

March 20, 2020

Air India Express Limited: Rating placed on watch with negative implications

Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|--|--------------------------------------|-------------------------------------|--|
| Short-term Loans | 573.22 | 573.22 | [ICRA]A4+@; placed on watch with negative implications |
| Short-term, Fund-based Bank Facilities | 727.85 | 727.85 | [ICRA]A4+@; placed on watch with negative implications |
| Total | 1301.07 | 1301.07 | |

*Instrument details are provided in Annexure-1

Rationale

The recent outbreak of coronavirus (COVID-19) in China has spread to over 162 countries worldwide, adversely impacting the travel and tourism industry globally, especially the airline industry. In India, the international passenger traffic will be adversely impacted following the implementation of travel restrictions (including cancellation of visas / permits) to / from most countries at least till March 31, 2020. In view of these travel restrictions, ICRA expects that the international operations of domestic airlines are likely to witness a significant reduction in passenger traffic, thereby exerting pressure on yields. Moreover, travel advisories issued by companies in India may start hurting domestic business travel, if the outbreak is not contained in a timely manner. Given these developments, ICRA has placed the rating of Air India Express Limited (AIEL) on watch with negative implications. Despite the possibility of moderation in passenger demand, the decline in fuel prices could cushion the impact on earnings. ICRA will continue to monitor the developments and will take appropriate rating action, if required, in future.

The rating reflects the continued stretched credit profile of AIEL, as characterised by negative net worth and high payables to Air India Limited (Air India) and other vendors. While the total debt for AIEL reduced to Rs. 1,665.1 crore as on September 30, 2019 from Rs. 1,791.1 crore as on March 31, 2019, the payables to Air India remain high at Rs. 941.9 crore as on September 30, 2019, though reduced from Rs. 1,151.1 crore as on March 31, 2019. The other payables also remain high, though reduced from the levels of March 31, 2019. Thus, while the overall total outside liabilities (TOL) for the company witnessed an improvement, they remain high. Overall, the company has high reliance on short-term borrowings. Coupled with negative net worth, this has resulted in significant asset-liability mismatch.

Furthermore, as against the earlier expectations of AIEL's net worth turning positive by FY2020, the same is now expected in FY2021. This is on account of the reduction in AIEL's operating profit margins (OPM) over FY2016 to FY2019 attributed to increased fuel cost (which has impacted the whole domestic aviation industry) not adequately compensated by an increase in yield due to high competitive intensity and economic slowdown in the Gulf region, which is one of the key markets for the company, increased lease rental charges due to induction of leased aircraft into the fleet and foreign exchange losses, among others. However, AIEL witnessed an improvement in OPM to 29.7% in H1 FY2020, as against 19.6% in FY2019.

AIEL's OPM continues to be supported by a largely owned and young fleet, resulting in lower maintenance charges, and favourable revenue sharing memorandum of understanding (now master service agreement or MSA) with its parent, Air India. As per the MSA, AIEL is required to share 12.5% of its revenues or Rs. 350 crore, whichever is lower, with Air India per annum. However, in the past, there have been instances of AIEL having provided additional amount to Air India over and above these. Any amendments to the MSA, resulting in higher outflow to Air India is a key rating monitorable. ICRA notes that the PLF for AIEL has improved to 83.9% during 9M FY2020. Coupled with a YoY decline in average fuel cost, this is expected to result in an improvement in AIEL's OPM in the current year despite increase in lease rentals. However, the net worth will remain negative.

The rating factors in the intrinsic risk associated with the airline industry such as volatility in crude oil prices and low pricing power due to intense competition. Furthermore, with a considerable portion of the company's expenses, including financial / operating lease payments, fuel expenses and a significant portion of aircraft and engine maintenance expenses, being denominated in Dollar terms, the company is exposed to foreign exchange risks, mitigated to a large extent by the earnings in foreign currency. The rating continues to factor in the continued operational synergies along with joint procurement of fuel and other services with Air India. ICRA notes that of the 25 aircraft operated by AIEL as on December 31, 2019, 17 are owned, providing opportunities for monetisation (sale and lease back) and thus debt reduction.

As per the independent Auditors Report for FY2019, AIEL has been non-compliant with certain provisions of the Companies Act, which include among others, appointment of Independent Directors and composition of the Audit Committee and the nomination and Remuneration Committee. As per the FY2019 Annual Report, the company has also restated its FY2018 financials, which resulted in the profit after tax (PAT) for FY2018 being lower by Rs. 42.5 crore as over the earlier reported PAT.

Key rating drivers and their description

Credit strengths

Continued reduction in debt levels supported by ongoing accrual to reserves and high, albeit reduced, payables to Air India and other vendors – AIEL has been reporting net profits since FY2016, which has resulted in continued reduction in debt levels to Rs. 1,665.1 crore as on September 30, 2019 from Rs. 1,791.1 crore as on March 31, 2019. The same has been supported by improved cash flows during the year along with high payables to Air India at Rs. 941.9 crore as on September 30, 2019, though reduced from Rs. 1,151.1 crore as on March 31, 2019. The other payables also remain high, though reduced from the levels of March 31, 2019.

Despite moderation in OPM over the last three years, they remain healthy, supported by a largely owned and young fleet with lower maintenance charges, and possibly by the revenue sharing agreement with Air India – AIEL's OPM had continuously declined over the last three years—down to 19.6% in FY2019 from 34.3% in FY2016 due to various reasons, including increase in fuel cost (which has impacted the whole domestic aviation industry), higher lease rental charges due to induction of leased aircraft and foreign exchange loss, among others. However, AIEL witnessed an improvement in OPM to 29.7% in H1 FY2020. AIEL's OPM continues to be supported by a largely owned and young fleet (17 of the 25 aircraft operated by AIEL as on December 31, 2019 are owned), resulting in lower maintenance charges, and favourable revenue sharing MSA with its parent, Air India. Any amendments to the MSA, resulting in higher outflow to Air India, are key rating monitorables. ICRA notes that the PLF for AIEL

improved to 83.9% during 9M FY2020. Coupled with a YoY decline in average fuel cost, this is expected to result in an improvement in AIEL's OPM in the current year, despite increase in lease rentals.

Of the 25 aircraft operated by AIEL, 17 are owned, providing opportunities for monetisation and debt reduction – AIEL has 17 owned aircraft as on date. In case of any requirements, the company can enter into a sale and lease back transaction for the same, and thus reduce the debt from the cashflows arising from the monetisation.

Support from Government of India through guarantees on long-term debt – The aircraft loans drawn by AIEL are guaranteed by the Government of India.

Credit challenges

Credit profile of the company remains stretched, characterised by negative net worth, significant asset-liability mismatch and high payables to Air India and other vendors – AIEL's credit profile remains stretched as characterised by negative net worth and high payables to Air India and other vendors. As against the earlier expectations of AIEL's net worth turning positive by FY2020, the same is now expected in FY2021. With high payables to Air India and other vendors, the company has high TOL, though reduced from the level of March 31, 2019. Overall, the company has high reliance on short-term borrowings. Coupled with negative net worth, this has resulted in significant asset-liability mismatch.

Instances of non-compliances with the Companies Act, as mentioned in the Independent Auditors Report for FY2019 – As per the independent Auditors Report for FY2019, AIEL has been non-compliant with certain provisions of the Companies Act, which include among others, appointment of Independent Directors and composition of the Audit Committee and the nomination and Remuneration Committee. As per the FY2019 Annual Report, the company has also restated its FY2018 financials, which resulted in the PAT for FY2018 being lower by Rs. 42.5 crore as compared to the earlier reported PAT.

Earnings remain susceptible to inherent volatility in crude oil prices and foreign exchange scenario – With jet fuel prices accounting for 35-40% of its total operating expenses and a considerable proportion of these expenses (i.e., lease rentals, aircraft and engine maintenance payments) being denominated in Dollar terms, AIEL's earnings remain susceptible to volatility in crude oil prices and fluctuations in foreign exchange rates, mitigated to a large extent by the earnings in foreign currency. While the fuel prices and Dollar/Rupee levels have tapered off significantly from the peak levels reached in October 2018, the limited ability to pass on any unanticipated increase in costs to the customers, given the intense competition, is likely to keep the profitability in check for the players.

Stiff competition in industry may put pressure on yields due to aggressive capacity expansion plans – The Indian aviation industry is highly competitive, as reflected by frequent foray of new entrants and sizeable fleet addition by the 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 the industry's yields.

Liquidity position: Stretched

AIEL's liquidity is stretched as evident in high creditor days and high payables, albeit reduced, to Air India towards revenue share. Furthermore, the company has high reliance on short-term borrowings. Coupled with negative net worth, this has resulted in significant asset-liability mismatch.

Rating sensitivities

Positive triggers – The rating would be upgraded if AIEL’s TOL/ TNW improves substantially through an improvement in net worth (either by way of improved accruals or adequate equity infusion) and reduced payables to Air India and other vendors.

Negative triggers – The rating would be downgraded in case of a further weakening in AIEL’s TOL/ TNW and a further stretch in liquidity. Inability to turn the net worth positive by FY2021 would also be negative. Additionally, significant weakening in operating performance, in terms of pressure on yields and PLF, on account of the recent coronavirus outbreak, would also exert pressure on the rating.

Analytical approach

| Analytical Approach | Comments |
|---------------------------------|--|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology |
| Parent / Group Support | Not applicable |
| Consolidation / Standalone | The rating is based on the standalone financial profile of the company |

About the company

Air India Express Limited (erstwhile Air India Charters Limited) is a wholly-owned subsidiary of Air India Limited, incorporated in 2005 as a low cost carrier. It operates under the ‘Air India Express’ brand. As on December 31, 2019, AIEL had a fleet of 25 B737-800 aircraft, of which 17 were owned.

For the six months ended September 30, 2019, AIEL reported a PAT of Rs. 554.7 crore on an operating income (OI) of Rs. 3,124.3 crore, as against a PAT of Rs. 161.6 crore on an OI of Rs. 4,101.6 crore for the 12 months ended March 31, 2019.

Key financial indicators (audited)

| | FY2018 | FY2019 |
|--|---------|---------|
| Operating Income (Rs. crore) | 3,518.9 | 4,101.6 |
| PAT (Rs. crore) | 218.3 | 164.4 |
| OPBDIT/OI (%) | 23.9% | 19.6% |
| RoCE (%) | 40.4% | 46.4% |
| Total Outside Liabilities/Tangible Net Worth (times) | -4.6 | -5.4 |
| Total Debt/OPBDIT (times) | 2.6 | 2.2 |
| Interest Coverage (times) | 2.8 | 2.5 |
| DSCR | 0.4 | 0.4 |

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

| | Instrument | Rating (FY2020) | | | | | | Rating History for the Past 3 Years | | | | |
|---|----------------------------|-----------------|--------------|--------------------|--|----------------|-----------|-------------------------------------|-------------|-----------|-----------|--------|
| | | Type | Amount Rated | Amount Outstanding | Current Rating | Earlier Rating | | FY2019 | | FY2018 | | FY2017 |
| | | | | | | 20-Mar-20 | 31-Oct-19 | 4-Sep-19 | 07-Jan-2019 | 02-Apr-18 | 05-Jun-17 | |
| 1 | Term Loans | Short-term | 573.22 | - | [ICRA]A4+@; on watch with negative implications | [ICRA]A4+ | [ICRA]A3 | [ICRA]A3 | [ICRA]A3 | [ICRA]A3 | [ICRA]A3 | - |
| 2 | Fund-based Bank Facilities | Short-term | 727.85 | - | [ICRA]A4+@; on watch with negative implications | [ICRA]A4+ | [ICRA]A3 | [ICRA]A3 | [ICRA]A3 | [ICRA]A3 | [ICRA]A3 | - |

Amount in Rs. crore

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 | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating |
|------|--------------------------|-----------------------------|-------------|---------------|--------------------------|---|
| NA | Short-term Loan – I | - | - | - | 350.00 | [ICRA]A4+@; on watch with negative implications |
| NA | Short-term Loan – II | - | - | - | 223.22 | [ICRA]A4+@; on watch with negative implications |
| NA | Fund-based Facility – I | - | - | - | 369.79 | [ICRA]A4+@; on watch with negative implications |
| NA | Fund-based Facility – II | - | - | - | 358.06 | [ICRA]A4+@; on watch with negative implications |

Source: Air India Express 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.

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