing to rising preference for video-conferencing and other digital means of communication
- In scenario 2, or S2, only essential travel is expected to continue, and, hence, domestic passenger traffic is projected at 98-105 million, which is somewhat near the fiscal 2017 level

Revival to pre-pandemic level unlikely even next fiscal

	FY17	FY18	FY19	FY20E	FY21P	FY22P-S1	FY22P-S2
 Domestic pax traffic (million)	104	123	140	142	78-83	122-130	98-105
 Domestic pax traffic growth	22%	19%	14%	1%	(45-40)%	50-55%	25-30%
 Domestic fares	-7%	2%	0%	5%	(10-5)%	↓	↓
 International pax traffic (million)	59	65	69	67	25-30	54-58	44-48
 International pax traffic growth	8%	10%	6%	-4%	(65-60)%	115-120%	75-80%
 Revenue growth	12%	16%	15%	1-2%	(60-55)%	75-80%	40-45%

E: Estimated; P: Projected

Notes:

- Projections are only for scheduled domestic and international services. Unscheduled services, such as Vande Bharat Mission, repatriation flights by countries, domestic passenger and cargo charters, and Mission Lifeline UDAN are not included
- We have based our views on two scenarios: S1 – Covid-19 is significantly controlled by end of the current fiscal; and S2 – The spread of Covid-19 continues till Q1FY22

On-year growth On-year decline Similar to previous year

Source: Directorate General of Civil Aviation (DGCA), Airports Authority of India, Company reports, CRISIL Research

International air traffic to mirror domestic trend

Delayed resumption of international operations is likely to translate into a steep drop in passenger numbers for fiscal 2021. CRISIL Research projects passenger numbers at 25-30 million, which was the level last seen in fiscal 2008.

While international operations are expected to resume in August (which were grounded from March 23), there is uncertainty with regard to granting of air travel permissions by different countries, and because of a visa application backlog. Also, the seasonally strong third quarter is expected to post a decline on-year as travellers would be apprehensive to undertake international leisure travel. Growth is only expected in the fourth quarter over a low base, led by travel for VFR and business.

But, unlike in the case of domestic air fares, international air fares are expected to rise 4-6% on-year despite the low passenger traffic volume. The reason for this dichotomy is the drop in capacity on international routes by global carriers due to bankruptcies and fleet retirement. The rise is on the back of already elevated fares in fiscal 2020 due to a shortage in capacity following the grounding of Jet Airways, which had a significant international network.

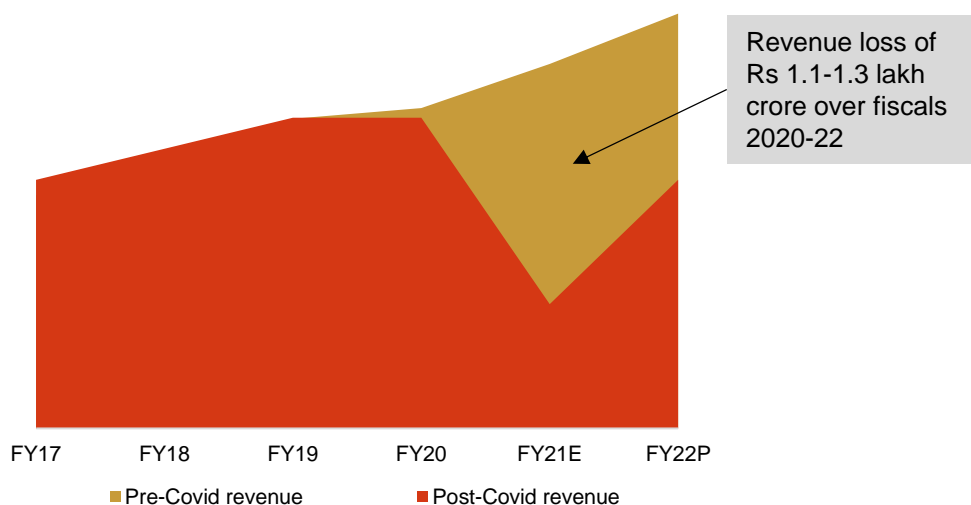
For fiscal 2022, CRISIL Research has again assessed passenger volume based on two scenarios:

- In **S1**, international passenger traffic is expected to recover to 54-58 million, which is fiscal 2017 level, with travel arising from pent up demand across VFR and business segments
- In **S2**, the traffic is forecast to slip back to fiscal 2014 level of 44-48 million, with only essential travel and a section of business people opting to fly

Looking through a wider lens, the share of Indian carriers in international traffic is set to rise to 40-42% in fiscals 2021 and 2022, from ~36% over fiscals 2016 to 2020 as travellers are likely to prefer short to medium haul destinations owing to lower incidence of Covid-19 cases in neighbouring countries, preference for direct flights over transit through hubs and lower trip costs, which can all be served by Indian carriers.

Overall, Indian airlines are staring at a massive Rs 1.1-1.3 lakh crore revenue forgone over fiscals 2020 to 2022. They are unlikely to recoup this loss as growth is not expected to return to pre-pandemic levels of double-digit increase at least in the medium term.

Indian airlines staring at Rs 1.1 to 1.3 lakh crore revenue loss due to pandemic



E: Estimated; P: Projected
Source: Company reports, CRISIL Research

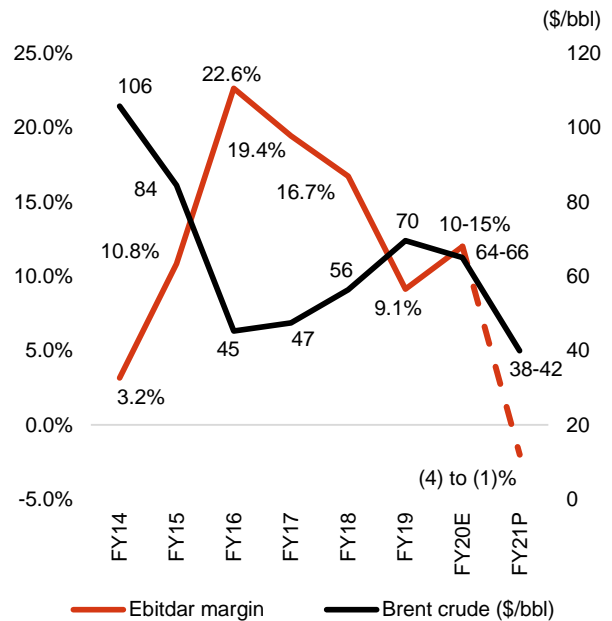
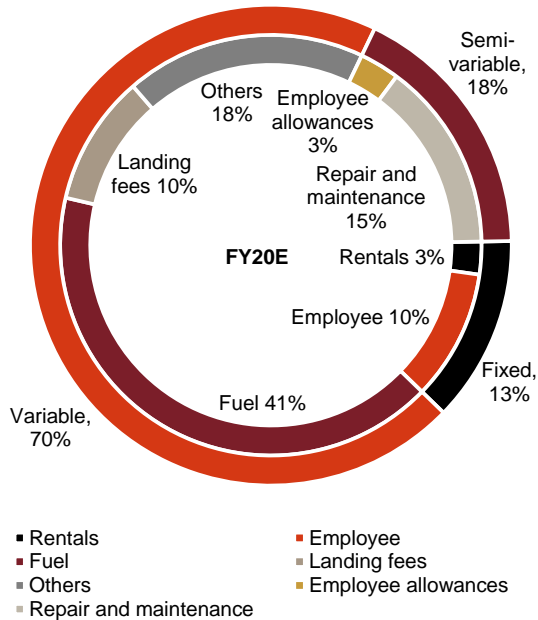
Lower crude price not cushion enough for airline margins

One would have assumed that the expected plunge in crude oil prices to \$38-42 per barrel in fiscal 2021 compared with \$64-66 per barrel in fiscal 2020 would have helped airline companies to an extent on the margin front as it forms a sizeable 30-45% of an airline’s cost base.

But because of the outsized impact of the demand destruction, airlines are curtailing capacity deployment, thereby restricting opportunities for airline companies to accrue the benefit of low crude oil prices.

In fact, airlines are projected to post losses at the earnings before interest, taxes, depreciation, amortisation and lease rentals (Ebitdar) as well as Ebitda levels in fiscal 2021. Ebitdar margin is forecast at (4)-(1)%, whereas Ebitda margin is seen at (9)-(6)%, as fixed costs, such as lease rentals, employee expenses and maintenance tasks, had to be met even when the airplanes were grounded.

Ebitdar margin to move in sync with fuel price for first time



E: Estimated; P: Projected

Note: Sample includes IndiGo, SpiceJet, Air India, Jet Airways, AirAsia India, Vistara and GoAir

Source: Company reports, CRISIL Research

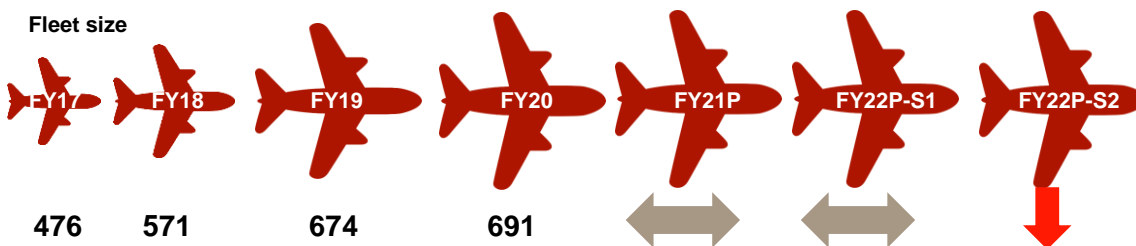
For the metrics to move back to the historical trend, CRISIL Research's calculations suggest airlines need a load factor of 72%, thereby achieving breakeven on the Ebitdar front.

Pandemic to impact net fleet addition of Indian carriers

The pandemic is bound to affect the net fleet addition of Indian carriers, which had ~900 aircraft on order as on March 31, because traffic is unlikely to rebound to even fiscal 2020 level in the medium term. Indeed, a major Indian carrier has already provided guidance to maintain its fleet number for the next two years at end-fiscal 2020 level, compared with a healthy net addition of 45-50 aircraft per year.

In the milieu, fleet additions are likely to be limited to fleet replacement, with newer generation aircraft replacing older generation leased aircraft.

Losing altitude



Note: Numbers reflect total fleet on hand for all Indian scheduled airlines

Source: DGCA, CRISIL Research

To be sure, leased aircraft, which comprise ~75% share of Indian carriers' fleet, is expected to continue to be the preferred mode for fleet acquisition as Indian carriers lack the balance sheet heft for outright purchases.

In fact, the carriers are expected to continue favouring the sale and leaseback model, although the premium is likely to drop as global demand for new generation aircraft is expected to weaken due to the pandemic, and ensuing airline bankruptcies, which will lead to higher availability in the secondary market.

Credit profiles remain weak

Compounding the woes of Indian carriers is their weak credit profiles. In fiscal 2019, interest coverage ratio across airline companies had deteriorated due to higher fuel prices. What's more, the net debt to Ebitda ratio for three of the five major private carriers was discomfotingly high at above 3.

Anatomy of a downturn

Interest coverage ratio				
	FY18		FY19	
<0	20%	0%	80%	64%
0-1	20%	0%	20%	36%
1-3	20%	40%	0%	0%
>3	40%	60%	0%	0%
	No. of firms	Debt	No. of firms	Debt
	5	~Rs 5,500 crore	5	~Rs 5,100 crore

Net debt/Ebitda				
	FY18		FY19	
<0	0%	0%	0%	0%
0-1	60%	42%	40%	2%
1-3	20%	19%	0%	0%
>3	20%	40%	60%	98%
	No. of firms	Debt	No. of firms	Debt
	5	~Rs 5,500 crore	5	~Rs 5,100 crore

Notes:

- 1) Sample set is only of private airlines, which had a share of 70% in domestic revenue per km (RPKM) terms in fiscal 2018, and 75% in fiscal 2019
- 2) Interest service coverage ratio = Ebit / Interest
- 3) Net debt/Ebitda = (Total debt - Cash) / Ebitda
- 4) Average crude oil price was \$56.4 per barrel in FY18 and \$69.6 per barrel in FY19

Source: CRISIL Research, Company reports

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