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Indian aviation industry struggles to soar high

by Vishal Kumar Singh

The aviation industry has emerged as one of the fastest growing industries in the country and has led to India becoming the third largest domestic aviation market in the world. But on the contrary, Indian airlines are facing turbulence. At least a dozen airlines have closed in the last two decades and all major airlines have declared overall losses in the past few quarters.

Before it defaulted in end 2018, Jet Airways was the second largest airline after InterGlobe Aviation, parent company of Indigo, based on market share of airline schedules as seen in Table 1 below. However, Jet Airways was then forced to cease all flight operations in mid-April 2019, due to lenders rejecting an INR 4bn emergency funding. Jet Airways has been taking up loans for continuing the operations increasing its debt to capital ratio as seen in Table 2 with its debt/capital reaching the highest level among the major airlines in FY 2018. Jet Airways' credit profile has also been a concern following the company's worsening financial results and poor operational performances as seen in the falling EBITDA margins in Table 3. Indigo and Spicejet however managed to capture more market share as Jet Airways plunged into crisis.

	Market Share (%)			
	Mar 2016	**Mar 2017**	**Mar 2018**	**Mar 2019**
Jet Airways India Ltd	20.9	18.1	16.7	10.3
SpiceJet Ltd	13.0	13.0	12.6	13.6
InterGlobe Aviation Ltd	37	39.7	39.7	44.3

Table 1: Market shares of Indian airlines. *Source: DGCA, India*

The lenders of Jet Airways, led by State Bank of India, are currently in the process of trying to sell the airline in order to recover their dues of INR 84bn. This is after lenders became the largest shareholders in the airline when nearly 98% of Jet Airways' shareholders agreed for conversion of loans into shares or convertible instruments in Feb 2019 under the bank-led provisional resolution plan as the carrier look to restructure its debts and raise fresh funds.

	Total Debt / Capital (%)		
	FY 2016	**FY 2017**	**FY 2018**
Jet Airways India Ltd	191.94	236.73	412.27
SpiceJet Ltd	644.49	247.39	105.87
InterGlobe Aviation Ltd	54.37	40.72	25.74
	EBITDA Margin (%)		
	FY 2016	**FY 2017**	**FY 2018**
Jet Airways India Ltd	14.18	13.11	3.23
SpiceJet Ltd	10.83	8.86	9.66
InterGlobe Aviation Ltd	19.44	11.62	13.14

Table 2 & 3: Debt/capital ratio and EBITDA Margin of Indian airlines. *Source: Bloomberg*

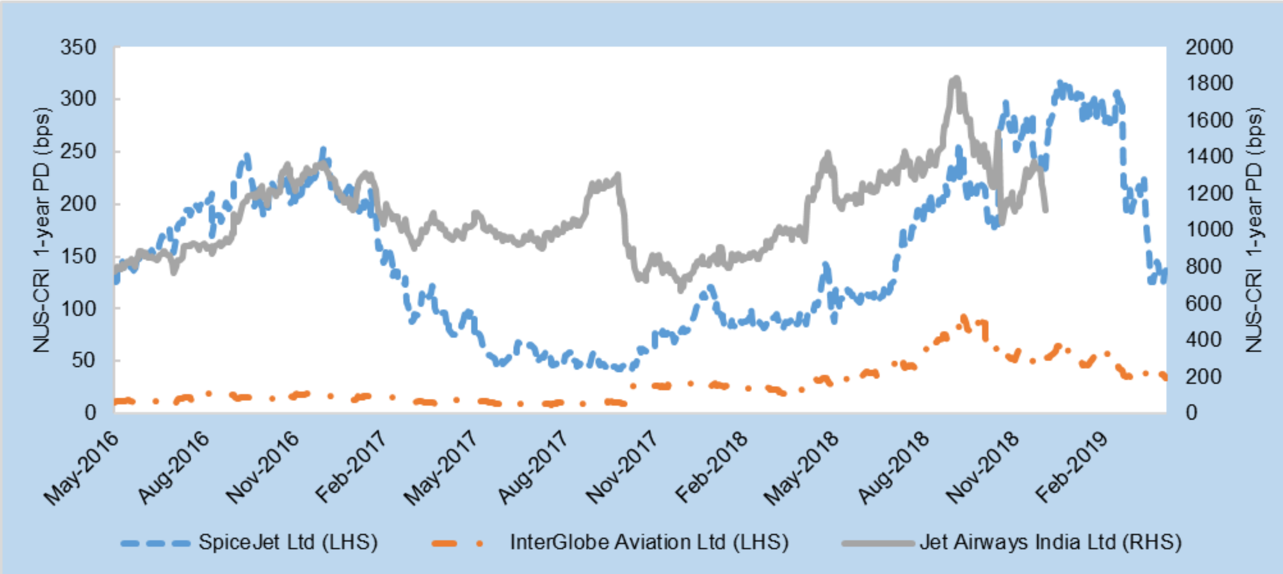

Figure 1: NUS-CRI 1-year PD for Indian Airlines. S*ource: NUS-CRI*

As compared to its competitors, the NUS-CRI 1-year Probability of Default for Jet Airways is much higher, which is demonstrated in Figure 1. The past few years have been tough for Indian airlines facing stiff competition and regulatory changes from the government. The rise in fuel price, a depreciating rupee, intense competition among the airlines and a resulting mismatch between high fuel prices and low fares have adversely impacted the Indian aviation industry, with one major airline, Jet Airways being impacted heavily as described earlier.

Despite the airline market growing by double digits, the Indian airlines struggle to turn a profit. Fuel cost accounts for 24.2% of an average global airline's cost structure while in India, it is 34%. In addition, the high taxes on jet fuel along with the lack of competition for fuel suppliers has led to the weakening profitability of the airlines. The Parliamentary panel in Indian also recommended an upper cap on airfares to discourage predatory pricing. As rising income spurs an air-travel boom in the USD 2.6tn economy, about 10 carriers are vying for passengers taking to the skies for the first time in their lives, offering discounts that have pushed down fares so low that they can barely recover costs.

A need to review the functioning and bring a change in the policies and frameworks in the aviation industry may be required. One proposed policy may be a respite to the airlines is that the airlines could expect an annual relief of up to INR 50bn by way of input tax credit if the Aviation Turbine Fuel is brought under GST as this will help reduce the burden of increased jet fuel prices.

Credit News
PBOC warns on trade, pledges targeted stimulus and steady Yuan **May 20.** The People's Bank of China will remain supportive of the economy as the escalating trade war affects the global economy. China's output has slowed more than expected in April due to slowing consumption and industrial output. The PBOC will keep a balance between tightening and easing measurers without flooding the economy with liquidity. The central bank will continue to improve credit structure in the vulnerable traditional sectors and improve its ability to direct credit to the needy parts of the economy. There are also room for the government to leverage on fiscal policy to support the economy. (Bloomberg)
Credit quality declines at big US business lenders

May 20. The quality of big US banks' commercial lending portfolios is deteriorating for the first time in nearly three years albeit low interest rates and relatively strong economic growth. Non-performing loans at the 10 largest commercial lenders rose 20%, or USD 1.6bn, in the first quarter, according to Financial Times. The sudden increase in problem credit is raising concerns given not a single industry is under pressure now. Investors are wondering whether there is worse to come should the economy slow. Commercial lending has grown rapidly since the 2008 financial crisis and there are a few uncertainties ahead that may affect the credit quality, such as management shortfalls at some companies, the withdrawal of liquidity by the Fed and the risk from nonbank lending. (FT)

Secret bond deals making China's debt market more confusing

May 16. The actual default rate in China may have been understated because of not fully disclosed bond payment process. In China, bond payments typically go through official venues including the China Securities Depository and Clearing Corporation Ltd. An issuer sometimes cuts out such clearing houses to undertake a restructuring without publicity that might affect its broader funding costs and the disposition of its other securities outstanding. Investors seem to have largely gone along with issuers, in part out of concern at the low recovery amounts they'd likely face in the case of a publicly recognized default. This has impaired transparency of the market and has increased market uncertainties, according to UBS Asset Management. (Bloomberg)

'Fragile' corporate debt emerges as key vulnerability in Canada

May 16. The Bank of Canada has added corporate borrowing to its assessment of financial stability. Non-financial corporate debt was 315% of income at the end of 2018 and are one of the top vulnerabilities to the country's financial system. In addition, the share of outstanding debt owed by firms that have poor debt-service capacity and low liquid asset holdings is higher than is typically the case. The central bank singled out commodity companies, which are said to carry higher debt loads while suffering from falling income due to declines in global resource prices. The central bank also highlighted the risk of non-bank credit providers, the loosened lending standards and deteriorated corporate-debt quality in global market. (Bloomberg)

Euro zone banking at risk of dangerous fragmentation, ECB warns

May 16. Euro zone banks are shunning cross-border activity as it is hindered by national rules, leaving lenders unable to compete effectively with their global peers. Euro zone banks are also heavily reliant on their home market as 60% of banks total exposures are to their home countries. The political momentum to complete the banking union is fading and could lead to the banks regrouping to focus their activities on their domestic markets, resulting in further fragmentation. (Reuters)

Huawei dollar bonds extend slide as U.S tech firms stop supplies (Bloomberg)

U.S. junk bond funds suffer biggest outflow since December (Bloomberg)

Investors shed European safe-haven bonds on trade talk hopes (Reuters)

Regulatory Updates

Growth Fears Leave ECB Exposed as Negative Rate Relief Doubted

May 17. Money markets are currently pricing a 40% chance that the ECB will cut rates by the first quarter of 2020. Amid growing trade tensions, some traders have placed their bets on higher borrowing costs as ECB's rate are in the negative region which will not have enough space to lower further if growth goes awry. A tiering of the deposit rate may be possible which can help lessen the squeeze on banks' profitability by exempting part of their reserves from the negative deposit rate. The proposal however met with little enthusiasm. On the other hand, market watchers are optimistic that ECB's track record in being innovative in coming up with additional measures. (Bloomberg)

Regulators cut banks some slack on shift away from Libor

May 14. Global market regulators are considering handing out concessions to banks to help aid in the shift away from the Libor lending benchmark. Leaving the Libor benchmark is a concern for banks as it might saddle them with intractable problems regarding old contracts and the need to hedge risks which might result in litigation and disruption. Bank of England accepts that a transition will involve multiple different rates in different market and the central bank is expected to allow banks to develop new rates to more closely match their sterling funding and lending costs. In the UK, the overnight lending rate- Sonia is starting to gain traction but Sonia-linked debts only account for 3% of the total market. An index sensitive to bank credit has been proposed as an alternative to Libor but it is unclear if the rate would be accurate and also its behaviour during market turmoil. (FT)

India's shadow banks gain on report RBI may offer credit line (Bloomberg)

China will launch pilot bond index mutual funds (Reuters)

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