Interglobe Aviation Limited

June 13, 2018

Summary of rated instruments

Instrument*	Current Rated Amount[1] (Rs. crore)	Rating Action
Short-term Fund-based Limits	155.00	[ICRA]A1+; Assigned
Short-term Non-fund Based Limits	325.00	[ICRA]A1+; Assigned
Short-term Non-fund Based Sub-Limits**	(545.00)	[ICRA]A1+; Assigned
Long-term/Short-term Non-Fund Based Limits	6,642.48	[ICRA]AA (Stable)/A1+; Assigned
Long-term Non-fund Based Limits	335.63	[ICRA]AA (Stable); Assigned
Long-term Non-fund Based Sub-Limits**	(100.00)	[ICRA]AA (Stable); Assigned
Unallocated	541.89	[ICRA]AA (Stable); Assigned
Total Bank Line Facilities	**8,000.0**	
Issuer Rating	NA	[ICRA]AA (Stable); Assigned

*Instrument details are provided in Annexure-1 ** Sub-limits of other facilities

Rating action

ICRA has assigned a long-term rating of [ICRA]AA (pronounced ICRA double A) and a short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 8000.0-crore[2] bank facilities of Interglobe Aviation Limited (Indigo)[3]. ICRA has also assigned an issuer rating of [ICRA]AA (pronounced ICRA double A) to the company. The outlook on the long-term rating is Stable.

Rationale

The assigned ratings reflect a) Indigo's well-established position as India's largest airlines with approximately 40% share of the passenger traffic and leading position on major routes in India, b) strong competitive position in terms of cost structure compared to peers, and c) comfortable leverage and strong liquidity profile relative to peers within the airline sector. Supported by its resilient business model, Indigo has demonstrated relatively less volatility in its earnings than other airlines. These strengths are partially offset by the inherent risk associated with the airline industry such as rising crude oil prices, sharp fluctuation in foreign exchange rates and low pricing power due to intense competition.

Indigo is the market leader in the Indian domestic aviation market with a share of 40% as on FY2018 and is steadily scaling up its presence on the international routes from India (primarily to Middle-East and South-East Asia). The company benefits from its extensive route network, operating in all high-traffic routes in the country at high frequencies, and consistent operating performance with high On-Time Performance (OTP) and low cancellation rates. With the Indian market poised for growth over the medium term, supported by current low penetration levels and favourable demographics, ICRA expects Indigo to continue to grow and expand in the domestic market going forward.

Indigo's superior cost structure has helped it remain profitable through economic cycles in the past ten years. The company has attained a sustainable cost-advantage, aided by structural and operational factors. Structurally, bulk orders placed

[1] *Exchange Rate of Rs. 66.78/USD taken as per the RBI Reference Rate on April 27, 2018 for USD-denominated facilities*

[2] *100 lakh = 1 crore = 10 million*

[3] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

with Airbus, operation of a single-fleet and competitive maintenance terms negotiated while placing orders have kept Indigo's aircraft ownership and maintenance costs lower than its peers while operationally, it continues to focus on improving asset utilisation and controlling overheads to maintain its cost advantage.

Nonetheless, an airline's profitability is prone to fluctuations in Aviation Turbine Fuel (ATF) costs and USD-INR exchange rate as is typical for the airline industry. These concerns have been visible over the recent months, as reflected in the Q4 FY2018 financial results of domestic airlines. Yields in the industry moderated due to increased competition, while the airlines faced headwinds from the rise in ATF prices and depreciation of the rupee, thereby impacting the profitability. Indigo also reported weak operating performance during Q4 FY2018, because of a 5% decline in yields and 7% increase in CASK on a YoY basis, which resulted in a sharp moderation in its profitability. Going forward, its ability to maintain healthy profit margins through economic cycles remains critical and would remain a key rating sensitivity. To some extent, the company would be able to mitigate the effect of rising fuel prices with the induction of 15% more fuel-efficient A320 NEOs going forward.

The ratings also reflect the company's comfortable credit metrics and strong liquidity position, in the form of free cash balances and investments in liquid instruments (Rs. 7,059 crore as on March 31, 2018). Although, the company aims to utilise its surplus cash balances for outright purchase of aircraft over the medium term, ICRA expects Indigo to continue to maintain adequate liquidity buffer for ongoing business requirements.

Indigo's foreign exchange exposure is higher than other domestic airlines because of the sizeable USD-denominated liability on its balance sheet, which is further compounded by the absence of foreign exchange hedging and limited share of revenues denominated in foreign currency. However, the company is evaluating various structures to reduce its balance sheet forex exposure.

ICRA also takes note of Indigo's supplier concentration risk related to having a single aircraft engine supplier. This has been visible over the past one year, with multiple instances of aircraft grounding and delayed aircraft deliveries because of issues faced with the Pratt & Whitney (P&W) engines in the latest generation A320 NEO aircraft, which has led to a delay in capacity addition. However, ICRA notes that out of the total aircraft order of 430 A320 NEOs placed, 150 of these comprise committed orders for P&W engines, giving the company flexibility to reduce this risk for the balance part of the order. Furthermore, the company maintains that it has been compensated from P&W by way of credits for issues faced due to aircraft grounding and delayed deliveries.

Although the company has expressed interest towards acquiring the international operations of Air India, ICRA considers this to be a low-probability event, and the impact of the same on the ratings would be factored in as and when it materialises. Indigo's expansion into long-haul international operations and its impact on financial performance would also be considered when greater clarity on its business plan in terms of fleet expansion, route network and funding emerge. Hence, these would remain rating sensitivities and developments on these fronts would be monitored.

Outlook: Stable

ICRA believes Indigo would continue to maintain its strong market position and competitive advantage in terms of the lowest cost structure among peers going forward. Although rising crude oil prices and a depreciating rupee are likely to exert pressure on the profitability over the near term, Indigo would be in a better position to tide over these challenges vis-à-vis other domestic airlines, primarily supported by its favourable cost structure and strong liquidity position.

The outlook may be revised to Negative if, the company's profitability comes under severe pressure, with competitive intensity or other factors suppressing the yields in periods of rising input costs, or in case of significant weakening of liquidity profile due to aircraft ownership plans of the company going forward.

The outlook may be revised to Positive in case of a favourable movement in input costs, which leads to a sustainable improvement in profitability for the company, or reduction in foreign exchange liability on the balance sheet, through practices adopted by the company.

Key rating drivers

Credit strengths

Leading domestic air carrier in India with 40% market share and a strong route network – Indigo, positioned as a Low-Cost Carrier (LCC), is currently India's largest domestic air carrier, in terms of the domestic passengers flown. Between FY2010 and FY2018, Indigo grew its fleet from 19 to 159 aircraft and expanded its capacity at a CAGR of 25%, while the industry capacity grew at a CAGR of 10%. Driven by its brand image of delivering high on-time performance than most other airlines, competitive pricing and phasing out of operations by other airlines, Indigo expanded its market share from 14% to 40% during this period to emerge as the leading domestic airline.

Most cost competitive and consistently profitable airline in India – Aided by large orders placed with Airbus and competitive terms negotiated with its vendors for maintenance, Indigo has lower cost of ownership and maintenance as compared to the Indian airlines industry. Additionally, maintenance of a single fleet and tight control on overheads have also contributed to the lowest CASK among Indian airlines, which also compares favourably with other global LCCs. On the back of these factors, Indigo has been the only Indian airline to remain consistently profitable over the past ten years, highlighting its resilient business model, in an industry that is known to exhibit sharp volatility in earnings and has witnessed exit of multiple airlines.

Comfortable credit metrics and strong liquidity position with ample funds parked in liquid investments – As on FY2018, Indigo's Adjusted Interest Coverage[4] stood at 5.2 times, which compares favourably among other airlines. In addition, Indigo has a strong liquidity profile, underpinned by a high free cash balance and liquid investment of Rs. 7,059-crore at the end of FY2018, compared with Rs. 4,433-crore at the end of FY2017. Although, the company aims to utilise its free cash flows and surplus cash balances for outright purchase of aircraft going forward, ICRA expects Indigo to continue to maintain an adequate liquidity buffer for meeting its ongoing business requirements. Furthermore, the company's long-term debt of Rs. 2,453-crore as on March 2018 has a long maturity profile, which limits its annual repayments to approximately Rs. 200-250-crore p.a.

Favourable growth prospects aided by current low penetration of air traffic in India and progressive policies - The Indian aviation market is currently one of the fastest growing markets in the world, supported by multiple factors including low penetration levels, favourable demographics, improving affordability as well as capacity expansion and addition of new airports and regional routes by airline operators. With Indigo's strong order pipeline of approximately 400 A320 NEO and 44 ATR aircraft, it remains in a comfortable position to capture a sizeable share of the expanding domestic market.

Sound and experienced management team with proven track record - Indigo was founded by Mr. Rahul Bhatia and Mr. Rakesh Gangwal in 2006, both of whom have extensive experience in the travel and aviation industry. Furthermore, the company is managed by professionals with extensive experience in the aviation sector, having served in various international carriers.

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[4] Adjusted for fixed lease rentals using a lease multiplier factor
Adjusted Interest Coverage = EBITDAR/(Reported interest + Lease Equivalent Interest)

Credit challenges

Earnings remain susceptible to inherent volatility in crude oil prices and foreign exchange scenario – With jet fuel prices accounting for 35-50% of total expenses, and a considerable proportion of operating expenses (i.e. lease rentals, aircraft and engine maintenance payments) denominated in US$ terms, airlines' earnings remain susceptible to volatility in crude oil prices and fluctuations in foreign exchange rates. With the increasing trend in crude oil prices and depreciating rupee over the past few months, the profitability of the airline is likely to come under pressure over the near term.

Highly competitive environment can put pressure on yields, especially during periods of high capacity addition – The Indian aviation market is highly competitive as reflected by frequent foray of new entrants and sizeable fleet addition by incumbents. Given the high fixed cost structure of the industry, airlines tend to follow aggressive pricing strategies to capture market share, which puts pressure on industry's yields. Over the past few months, the yields in the domestic market have exhibited some weakness, which coupled with rising jet fuel prices have resulted in contraction in profitability of airlines. Going forward, the industry yields are likely to remain pressurised, especially in view of significant capacity addition planned by multiple airlines over the medium term and potential slowdown in air traffic. In the current fiscal, with Indigo planning to expand capacity by 25%, its ability to maintain yields and load factors remain critical to its profitability.

Vulnerable to foreign exchange risks with significant forex-denominated liabilities on balance sheet - In addition to the impact of sharp foreign exchange movements on the profitability of the company, due to foreign currency denominated costs, Indigo also has significant forex-denominated liabilities on its balance sheet. This includes finance lease obligations and liabilities related to maintenance costs viz., supplementary rentals. As per ICRA estimates, forex-denominated liabilities accounted for close to half the capital employed as on March 31, 2018, exposing the company to forex fluctuations. However, the company plans to reduce this risk through various structures going forward.

Concentration risks associated with dependence on single aircraft and technology – Although Indigo derives significant cost advantage over other airlines by operating a single type of aircraft, the company is exposed to concentration risks arising due to high dependence on a single OEM and engine supplier. This has been visible over the past one year, with multiple instances of aircraft grounding and delayed aircraft deliveries because of issues faced with the Pratt & Whitney engines in the latest generation A320 NEO aircraft, although compensation has been received from the engine supplier to offset the impact of the same. The company also has the flexibility to source engines from an alternate engine supplier post the delivery of 150-committed engines out of the total order of 430.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below. The reported financials have been adjusted for the fixed lease rentals of the company, considering a lease multiplier factor.

Links to applicable criteria:

Corporate Credit Rating Methodology

About the company:

InterGlobe Aviation Limited is the operating company for Indigo, India's largest passenger airline in terms of domestic market share. The airline operates on a low-cost carrier (LCC) business model, offering no-frills air-commute to passengers both in the domestic as well as international sectors. The company currently commands ~40% of the domestic market in terms of passengers carried. It commenced operations in August 2006 with a single aircraft and has grown its fleet over the years to 159 aircraft at present. As on March 2018, the company had a fleet of 159 aircraft, comprising 153 Airbus A320s and six ATRs, which connected 42 domestic and eight international destinations.

In FY2018, the company decided to enter the regional market by inducting a fleet of 74-seater ATR aircraft. Having established a strong presence in the domestic market and short-haul international routes, Indigo is now planning to enter the long-haul international market.

Promoted by Mr. Rahul Bhatia and Mr. Rakesh Gangwal, the company was originally incorporated in January 2004 as a private limited company and converted into a public limited company in June 2006 as Interglobe Aviation Limited. Subsequently, Indigo proceeded with its Initial Public Offering in FY2016, wherein its shares were listed on the BSE and the NSE. Indigo is part of the Interglobe Group, which has diverse business interests across the aviation, hospitality, real estate, travel commerce, airline management, pilot training, aircraft maintenance and IT&BPO spaces.

Key financial indicators (audited)

	FY 2017	FY 2018
Operating Income (Rs. crore)	18,580.5	23,020.9
PAT (Rs. crore)	1,659.2	2,242.3
OPBDIT/ OI (%)	12.0%	12.8%
RoCE (%)	40.6%	42.4%
Total Debt/ TNW (times)	0.7	0.3
Total Debt/ OPBDIT (times)	1.2	0.8
Interest Coverage (times)	5.5	8.7
NWC/ OI (%)	-19%	-18%

Note: Financials are as per the reported numbers of the company.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding^ (Rs Crore)	Current Rating (FY2019) Date & Rating June 2018	Chronology of Rating History for the past 3 years Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
						-	-	-
1	Short Term Fund Based Limits	Short Term	155.00	-	[ICRA]A1+	-	-	-
2	Short Term Non Fund Based Limits	Short Term	325.00	168.26	[ICRA]A1+	-	-	-
3	Short Term Non-Fund Based Sub-Limits*	Short Term	(545.00)	(5.82)	[ICRA]A1+	-	-	-
4	Long Term/Short Term Non Fund Based Limits	Long Term/ Short Term	6,642.48	4,944.49	[ICRA]AA (Stable)/ [ICRA]A1+	-	-	-
5	Long Term Non Fund Based Limits	Long Term	335.63	217.43	[ICRA]AA (Stable)	-	-	-
6	Long Term Non-Fund Based Sub-Limits*	Long Term	(100.00)	(76.73)	[ICRA]AA (Stable)			
7	Unallocated	Long Term	541.89	-	[ICRA]AA (Stable)	-	-	-
8	Issuer Rating	Long Term	-	-	[ICRA]AA (Stable)	-	-	-

*Sub-limits of other facilities ^As on March 31, 2018

Note: Exchange Rate of Rs. 66.78/USD taken as per the RBI Reference Rate on April 27, 2018 for USD-denominated facilities

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Short Term Fund Based Limits	-	-	-	155.00	[ICRA]A1+
NA	Short Term Non Fund Based Limits	-	-	-	325.00	[ICRA]A1+
NA	Short Term Non-Fund Based Sub-Limits*	-	-	-	(545.00)	[ICRA]A1+
NA	Long Term/Short Term Non Fund Based Limits	-	-	-	6,642.48	[ICRA]AA (Stable)/ [ICRA]A1+
NA	Long Term Non Fund Based Limits	-	-	-	335.63	[ICRA]AA (Stable)
NA	Long Term Non-Fund Based Sub-Limits*	-	-	-	(100.00)	[ICRA]AA (Stable)
NA	Unallocated	-	-	-	541.89	[ICRA]AA (Stable)
NA	Issuer Rating	-	-	-	NA	[ICRA]AA (Stable)

Source: Interglobe Aviation Limited * Sub-limits of other facilities

Note: Exchange Rate of Rs. 66.78/USD taken as per the RBI Reference Rate on April 27, 2018 for USD-denominated facilities

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About ICRA Limited:

ICRA 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. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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