Research

CRISIL
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The ascent of profitability

For LCCs, operating cash flows seen rising to decadal highs

CRISIL Opinion l September 2019

Airline margins set for take-off as supply shock pushes up fares

Firmer fares and strong passenger-traffic growth are estimated to propel the earnings before Interest, tax, depreciation, amortisation and lease rentals (EBITDAR) margin of India's low-cost carriers (LCCs) to 24-25% this fiscal, compared with 15-16% in the last.

Fares are expected to rise because of limited capacity additions in the industry since Jet Airways ran aground.

With the improvement in EBITDAR margin, the LCCs' operating cash flows are expected to touch a decadal high of Rs 4,700-5,200 crore this fiscal.

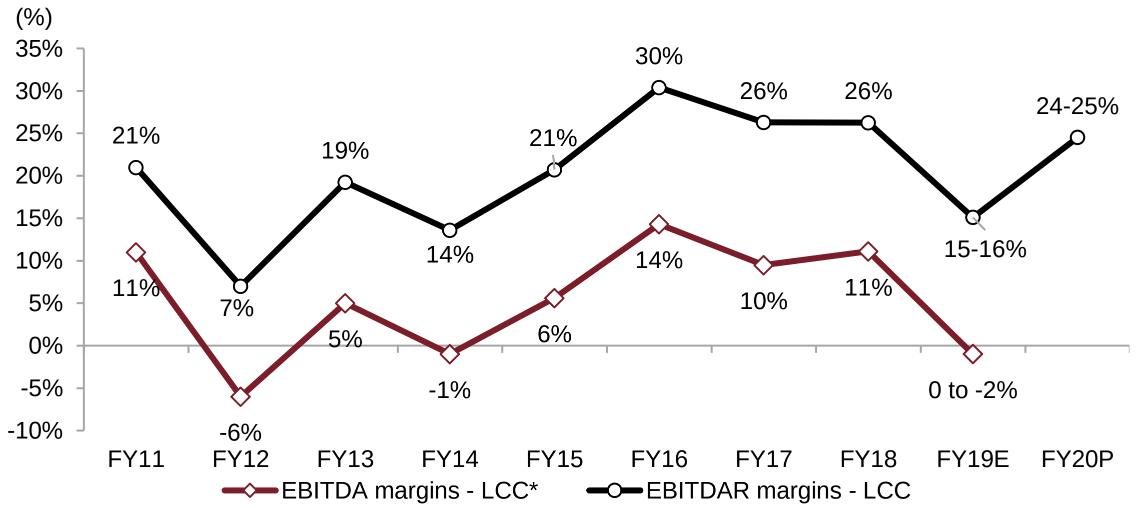
The LCCs are expected to post a strong double-digit growth of 25-30% on-year in domestic passenger traffic, led by robust expansion of domestic capacity by SpiceJet and Indigo. However, non-revival of Jet Airways would curb growth at the industry level.

Profitability to rebound as airfares rise; EBITDAR margins to hop up

With the improvement in fares and robust growth in passenger traffic for LCCs, we anticipate the EBITDAR margin to rebound to 24-25% this fiscal from 15-16% in fiscal 2019. The carriers' operating margin had come off after touching a decadal high of ~30% in fiscal 2016.

The recovery this time will be led by a significant jump in air fares due to sudden squeeze in capacity by airlines, following the grounding of the Jet Airways fleet in April.

EBITDAR margin of LCCs to soar 900 bps this fiscal



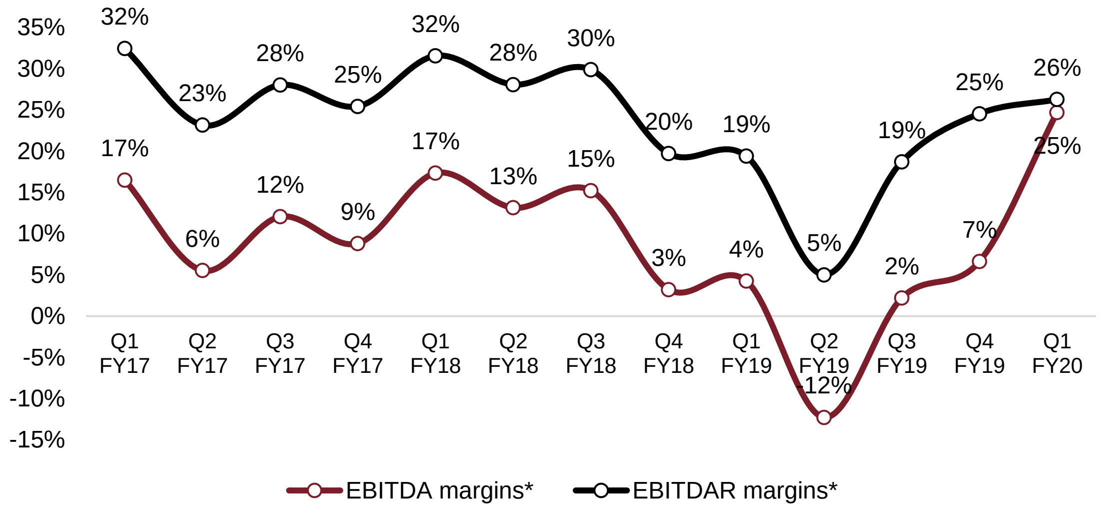
E: Estimated, P: Projected

**Due to a change in reporting by airlines to Ind AS 116, EBITDA margins for the players may not be comparable in FY20.*

Note: Considering Indigo, SpiceJet, GoAir and AirAsia (India), which account for 70% of domestic revenue passenger kilometer (RPKM) in FY19

Source: Company reports, CRISIL Research

Ind AS 116 has narrowed the differential between EBITDA and EBITDAR margins



*Note: *EBITDA/EBITDAR margins are for Indigo and SpiceJet, which account for 79% of LCCs RPKM in FY19*
LCCs include Indigo, SpiceJet, GoAir and AirAsia (India) which account for 70% of RPKM in FY19
Source: Company reports, CRISIL Research

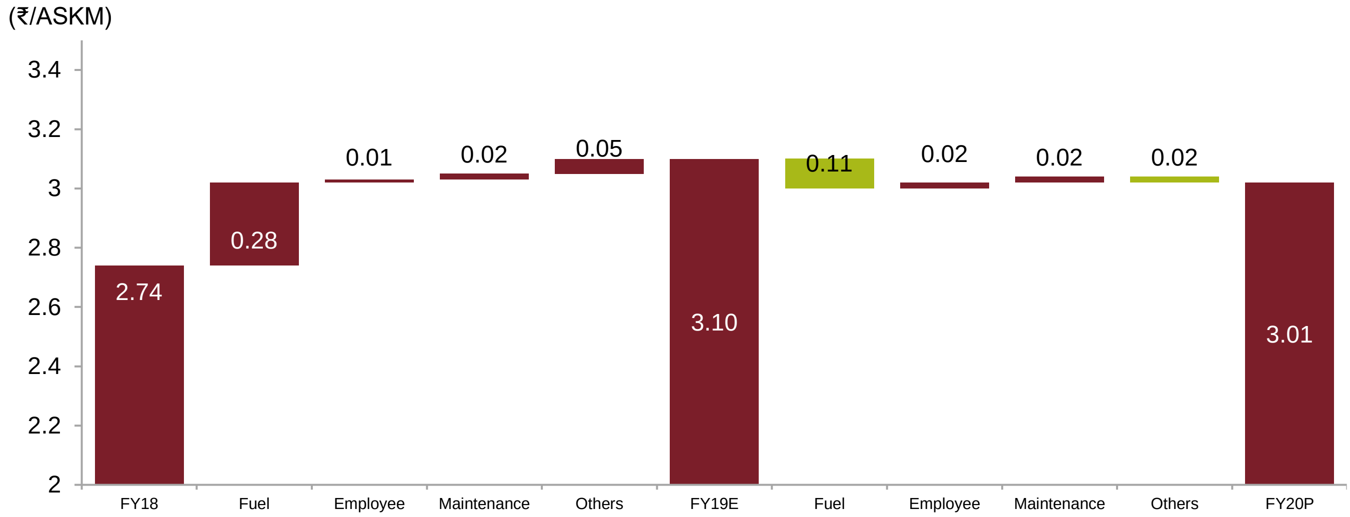
From fiscal 2020, due to implementation of Accounting Standard 116 (Ind AS 116), the earlier reporting structure of aircraft lease rentals has changed. As part of this change, the operating lease rentals of aircraft, which were earlier part of operating expenses, will now be classified as depreciation and interest expense. This has removed the differential in reporting structure between operating and financial leased aircraft in the profit and loss statement.

Accordingly, the EBITDA margin of the industry has inched closer to the EBITDAR margin from the first quarter of fiscal 2020.

Fiscal 2020 EBITDAR margins have been projected considering a 5-10% on-year decline in crude oil prices at $63-68 for calendar year 2019, depreciation in exchange rate to Rs 71/$ and a 300 bps cut in excise duty for aviation turbine fuel (ATF) in October 2018.

The benign fuel cost, coupled with expected lower foreign exchange losses and a rise in share of fuel-efficient aircraft such as A320neo and A321neo from 23% in fiscal 2019 to about 27-30% in fiscal 2020, is expected to aid contraction in operating costs (excluding rentals) in fiscal 2020.

Chief contributors to operating cost (excluding rentals) for LCCs, fiscals 2018-2020



Note: Includes Indigo, SpiceJet, GoAir and AirAsia India which account for 70% of domestic revenue passenger kilometers (RPKM) in FY19

Source: Company reports, CRISIL Research

Industry to see single-digit growth in passenger traffic this fiscal, but LCCs 4x that

For the industry overall, domestic passenger traffic is forecast to grow 6-8% this fiscal, mainly due to non-revival of Jet Airways.

This is way below the 14% growth logged in fiscal 2019 and the compound annual growth rate (CAGR) of 18% seen in the last five years, but is higher than our earlier estimate of 2% growth and factors an upward revision in capacity addition plans of LCCs.

LCCs, on their part, are expected to post strong double-digit growth of 25-30% in passenger traffic for fiscal 2020.

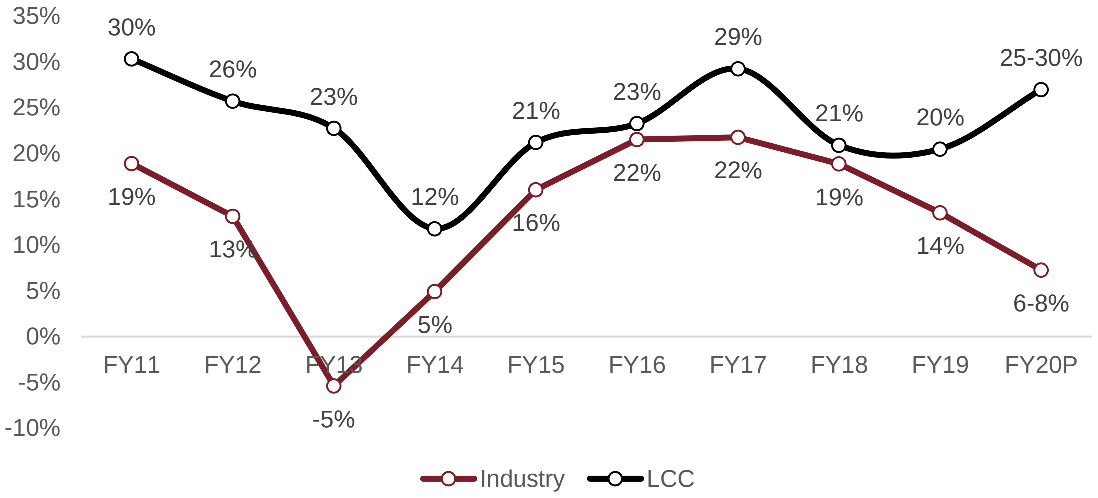
The traffic forecast assumes

- Capacity (in terms of available seat kilometers (ASKM)) increase of more than 45% and 30% by SpiceJet and Indigo, and 15-20% by the rest of the players, including Go Air, AirAsia (India) and Vistara
- Non-revival of currently grounded Boeing 737 Max for fiscal 2020.
- Non-revival of Jet Airways as the deadline set by lenders for on-boarding new investors through Expression of Interest has expired

Even if Boeing 737 Max aircraft resumes operations post H1 FY20, the domestic passenger traffic growth for the industry could grow faster by about 80-100 bps at best to 7-9%.

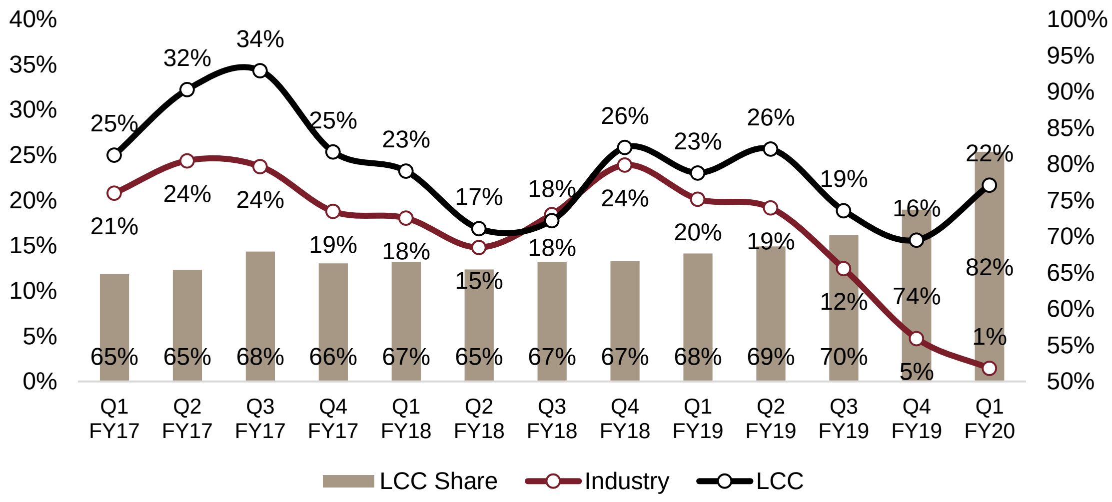
The capacity addition of players is supported by deregistration of aircraft of Jet Airways, which were under operating lease (accounting for about 85% of the airline's fleet) and re-leasing them to players such as SpiceJet and Vistara.

For LCCs, domestic passenger-traffic growth has been consistently faster than the industry



Note: LCCs include Indigo, SpiceJet, GoAir and AirAsia (India)
Source: Directorate General of Civil Aviation (DGCA), CRISIL Research

Quarterly on-year growth in domestic passenger traffic for the industry and LCCs



Source: DGCA, CRISIL Research

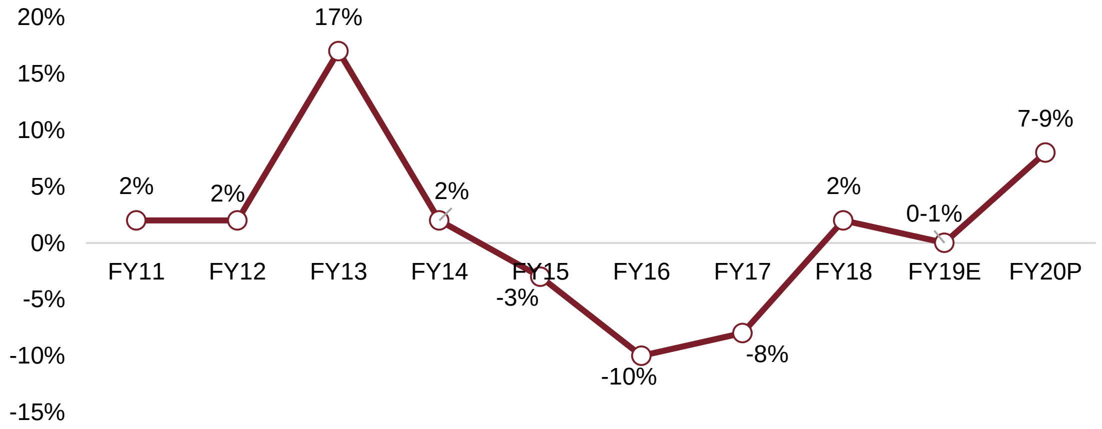
Due to the admittance of Jet Airways in the National Company Law Tribunal (NCLT), even the scheduled slots of Jet are being reallocated to other airlines on a temporary basis, especially at key metro airports.

Meanwhile, international passenger traffic growth for the industry is expected to fall to 3-5% on-year in fiscal 2020, compared with 6% in fiscal 2019. Despite the lower growth, the share of such traffic for domestic carriers is expected to remain flat at 37%. The estimate factors the evacuation of Jet Airways – which accounted for 33% of the international market among domestic carriers in terms of RPKM – and significant expansion planned by other domestic players.

Spurt in fares highest in many years

Domestic fares for the industry are expected to jump 7-9% on-year, the highest rise since fiscal 2013, when Kingfisher exited. Consequently, CRISIL Research expects domestic passenger load factor (PLF) for the industry to remain flat at ~86% in fiscal 2020.

Domestic fare hike this fiscal to be highest since fiscal 2013



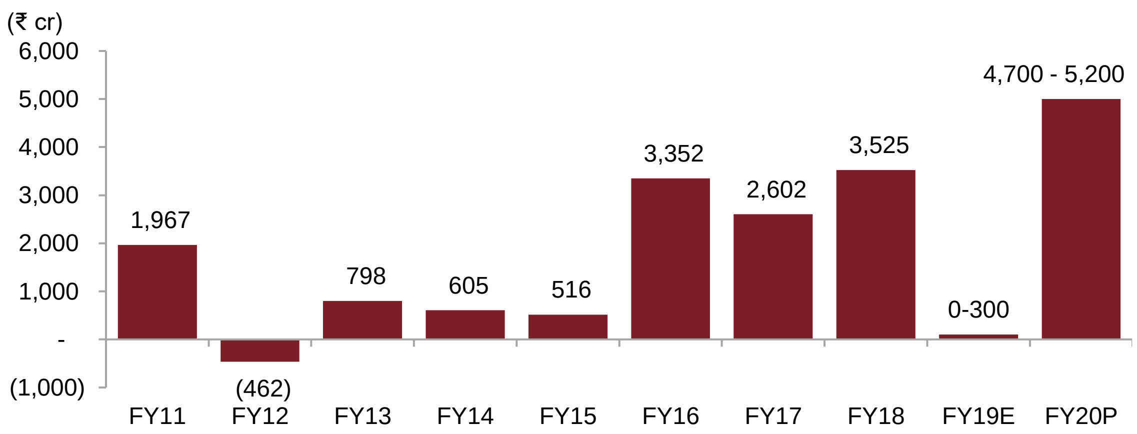
Note: The above fares are for the industry
Source: Company filings, CRISIL Research

Operating cash flows of LCCs in fiscal 2020 to be at a decadal high

With operating costs rising, LCCs are estimated to have hovered around breakeven level in fiscal 2019, in line with their operating margins.

For fiscal 2020, however, CRISIL Research expects operating cash flows to jump to a decadal high of Rs 4,700-5,200 crore, led by a significant improvement in fares and EBITDAR margins. Moreover, unlike fiscal 2019, the majority of the LCCs are expected to post positive operating cash flows.

Jump in operating margins to boost cash flows of LCCs this fiscal



Note: includes Indigo, SpiceJet, GoAir and AirAsia (India) which account for 70% of the domestic RPKM domestic market in FY19
FY19 numbers are based on abridged financials of listed players
Source: Company reports, CRISIL Research

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