October 09, 2019

Interglobe Aviation Limited: Ratings reaffirmed

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. Crore)	Rating Action
Short Term Fund Based Limits	155.00	107.00	[ICRA]A1+; reaffirmed
Short Term Non-Fund Based Limits	325.00	589.25	[ICRA]A1+; reaffirmed
Long Term Non-Fund Based Limits	335.63	700.02	[ICRA]A+(Negative); reaffirmed
Long Term/Short Term Non-Fund Based Limits – Standby Letter of Credit	6,642.48	5085.91	[ICRA]A+(Negative); reaffirmed
Short Term Interchangeable	(545.00)	(245.00)	[ICRA]A1+; reaffirmed
Long Term interchangeable	(100.00)	(615.46)	[ICRA]A+(Negative); reaffirmed
Long-term- Unallocated	541.89	1517.82	[ICRA]A+(Negative); reaffirmed
Total Bank Line Facilities	**8,000.0**	**8,000.0**	
Issuer Rating	**NA**	**NA**	[ICRA]A+(Negative); reaffirmed

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings continues to factor in Interglobe Aviation Limited's (IAL) well-established position as the operator of Indigo airlines - India's largest airline with nearly 49% share of the passenger traffic (as of June 2019), its strong competitive position in terms of cost structure, comfortable leverage (on lease adjusted basis) and strong liquidity profile (as reflected by free cash balances of Rs. 7,697 crore as on June 30, 2019) relative to its peers in the airline sector. While the company experienced significant cost pressures in H1 FY2019 due to volatility in crude prices and rupee depreciation leading to muted profitability, it maintained its status of being the lowest cost airline[1], demonstrating the resilience of its business model. Despite pressure on yields, the company continued to aggressively add capacity[2] (27% increase on a YoY basis), indicating commitment to its long-term growth strategy. Notwithstanding the moderation in industry passenger traffic in YTD FY2020, which was partially contributed by lower capacity addition, ICRA believes that Indigo's financial performance in FY2020 would benefit from easing of cost pressures on a YoY basis, consistent addition of more fuel efficient NEOs in the fleet, planned foray into international routes as well as enhancement of its network between Tier II/III cities in India. The airline has benefitted from the discontinuation of operations by Jet Airways (April 2019) and grounding of Boeing 737 max aircraft (March 2019), as reflected in improvement in yields (>10% YoY over the past two quarters), market share gains (~49% in June 2019 from 43% in March 2019) and strong profitability in Q1 FY2020.

Going forward, Indigo is well poised to enhance its market position, given its steady capacity expansion plans supporting network expansion, besides low air transport penetration levels in India and conducive policy environment. Although, the company aims to utilise its surplus cash balances for outright purchase of aircraft over the medium term, ICRA

[1] *Comparison made in terms of total cost, net of finance income, per available seat kilometer (CASK) of listed players*
[2] *Capacity as measured by available seat kilometer (ASKM) growth.*

expects Indigo to maintain adequate liquidity buffers for the ongoing business to tide through the inherent industry headwinds.

These strengths are partially offset by the intrinsic risk associated with the airline industry such as volatility in crude oil prices, sharp fluctuation in foreign exchange rates and low pricing power due to intense competition. 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 limited share of revenues denominated in foreign currency. However, in FY2019, the company moved a significant portion of its encumbered cash (collateral for liability for supplementary lease payments) to forex-denominated deposits to partially mitigate itself against the currency fluctuation risk.

ICRA takes note of Indigo's supplier concentration risk emanating from having a single aircraft engine supplier. This has impacted the company's performance in the past few years, with multiple instances of aircraft grounding and delayed aircraft deliveries because of issues faced with the Pratt & Whitney (P&W) engines. In Q1 FY2020, the company placed a 280-engine order with CFM International, which would reduce this dependence on P&W, over the medium term. 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.

The **Negative** outlook reflects ICRA's belief that the industry is still stabilising after the exit of Jet Airways and the grounding of 737 max aircraft. The capacity gap created by these events contributed to market share gains and improvement in yields in the last two quarters for Indigo. However, slower than anticipated industry passenger traffic growth and players continuing with their aggressive capacity expansion plans could exert pressure on the yields in the forthcoming period, thereby impacting profitability. In addition, crude oil prices have moved upwards over the past few months, which along with INR depreciation vis-a-vis USD would exert pressure on cost structure. Furthermore, the delay in resolving the differences between the founding promoters on various aspects including related party transactions, board representation, etc, could have an impact. The same, including any governance concerns remain a key monitorable.

Key rating drivers and their description

Credit strengths

Leading domestic air carrier in India with 49% market share – The low-cost carrier (LCC) Indigo is, at present, India's largest domestic air carrier, in terms of the domestic passengers flown. Between FY2010 and FY2019, Indigo grew its fleet steadily from 19 to 217 aircraft and expanded its capacity at a CAGR of ~25%, while the industry capacity grew at a CAGR of 11%. Driven by its brand image of delivering high on-time performance, competitive pricing and phasing out of operations by other airlines, Indigo expanded its market share from 14% to 43% during this period to emerge as the leading domestic airline. In Q1 FY2020, after discontinuation of operations by Jet Airways, Indigo further consolidated its position and its domestic market share increased to ~49% as of June 2019. With visibility on new fleet addition and planned foray into international routes as well as enhancing connectivity between Tier II/III cities in India, Indigo is well poised to strengthen its market position further.

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/operations, Indigo has demonstrated lower cost of operations compared to its peers in the Indian airlines industry. Additionally, maintenance of a single fleet and tight control on overheads contributed to the lowest CASK among Indian airlines, which compares favourably with other global LCCs.

Financial profile characterised by comfortable credit metrics and strong liquidity – In FY2019, Indigo's adjusted interest coverage[3] stood at 2.6 times, which compares favourably against other airlines. Despite the volatility in crude prices and rupee depreciation faced during the fiscal, Indigo maintained strong liquidity profile, evidenced by a large free cash balance and liquid investment of Rs. 7,245-crore at the end of FY2019, compared with 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 maintain an adequate liquidity buffer for meeting its ongoing business requirements. Furthermore, the company's long-term debt (on reported basis) of Rs. 2,429 crore as of March 2019 has a long maturity profile, which limits its annual repayments to approximately Rs. 230-250-crore p.a.

Favourable growth prospects aided by low penetration of air traffic in India and progressive policies – Barring the recent slowdown in passenger traffic due to supply constraints, the Indian aviation market has been among 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, along with addition of new airports and regional routes by airline operators. With Indigo's strong order pipeline of approximately 358 A320 NEO and 32 ATR aircraft, it remains in a comfortable position to capture a sizeable share of the expanding domestic market.

Credit challenges

Earnings susceptible to inherent volatility in crude oil prices – 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 US$ terms, Indigo's earnings remain susceptible to volatility in crude oil prices and fluctuations in foreign exchange rates. While the fuel prices and US$/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.

Vulnerable to fluctuation in foreign exchange risks with significant forex-denominated liabilities on balance sheet – In addition to the impact of sharp foreign exchange movements on the company's profitability, due to foreign currency denominated costs, Indigo 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's estimates, forex-denominated liabilities accounted for nearly 86% of the total capital employed as on March 31, 2019, exposing the company to forex fluctuations. However, it partially mitigated this risk through maintenance of funds (i.e. collateral against stand-by letter of credit (SBLC) limits for supplemental rent payments) in foreign-denominated deposits. Going forward, expansion of overseas operations is expected to increasingly provide natural hedge against the forex risk.

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

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. The improvement in yield over the past few quarters has been supported by capacity reduction caused by discontinuation of operations by Jet Airways. However, with majority of the capacity void fulfilled by other airlines, the yields in the domestic market have exhibited some weakness during Q2 FY2020, which coupled with rising jet fuel prices and INR depreciation would exert pressure on the profitability indicators of airlines. With Indigo planning to expand its capacity by 30%, its ability to maintain yields and load factors remain critical to its profitability.

Concentration risks associated with dependence on single type of aircraft and engine supplier – 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 last few years with multiple instances of aircraft grounding and delayed aircraft deliveries because of issues faced with the P&W engines in the latest generation A320 NEO aircraft, notwithstanding the compensation received from the engine supplier to offset the impact of the same. FY2019 witnessed improvement in the aircraft deliveries and with the 280-engine order placed with CFM International in June 2019, Indigo has diversified its supplier base and reduced dependence on P&W. However, the delivery of these CFM engines is expected from 2020 onwards and Indigo fleet will continue rely on P&W powered engines over the medium term. With a fast-expanding fleet, the overall impact on capacity due to grounding of a few aircraft has now become marginal. Nonetheless, any severe regulatory intervention by DGCA leading to grounding of entire NEO fleet remains an event risk.

Liquidity position: Strong

IAL's liquidity is strong as reflected by a net cash surplus of Rs. 7,697 crore as on June 30, 2019. Barring FY2019, IAL's fund flow from operations had been positive over the years due to healthy profitability. Coupled with its low working capital intensity of operations and incentives, this has resulted in positive cash flow from operations. The entire lease liability obligations are backed by SBLC, which are secured against 100% cash or liquid investment. While the company has aggressive plans for fleet expansion, ICRA expects 8-10 ATRs to be purchased and most of NEO's to be inducted on an operating lease in FY2020. Apart from the same, the capex is expected to be limited to Rs. 400-500 crore on other airport infrastructure and will be funded through internal accruals.

Rating sensitivities

Positive triggers – ICRA could revise the outlook to Stable on Indigo's rating, if there is demonstrated track record of sustainable improvement in its profitability indicators along with strong liquidity profile. A stable capital structure and healthy debt coverage indicators, as indicated by TD/TNW and TD/EBDITA ≤3x on sustained basis, coupled with a reduction in unhedged forex-denominated liability on the balance sheet or creation of natural hedge through higher overseas operations remain a monitorable.

Negative triggers – Negative pressure on Indigo's rating could arise for reasons including weakening of profitability and liquidity profile due to - a) unanticipated sharp increase in crude oil prices and/or adverse movement in USD/INR conversion rate leading to cost pressure; and/or b) aggressive fleet expansion without commensurate increase in passenger traffic, leading to decline in yields; and/or c) unanticipated acceleration of aircraft ownership plans or in-organic investments to further international expansion plans. Any adverse regulatory intervention by DGCA *inter alia* continuing issues in P&W engines leading to grounding of affected fleet remains an event risk. Further, any adverse impact on its financial profile due to alleged differences between the founding promoters and any Governance concerns will remain key monitorable.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	The rating is based on consolidated financial statements of the issuer. The list of entities consolidated is given under Annexure-2.

About the company

IAL is the operating company for Indigo, India's largest passenger airline in terms of domestic market share. The airline operates on an LCC business model, offering no-frills air-commute to passengers both in the domestic as well as international sectors. At present, the company commands ~49% of the domestic market in terms of passengers carried. It commenced operations in August 2006 with a single aircraft and as on June 30, 2019 had a fleet of 235 aircraft, comprising 129 Airbus A320 CEOs, 83 Airbus A320 NEOs, 5 Airbus A321 NEOs and eighteen ATRs. As of September, 2019[4], these connected 57 domestic and 19 international destinations.

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 the key investee company of 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.

[4] *Source: https://www.goindigo.in/content/dam/goindigo/investor-relations/press-releases/2019-20/190822-IndiGo-Delhi-Singapore-and-Doha.pdf*

Key financial indicators (audited)

Consolidated	FY2018	FY2019
Operating Income (Rs. crore)	23,020.9	28,496.8
PAT (Rs. crore)	2,242.4	157.3
OPBDIT/OI (%)	13.4%	1.1%
RoCE (%)	43.3%	4.3%
Total Outside Liabilities/Tangible Net Worth (times)	2.0	2.6
Total Debt/OPBDIT (times)	0.8	7.5
Interest Coverage (times)	7.5	0.6
DSCR (times)	5.2	1.8

Source: Company; ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

S. No.	Instrument	Current Rating (FY2020)					Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount O/S as of Jun-19 (Rs. crore)	Date & Rating		Date & Rating in FY2019		Date & Rating in FY2018	Date & Rating in FY2017
					9-Oct-19	17-Jul-19	17-Oct-18	13-Jun-18	-	-
1	Fund Based Limits - Overdraft	Short Term	107.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
2	Non-Fund Based Limits- Letter of Credit	Short Term	589.25	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
3	Non-Fund Based Limits- Bank Guarantee	Long Term	700.02		[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA (Stable)	-	-
4	Non-Fund Based Limits – Standby Letter of Credit	Long Term / Short Term	5085.91		[ICRA]A+ (Negative)/ [ICRA]A1+	[ICRA]A+ (Negative)/ [ICRA]A1+	[ICRA]A+ (Negative)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	-	-
5	Interchangeable limits	Short Term	(245.00)		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
6	Interchangeable limits	Long Term	(615.46)		[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA (Stable)	-	-
7	Unallocated	Long-term	1517.82		[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA (Stable)	-	-
8	Issuer Rating	Long-term	-	-	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA (Stable)	-	-

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-Overdraft	-	-	-	107.00	[ICRA]A1+
NA	Short Term Non-Fund Based Limits – Letter of Credit	-	-	-	589.25	[ICRA]A1+
NA	Long-Term Non-Fund Based Sub-Limits*	-	-	-	700.02	[ICRA]A+
NA	Long Term/Short Term Non-Fund Based Limits	-	-	-	5085.91	[ICRA]A+ (Negative) / [ICRA]A1+
NA	Short-Term Fund/ Non-Fund Based Limits	-	-	-	(245.00)	[ICRA]A1+
NA	Long Term Non-Fund Based Sub-Limits*	-	-	-	(615.46)	[ICRA]A+ (Negative)
NA	Unallocated limits	-	-	-	1517.82	[ICRA]A+ (Negative)
NA	Issuer Rating	-	-	-	NA	[ICRA]A+ (Negative)

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

Annexure-2: List of entities considered for consolidated analysis:

Company Name	Ownership	Consolidation Approach
Interglobe Aviation Limited	100.00%	Full Consolidation
Agile Airport Services Private Limited	100.00%	Full Consolidation (Subsidiary)

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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.

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