Interglobe Aviation Limited

October 17, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount[1] (Rs. crore)	Current Rated Amount[2] (Rs. crore)	Rating Action
Long-term Non-fund Based Limits	335.63	335.63	[ICRA]A+ (Negative); Revised from [ICRA]AA (Stable)
Long-term Non-fund Based Sub-Limits**	(100.00)	(100.00)	[ICRA]A+ (Negative); Revised from [ICRA]AA (Stable)
Unallocated	541.89	541.89	[ICRA]A+ (Negative); Revised from [ICRA]AA (Stable)
Long-term/Short-term Non-Fund Based Limits	6,642.48	6,642.48	[ICRA]A+ (Negative)/A1+; Revised from [ICRA]AA (Stable)/A1+
Short-term Fund-based Limits	155.00	155.00	[ICRA]A1+; Reaffirmed
Short-term Non-fund Based Limits	325.00	325.00	[ICRA]A1+; Reaffirmed
Short-term Non-fund Based Sub-Limits**	(545.00)	(545.00)	[ICRA]A1+; Reaffirmed
Total Bank Line Facilities	**8,000.0**	**8,000.0**	
Issuer Rating			[ICRA]A+ (Negative); Revised from [ICRA]AA (Stable)

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

Rating action

ICRA has revised the long-term rating to [ICRA]A+ (pronounced ICRA A plus) from [ICRA]AA (pronounced ICRA double A) and reaffirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) outstanding on the Rs. 8000.0-crore[3] bank facilities of Interglobe Aviation Limited (Indigo)[4]. ICRA has also revised the issuer rating to [ICRA]A+ (pronounced ICRA A plus) from [ICRA]AA (pronounced ICRA double A) on the company. The outlook on the long-term rating has been revised to Negative from Stable.

Rationale

The rating action takes into consideration expected adverse impact of the significant increase in operating costs of airlines, including Indigo, and their limited flexibility to effect price hikes to offset cost pressures. Over the last nine months, the Indian Rupee (INR) has witnessed significant depreciation against the US$, which coupled with sharp rise in global crude oil prices has led to 34% Y-o-Y increase in domestic Aviation Turbine Fuel (ATF) prices and other operating costs (operating leases and maintenance) of airline companies during H1 FY2019.

With competitive intensity in the industry at elevated levels, the ability to pass on these cost pressures to passengers in the form of increased fares has also been limited. Consequently, Indigo's RASK has remained under pressure from Q4 FY2018 onwards as reflected by a decline of 3.4% (in Q4 FY2018) and 3.1% (in Q1 FY2019). At the same time, CASK (ex-fuel) has increased by 5.4% (in Q4 FY2018) and 13.6% (in Q1 FY2019) to Rs. 2.17 in Q1 FY2019 and is expected to have

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

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

[3] *100 lakh = 1 crore = 10 million*

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

increased further in the near-to-medium term. Additionally, ATF prices have increased by 27% on a Y-o-Y basis in Q1 FY2019, and a sharper 41% during Q2 FY2019, on account of the uptrend in global brent prices. Furthermore, with the recent 5% hike in import duty on jet fuel in India, and ATF prices announced in October 2018 being 7% higher on a sequential basis, the fuel cost pressure for airlines is only expected to increase further going forward.

Accordingly, the company's earnings over last couple of quarters have deteriorated sharply. As compared to double-digit operating profit margins (OPM) that the company had reported consistently over the past four fiscals, the OPM declined to 1.5% in Q4 FY2018 and further to -0.2% in Q1 FY2019, highlighting the stress on profitability underway in the industry.

Apart from adverse impact of INR depreciation on the operating expenses of the airline, Indigo also has additional foreign exchange exposure as compared to other domestic airlines because of the sizeable USD-denominated liability on its balance sheet. Although the company has been evaluating various structures to reduce its balance sheet forex exposure, it is expected to report sizeable Mark-to-Market (MTM) losses on these forex-denominated liabilities because of the rupee movement, at least over the near term.

The industry level headwinds are offset to some extent by Indigo's adequate liquidity position and superior cost structure which are expected to help the company to manage cash burn during the current period. As on June 2018, the company had free cash balances and investments in liquid instruments to the tune of Rs. 6,105 crore as on June 30, 2018. Although, the company has plans to utilise its surplus cash balances for outright purchase of aircraft, ICRA expects the airline would alter its aircraft acquisition strategy over the near term, considering the prevailing industry headwinds and maintain adequate liquidity buffer for ongoing business requirements.

The ratings also reflect Indigo's market leadership and superior cost structure, which has helped it remain profitable through economic cycles over the past ten years. Aided by both structural and operational factors, the airline has attained a sustainable cost-advantage. This is supported by placement of large bulk orders with Airbus at competitive prices, operation of a single-fleet and competitive maintenance terms negotiated while placing orders. As a result, Indigo's aircraft ownership and maintenance costs are lower than its peers while operationally, it has superior asset utilisation and lower overheads. As per ICRA, the competitive cost-structure coupled with its strong liquidity position together places Indigo in a better position to overcome this phase as compared to other domestic airlines. However, it remains imperative that pricing sanity returns in the industry and airlines pass on the increase in input costs to passengers in the form of increased yields, for operations to continue to remain sustainable.

Outlook: Negative

The Negative outlook reflects ICRA expectation that over the near-term, cost pressures would remain significant, considering the continued sharp increase in ATF prices and depreciation of rupee, while competitive intensity in the industry continues to be high.

The outlook could be revised to Stable in case the airline is able to pass on the increase in input costs to passengers in the form of increase in yields, which would help the airline arrest the decline in profitability and protect its credit metrics. The outlook could also improve in case of any significant improvement in liquidity position or reduction in forex risks supported by steps undertaken by the company for the same.

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 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.

Adequate liquidity position –Indigo has adequate liquidity, underpinned by a high free cash balance and liquid investment of Rs. 6,105 crore as on June 2018 compared to Rs. 7,059-crore at the end of FY2018. 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 operational 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.

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.

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 has come under pressure in recent quarters, which is likely to deteriorate further 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 been under pressure, 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	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding^ (Rs Crore)	Date & Rating Oct 2018	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+	[ICRA]A1+	-	-	-
2	Short Term Non Fund Based Limits	Short Term	325.00	168.26	[ICRA]A1+	[ICRA]A1+	-	-	-
3	Short Term Non-Fund Based Sub-Limits*	Short Term	(545.00)	(5.82)	[ICRA]A1+	[ICRA]A1+	-	-	-
4	Long Term/Short Term Non Fund Based Limits	Long Term/ Short Term	6,642.48	4,944.49	[ICRA]A+ (Negative)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	-	-	-
5	Long Term Non Fund Based Limits	Long Term	335.63	217.43	[ICRA]A+ (Negative)	[ICRA]AA (Stable)	-	-	-
6	Long Term Non-Fund Based Sub-Limits*	Long Term	(100.00)	(76.73)	[ICRA]A+ (Negative)	[ICRA]AA (Stable)			
7	Unallocated	Long Term	541.89	-	[ICRA]A+ (Negative)	[ICRA]AA (Stable)	-	-	-
8	Issuer Rating	Long Term	-	-	[ICRA]A+ (Negative)	[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]A+ (Negative)/ [ICRA]A1+
NA	Long Term Non Fund Based Limits	-	-	-	335.63	[ICRA]A+ (Negative)
NA	Long Term Non-Fund Based Sub-Limits*	-	-	-	(100.00)	[ICRA]A+ (Negative)
NA	Unallocated	-	-	-	541.89	[ICRA]A+ (Negative)
NA	Issuer Rating	-	-	-	NA	[ICRA]A+ (Negative)

* Sub-limits of other facilities

Source: Interglobe Aviation Limited

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:

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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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