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CAPA INDIA

# Key Themes of CAPA India Aviation Outlook Report FY2015


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**South Asia's Leading Aviation Knowledge Practice:** CAPA India launched 10 years ago, and has become synonymous with aviation in the country. Our breadth of sectoral knowledge, research capabilities, databases and extensive contacts with key stakeholders in government and industry are unmatched.

**Extensive South Asia Advisory Experience:** CAPA's advisory capabilities combine local knowledge and international experience. We have completed almost 60 consulting engagements in South Asia, delivering bespoke strategic, commercial and operational advisory services to airlines, airports, investors, governments, ground handlers, MROs, general aviation operators and travel distribution companies. Our global portfolio of work exceeds 600 projects.

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- CAPA Ventures, our capital advisory division;
- CAPA Services, providing dedicated outsourced research capabilities;
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- CAPA-VIC Aerospace City, high-tech aviation research and manufacturing park.

# About CAPA – Centre for Aviation

**Global Aviation Knowledge:** CAPA was established more than 20 years ago with a mission to become a leader in global aviation knowledge. Since then we have established a worldwide presence and an enviable reputation for independence, insight and integrity. Today our market analysis and data is used to support strategic decision making at hundreds of the most recognised organisations in the industry.

**Comprehensive Worldwide Coverage:** We have published more than 10,000 daily, monthly and annual reports for the global aviation community with research desks providing coverage of all international regions, including North & South America, Europe, China, Asia Pacific, the Middle East and most recently Africa.

**Research & Data Analytics:** CAPA has developed a powerful proprietary platform to deliver online research and data, including customisable news and analysis and configurable real-time data analytics tools for more than 7,000 airline, airport, country and supplier profiles globally. We monitor key metrics such as:

- Traffic;
- Schedules & capacity;
- Fleet data;
- Aircraft valuations
- Aircraft maintenance profiles;
- Financial indicators;
- Ranking tools;
- Share prices;
- Fare tracking;
- Route maps;
- Forward travel searches;
- Fuel uplift demand.

In addition we conduct continual monitoring of airline strategies, management decisions, network planning and corporate structuring to ensure that we remain ahead of industry developments. Our clients include more than 500 of the leading organisations in global aviation.

# Key Themes from CAPA India Aviation Outlook FY2015

### Three carriers expected to post combined losses in excess of USD1.2 billion in FY14, with Jet Airways and SpiceJet likely to report record full-year losses

As we approach the end of FY2014 on 31-Mar, India's carriers are set to report yet another year of widespread red ink. Three carriers – Air India, Jet Airways and SpiceJet – are expected to post combined losses in excess of USD1.2 billion. And this figure could rise higher as a weak outlook for March could trigger further promotional pricing.

Air India is once again expected to incur the largest loss at close to USD700 million, although this represents an improvement of approximately 20% year-on-year in local currency terms. Jet Airways and SpiceJet are likely to report record losses. In addition to their losses, Air India and Jet Airways are also likely to be impacted by travel agency defaults which have reached USD40 million in Delhi recent weeks and could increase further.

GoAir is expected to end the year with a break-even result or a modest profit which is disappointing after a very promising first quarter. IndiGo will be the only carrier to report full year profitability but this too will be significantly lower than our earlier estimates. Nevertheless, as the only consistently profitable airline in India the time may be approaching to leverage this achievement and an IPO is possible in FY2015.

*"CAPA India Aviation Outlook Report will include detailed analysis of the operating and financial performance of each carrier in FY14 and the outlook for the year ahead"*

As at 31 March 2013 the total accumulated losses of the airline industry over the previous seven years had risen to USD8.6 billion (based on current exchange rates). Industry debt had climbed to USD12.6 billion, however the full service carriers – Air India, Jet Airways and Kingfisher – accounted for 94% of this. Approximately 40-50% of full service carrier debt was related to working capital. In addition, there were close to USD2.4 billion worth of outstanding payments to vendors. In contrast LCC debt was just over USD750 million and most of this was aircraft-related.

### Start-up carriers expected to place downward pressure on yields and risks will peak for some carriers in FY2015

India's incumbent carriers can expect no respite on the competitive front heading into FY2015 with several new carriers expected to launch operations. Apart from AirAsia India and Tata-SIA a further 2-3 start-ups are reportedly awaiting licences to commence national and regional operations. The induction of additional capacity when load factors are already soft, and the consequent downward pressure on yields is expected to hurt all carriers. Continued red ink may start to test the holding power of a couple of airlines.

### Expected downsizing by SpiceJet and freezing by Jet on domestic routes will at least help to moderate capacity growth

Fortunately the incumbent carriers are only planning modest capacity increases in the year ahead. Jet Airways is likely to freeze its domestic operations at close to current levels for the near term, and similarly Air India, despite the fact that the national carrier is in the market to lease narrow body equipment. GoAir is due to take one more aircraft in mid-2014 and then does not have any aircraft scheduled for delivery until the first of its A320neos start to arrive in 2016. The carrier has been considering an interim expansion strategy but this may or may not proceed. And SpiceJet is conducting a detailed review of its operations which could involve a short-term reduction of its domestic narrow body operations by the equivalent of close to 10 737s. Question marks continue over its long term plans in the regional segment which has to date faced significant operational and reliability issues.

### Traffic in FY2014 has performed in line with CAPA estimates. In FY2015 domestic growth could remain volatile, but international expected to continue steady double digit growth

*"CAPA India Aviation Outlook Report will include an airline-by-airline assessment of their fleet and network expansion plans in FY2015"*

In Mar-13 we had presented our FY2014 growth projections for the Indian market. Data for the first three quarters of the year shows actual growth to be in line with our estimates. Domestic traffic is up 6% (CAPA estimate was 4-6% with expectations towards the upper end of the range) and international traffic for the first eight months is up 10.7% (CAPA estimate was 10-12%).

The high cost operating environment and the continued weakness in the economy would suggest that domestic traffic growth remains vulnerable and all other things being equal may remain in low single-digit territory in FY2015. However, there is considerable uncertainty about the potential impact of the new market entrants. If a fares war is instigated traffic growth could be stimulated significantly above this underlying rate however this would be at the expense of the airline balance sheets. Domestic traffic performance could therefore be volatile from month to month. However, we may see signs of a more sustained recovery from 3QFY2015 onwards as economic confidence is expected to increase following the general elections.

International traffic on the other hand has been a strong and steady performer over the last decade, even during periods where the domestic has dropped into negative territory. Growth for the 12 months ending 31-Mar-14 is expected to reach 12% year-on-year. In FY2015 double-digit growth of 10-12% is expected once again and may exceed 15% if the 5 year/20 aircraft rule is lifted and a number of bilaterals are relaxed.

*"Detailed domestic and international growth forecasts will be available in the full CAPA India Aviation Outlook Report"*

### Foreign investors may take a watch and wait approach for now, no new transactions are likely until at least 1HFY2015

Further foreign airline investment transactions involving existing Indian carriers appear unlikely in the short term given recent losses and in light of the increasing intensity of competition in the market as a result of the expected launch of several new airlines. SpiceJet has reportedly signed a terms sheet with a UAE-based investor however the ongoing challenges in the market may make it difficult to close this deal. Go which has also been in the market for some time is similarly expected to face challenges in securing an investor in the near term.

Indian carriers are expected to require capital infusions of USD1.6 billion over the next 12-18 months just to continue operations, let alone investment in aircraft. Air India accounts for approximately USD1 billion of this requirement. Inability to access sufficient funds when required may impact the operational integrity and customer proposition of some carriers.

*"CAPA India Aviation Outlook Report will include detailed analysis of the funding requirements of each airline"*

**Privatisation of Air India is expected to be back on the agenda in FY2014 as realistic funding requirements likely to exceed earlier government commitment**

With general elections due by May-14 the administration that comes into power will have to face up to developing a credible plan for the ownership of Air India. The government's fiscal deficit means that it is already facing challenges in honouring the funding that it has committed to the national carrier. And under its proposed turnaround plan Air India is expected to require a further USD3.9 billion of funding before returning to profitability. With the internal and external operating environments having become even more challenging since the turnaround plan was developed, these estimates are likely to be conservative. As a result, a practical and dispassionate approach requires that all options be on the table, including privatisation.

However Air India has made improvements across operational, commercial and financial metrics and the decision by Star Alliance to resume the carrier's preparation for membership is a positive development. Integration with and formal membership of the alliance is expected to be concluded by Jun-14.

*"CAPA India Aviation Outlook Report will provide a comprehensive assessment of the realistic options on the table for the future of Air India"*

**Regulatory uncertainty remains a key concern and represents a key disincentive and barrier to serious investors**

The unpredictability and lack of transparency in India's regulatory framework continues to be the greatest strategic challenge in the market. For example, on the issue of new airline licences there are no defined criteria for whether, how and when applications will be assessed. Indeed the process seems to differ depending upon the applicant as evidenced by the sudden, unexpected and unprecedented call for public representations at the AOC stage for AirAsia India. The start-up had earlier received its Foreign Investment Promotion Board approval and No-Objection Certificate in record time. Tata-SIA is also awaiting its No-Objection Certificate and there is no certainty about the status or timing. Yet other weaker start-ups may find it easier to obtain approvals.

Several elements of launching an airline can require long lead times such as taking delivery of aircraft and recruiting pilots (those employed with incumbent carriers are required to provide six months notice to their current employers). But the arbitrary nature of the timing and process of regulatory approvals makes planning virtually impossible for start-up airlines. Move ahead too early and you could be saddled with expensive overheads while still awaiting permission to fly. But wait until your approvals are certain and your launch is delayed until later than it needs to be and valuable revenue generating opportunities are missed.

Similarly the discriminatory 5 year/20 aircraft rule was expected to be lifted in Nov-13 but this did not happen. Strong expectations have once again surfaced that the regulation could be abolished in Feb-14 but uncertainty remains and a last minute change of heart cannot be ruled out.

*"CAPA India Aviation Outlook Report will review each of the prospective start-ups in FY2015 including AirAsia India, Tata-SIA, Air One and others, and analyse their planned business models, networks and competitive positioning"*

Indian aviation will require billions of dollars of investment over the next decade however serious investors are unlikely to be forthcoming in the absence of a structured and predictable framework.

### Jet-Etihad deal is once again under the spotlight, significant challenges still remain. Delays have been costly and almost all of the USD379 million equity infusion will be wiped out by FY2014 losses.

After having earlier received all of the necessary approvals, the Jet-Etihad deal has reportedly once again come under scrutiny from several agencies including the Competition Appellate Tribunal (COMPAT), the Securities and Exchange Board of India (SEBI) and even the Home Ministry, seeking additional clarifications with respect to the ownership and control of the company. The opposition Bharatiya Janata Party has once again raised the issue of control with the Prime Minister. A court case is also pending questioning the circumstances under which the India-Abu Dhabi bilateral air services agreement was re-negotiated. Most recently SEBI is also understood to have issued a notice to Jet Airways stating that it is investigating whether the promoters need to make an open offer for the outstanding shares in the company.

*"CAPA India Aviation Outlook Report will present a detailed review of the Jet Airways-Etihad partnership and the expected developments and implications for the year ahead"*

We do not see any major issues emerging out of these reviews however the pending legal case could be more challenging. Meeting compliance with the regulatory requirements has distracted management focus away from turning around Jet Airways and from strengthening the extent of cooperation with Etihad. And going forward the FAA downgrade will force a re-think of the carrier's network expansion plans which included the opening of new routes to the US which will not be permitted until India's Category 1 status is restored.

### In FY2014 Jet and Etihad were the only beneficiaries of bilateral largesse. A clearer long term bilateral policy is unlikely to emerge until later in the year.

With the current government shortly expected to move into caretaker mode in advance of the general elections a clear bilateral strategy will only emerge in the second half of 2014, subject to there being a stable government. However in the meantime the seat entitlements in selected bilateral agreements, such as that with Dubai, may be increased modestly to permit carriers to operate A380s without having to reduce frequencies. The government has only recently relaxed the restriction on A380s operating to India.

*"CAPA India Aviation Outlook Report will present a detailed analysis of the structure of India's bilateral air services agreements and their impact on international traffic flows"*

Emirates may be the first to launch A380 services once it has sufficient additional seats to be able to upgauge those services from Mumbai and/or Delhi that connect with the morning departure bank from Dubai. Other carriers which are likely to start A380 operations to India in FY2015 include Lufthansa and Singapore Airlines.

Additional Indian entitlements for Gulf carriers are likely to be utilised to feed their rapidly expanding US networks. And with the US pre-clearance facility in Abu Dhabi set to be joined by another in Dubai next year, the Gulf carriers will offer a very competitive and convenient product on India-US routes. This is expected to hurt Air India as well as the European airlines which are heavily dependent on US traffic to support their India services.

**Opportunity to leverage the FAA downgrade to strengthen the regulator may be missed. Instead of greater independence we may see more government control.**

The downgrade of India to Category 2 by the FAA in Jan-14 due to concerns about deficiencies in the safety oversight framework is an embarrassing development for India, but reflects systemic weaknesses at the Directorate General of Civil Aviation (DGCA). Restoration of Category 1 could take much longer than expected. An urgent, comprehensive and independent White Paper on the state of aviation safety is critical to understand the depth of the problem. Only then can appropriate long-term solutions be developed.

A silver lining perspective is that this could be a useful wake-up call which will act as a catalyst to bring the focus on to strengthening the regulator institutions and help to establish a professional and independent Civil Aviation Authority (CAA) run by technical and domain experts. However, some of the early indications are not encouraging. In an effort to be seen to be taking action in the aftermath of the downgrade the government appears to be re-thinking the independence of the CAA and may rush through under-prepared legislation to form the new authority, the outcome of which may be a regulator that continues to be run by bureaucrats and controlled by government.

**Airport privatisations likely to remain stalled until after the elections. Navi Mumbai project costs are likely to be revised upwards and uncertainty about the project is likely to continue until the RFP is issued.**

The Airports Authority of India remains committed to plans to award PPP concessions for 15 of its most profitable airports, starting with Chennai, Kolkata, Ahmedabad, Guwahati, Jaipur and Lucknow. However the tender process for these first six airports has been stuck since Oct-13 due to a lack of preparedness with respect to the concession agreement and the approved tariff structure. Although the qualification and bid process may resume in the coming weeks the award of the concessions will only happen after the elections. It is a matter of concern that the tenders for projects of such significance were commenced before the relevant government agencies had even reached internal agreement amongst themselves on fundamental issues.

*"CAPA India Aviation Outlook Report will present detailed operational and financial analysis of the AAI and the private airport operators, and in-depth perspectives on the prospects for further privatisation and greenfield airport development"*

Meaningful action on three PPP greenfield airport projects at Navi Mumbai, Kannur and Aranmula is similarly stalled until the post-election period. Request for qualification documents for the delayed Navi Mumbai Airport project were finally issued on 5-Feb-14 however qualified bidders will not be announced until Aug-14.

Although the commencement of the long-awaited tender process is a welcome development the Navi Mumbai project continues to face a number of challenges. Land acquisition is yet to be completed; the preparatory earthworks required are significant projects in their own right requiring the diversion of two rivers; and the absence of convenient surface connectivity between Greater Mumbai (home to the majority of the residents of the Mumbai Metropolitan Region) and the airport will be a key obstacle to attracting airlines and passengers. As a result it is difficult to see the airport opening before 2018/19 and very possibly later, and costs are likely to be revised upwards as the complexities of the project become more apparent.

The new government is however expected to provide a strong push to encouraging the development of 50-100 low cost airports designed to increase regional connectivity to Tier III towns. This is expected to be supported by a new regional airline policy consisting of a package of incentives and concessions to address the viability challenges that have been faced by airlines seeking to address this segment of the market.

### Airport tariff regulation may shift from single-till to hybrid-till, representing a conflict in philosophy between the Ministry and the regulator

The Ministry of Civil Aviation is expected to announce a new orientation to its preferred regulatory framework for airport tariffs by the end of Feb-14. This is likely to involve a shift in stance from a single-till to a hybrid-till (already in operation at Delhi and Mumbai) in response to representations by airport operators. Private operators and the government had in fact wanted a dual-till framework however this was rejected by the Attorney-General. The Airports Economic Regulatory Authority on the other hand has sought to apply a single-till.

It is not yet clear whether the government's expected statement in favour of a hybrid-till will be legally binding on the regulator. Either way, this represents a fundamental shift in tariff regulation, and it may be more appropriate to leave a decision of such magnitude until the new government is formed.

### Corporatisation of air navigation services remains on the agenda with plans to hive it off as a separate entity

The Airports Authority of India is responsible not only for managing and developing more than 120 airports but also for providing air navigation services in Indian airspace. It has been argued that having these distinct activities combined under a single entity and with common financials leads to mis-allocation of capital and prevents efficiencies from being realised. A proposal is under consideration to hive off the air navigation services division as a separate entity with its own balance sheet, however a decision on this is not expected until after the elections.

### Ground handling policy remains stuck in the courts:

The new ground handling policy, which was first proposed in 2007, has remained stuck in the courts as airlines have objected to mandatory outsourcing of customer-facing terminal handling to third party providers. A Supreme Court hearing scheduled for 26-Feb-14 may offer some guidance about the direction of the policy however certainty on this issue is only likely once the new government is in power.

**Indian carriers expected to order up to 400 aircraft this year in addition to those already on the order books. However some carriers may face challenges in raising funding for the acquisitions.**

At the end of 2013 Indian carriers had approximately 350 aircraft on order. By the end of FY2015 this is likely to have swelled to over 700 aircraft, including Air Costa's recent order for 50 firm (plus 50 options) Embraer regional jets, and Tata-SIA's 20 A320s, which may be converted from an operating to a finance lease. Tata-SIA's conservative initial order will certainly be followed by a more robust long term order if the 5 year/20 aircraft regulation is lifted. SpiceJet and Jet Airways are expected to confirm reported orders for 40 and 50 737MAX aircraft respectively. Jet may also be allocated some of the more than 100 wide body aircraft ordered by Etihad at the Dubai Air Show in Nov-13. Meanwhile, IndiGo is expected to place another massive order for 200-250 additional aircraft.

*CAPA's Risk Advisory services include company monitoring and asset management for banks, investors, aircraft and engine lessors, providing on-the-ground intelligence on key strategic, operational or financial concerns, maintenance procedures and airworthiness issues"*

However financing of this equipment may be challenging for some carriers. Given the ongoing difficulties in the operating environment and with the Kingfisher experience still fresh, some banks and lessors remain concerned about the level of risk in the Indian market, especially as the provisions of the Cape Town Convention are yet to be formally incorporated into the Indian Civil Aviation Regulations.

**General aviation continues to be neglected with no clear signs of improvement**

Despite the fact that the number of general aviation (GA) aircraft in India is larger than the scheduled fleet, the sector has remained neglected in terms of dedicated airport infrastructure, access to airspace and availability of maintenance and training facilities. At a policy and regulatory level the industry has largely been ignored and the sector is subject to numerous taxes. These challenges are expected to continue into FY2015 with no clear developments on the horizon which could ameliorate the situation.

*"CAPA India Aviation Outlook Report will assess the environment for the MRO sector in India and the prospects for new investment as well as changes of ownership in 3rd party facilities"*

**Financial and viability challenges for 3rd party MROs are set to continue**

India represents a challenging environment for 3rd party MROs, with high taxation, expensive infrastructure, a shortage of skills and strong competition from neighbouring markets. So much so that Indian carriers continue to offshore heavy checks. IndiGo alone recently completed its 100th C-check in Sri Lanka, representing in excess of USD25 million foregone revenue for Indian MROs due to the absence of an enabling operating environment.

## About CAPA India Aviation Outlook

This report highlights the key themes from the FY2015 edition of CAPA India's flagship report, the annual India Aviation Outlook. The full 300+ page report is keenly anticipated by the industry each year as the leading analysis of the direction of one of the world's most important emerging markets.

CAPA has a strong and established track record in accurately identifying key trends and developments in the Indian market, both on an annual and long term basis. Each edition includes:

- CAPA's forecasts for traffic, capacity and yields;
- profit and loss projections for each carrier;
- fleet induction plans and expected new orders;
- detailed risk assessment of each Indian carrier.

An assessment of the strategic plans of all domestic carriers is presented including prospects for foreign airline investment, capital raising, risk assessments and prospects for new entrants particularly in the regional sector.

Meanwhile international strategies and network plans are reviewed including expected bilateral developments, prospects for code sharing and scenarios for global alliances. The report also addresses airport privatisation and development programmes, corporatisation of air navigation services, expected policy and regulatory developments and the outlook for ancillary sectors.

For more information, or to order the full 300+ page report to be released on 15 June 2014, contact Tarika Wadhwa on +91 11 4692 1036 or twadhwa@centreforaviation.com.

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