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India's Jet Airways faces uncertainty amid high fuel cost and stiff competition

By Shubham Maheshwari

Corrections: The paragraph discussing the Interest Coverage Ratio has been revised as there was a typographical error. "ICR" was mistakenly written as "IRR". Words in Italics below highlight changes made to the original article.

The Indian airline industry has grown by leaps and bounds over the past few years. Revenue Passenger Kilometers (RPK), a measure of passenger volumes, rose by 17.5% for the Indian domestic market, in comparison to 7.6% globally in 2017. Despite the rapid growth of the aviation market for the last three years, the airlines' profits have been considerably poor owing to increasing fuel prices and declining rupee.

One such airline is, Jet Airways, the second largest Indian airline in terms of market share. Jet Airways has a domestic market share close to 18% and a load factor of 91%, the airline is second only to Indigo in the Indian airline market (Figure 1a). Jet Airways reported losses in the past few quarters and in the latest earnings release, the company reported a loss of USD 146mn for Q4 2017-18. Along with the high aircraft fuel charges, lower yields, high maintenance charges and exchange losses have left the company's financials in a bad shape.

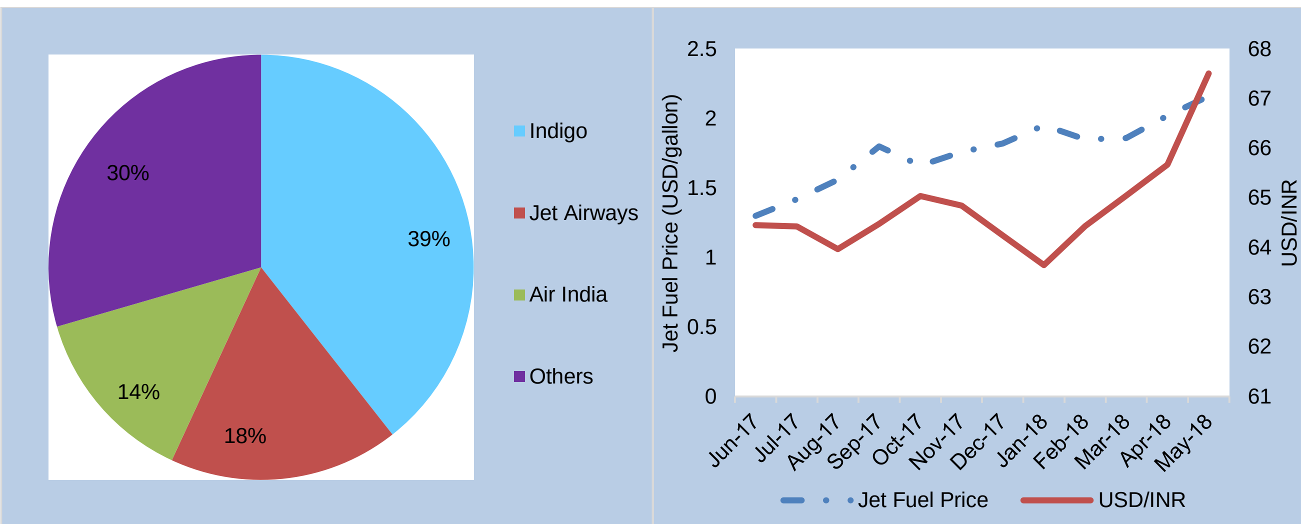

Figure 1a (LHS): Market share of Indian airlines as of Jan 2018 based on number of passengers transported. Figure 1b (RHS): Jet fuel monthly spot price and USD/INR exchange rate. *Sources: IBEF, Index Mundi & Board of Governors of the Federal Reserve System (US)*

Indian airlines have been badly hurt by the increasing jet fuel prices. India has one of the highest airline fuel costs in the world due to high import tariffs on Aviation Turbine Fuel (Figure 1b). With the government's reluctance for any decrease in the taxes on jet fuel, the high jet fuel price will certainly be a drag for the airline industry.

Jet Airway's competitor, InterGlobe Aviation which runs Indigo Airlines, the market leader and a low cost airline, also reported a contracted operating margin of 19.4% as compared to 27.5% for Q4 last year. Simultaneously, net profit dropped 73% to USD 17mn as compared to Q4 last year. Of all the airlines, Jet Airways has been affected the most. Its RMI-CRI 1-year Probability of Default (PD) suggests that the uncertainty for Jet Airways has grown at a worrying rate over the past one year. Its PD has been around 1000 bps (equivalent to the credit grade of CCC in Probability of Default implied Ratings (PDiR)) since July 2017 with the peaking value over 2100 bps (equivalent to CC in PDiR) in May 2018. At the time of this report, Jet Airways' PD is about 1866 bps which is equivalent to the credit grade of CCC-. (Figure 2)

As the financials in Table 1 suggest, Jet Airways suffered huge losses in Q4, 2017-18. One potential reason behind this poor performance is the rise in jet fuel prices. As the jet fuel price has been increasing lately (refer to Table 1), the company has to shell out more for its fuel expenses but its inability to pass on the cost to passengers has hampered the company's financials, as displayed in the decreasing operating margin. This inability is due to the severe competition Jet Airways faces in the domestic circuit from Indigo, the low cost airline with a leading market share of over 40%.

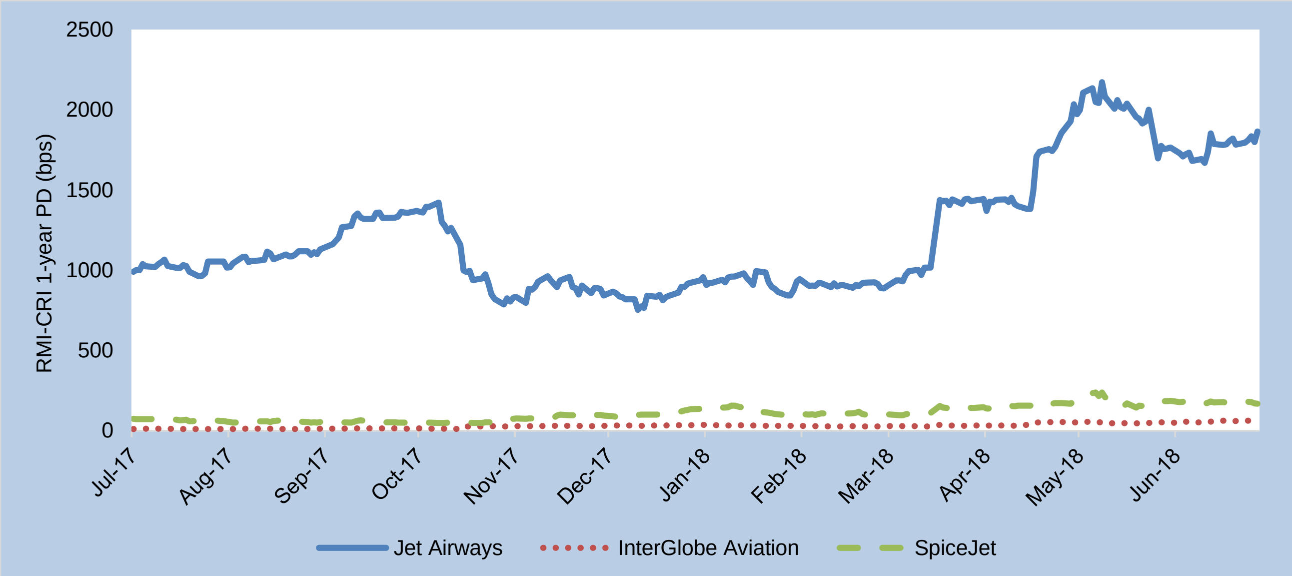

Figure 2: RMI-CRI 1-year Probability of Default for Jet Airways, InterGlobe Aviation and Spice Jet. *Source: RMI-CRI*

	Mar 2018	Dec 2017	Sep 2017	Jun 2017
Earnings per Share (USD)	-19.20	14.55	4.37	4.71
Operating Margin (%)	-13	4.6	4.6	1.5
Power & Fuel Cost (USD mn)	301	268	222	222
Net Income (USD mn)	-146	24	7.24	0.78
Interest Coverage Ratio (x)	-3.38	1.74	1.26	1.56

Table 1: Key financial figures of Jet Airways. *Source: Bloomberg*

What weakens Jet Airways further is its USD-dominated debt structure and high leverage. As more than 65% of company's total debt is denominated in US dollars, the weakening of Indian Rupee worsened the company's already fragile standing. According to the company's press release, the airlines foreign exchange losses amounted to USD 20mn for Q4. The falling interest coverage ratio (*ICR*) has also raised concerns about its debt on its balance sheet. Compared to InterGlobe Aviation whose *ICR* stood at 2.79 in March 2018, Jet Airways' *ICR* was a stark contrast at -3.38.

Its recent quarter loss and impairment losses amounting to USD 6.7mn for the investment in Jet Lite Limited, the low-cost subsidiary of Jet Airways, have led the company's net worth in negative. With a negative net worth and current liabilities of over USD 2bn, the company's future could be at stake if it could not refinance or generate enough cash flows to meet its obligations. A one-time maintenance charge of USD 35mn didn't help either in an already crunched quarter.

Another issue which has tethered the Indian airlines is the fleet size. The current fleet size of Indian airline industry is too small to cope with the increasing travel demand and to meet that demand, Indian airlines will need cash to buy aircrafts. With airlines facing mounting losses and a declining rupee, doubts may be raised about Indian airlines' ability to capture this travel boom.

Even with the booming Indian aviation industry, the current scenario looks grim for the airlines with the growing jet fuel prices and declining rupee. Despite Jet Airways' efforts made to improve the situation such as improving on operational efficiency, the credit prospect is still at distress. The company may need to revamp itself to bring in more cash flows in order to improve on its financial standing.

Credit News

Banks see surge in unsecured loans

Jul 16. Loans in the form of unsecured credit card and personal loans are rising quickly among Indian banks. ICIC Bank saw a 41% growth in its unsecured credit card and personal loan portfolio during the year as of March 31, 2018. HDFC Bank similarly reported a 39% increase in credit cards and 44% in personal loans, and other banks have seen a similar trend. According to Crisil Research, such credit - comprising personal, small and medium enterprise (SME) and credit card loans - has a compound annual growth rate (CAGR) of 27%, almost four times growth in bank credit, between the fiscal year 2015 to 2018. In addition, the rating agency also says the growth will nearly double in the next three fiscal years. (Telegraph India)

Insolvency limbo: the SGD bond market

Jul 14. Since Nov 2015, there have been at least 13 issuers that have defaulted amounting to a face value of SGD 3.2bn of Singdollar bonds and perpetual securities. The amount represents about 2.6% of the SGD 123bn outstanding Singdollar corporate bond market. The high-yield Singdollar bond and corporate perpetual securities sales took off in 2012 in line with a strong bull market offering companies a relatively easier and convenient way to diversify their capital structure. However, the recent defaults by issuers raised question about the market given that the credit cycle may have peaked, turning some high-yield instruments into junk. Observers have asked banks to disclose more information on issuers in order to close the gaps in investor education as a lot of these instruments are geared towards accredited investors. (Business Times)

China's rising defaults bring more safeguards to Yuan bonds

Jul 13. As China is coming to a record year of corporate-bond defaults, there has been a greater application of safeguards to local bonds. The ratio of domestic bonds with a cross-default covenant, which puts a borrower in default of other debt if it fails payment on one bond, has surged to 82% of all company notes sold this year, compared to almost zero percent five years ago. The growing number of cross-default clauses accords with investors' increasing awareness of credit risk in recent years, according to a portfolio manager at Income Partners Asset Management Ltd. Over the past five years, more and more yuan corporate-bond issuers have added debt covenants with the cross-default clause having the highest adoption rate. (Bloomberg)

Wall Street competes with unregulated banks for the riskiest loans

Jul 12. As US regulators loosen lending curbs, Wall Street banks are diving back into high-risk corporate lending. Competition in the USD 2.3tn junk bonds and leveraged loans markets are growing at a higher pace. This lucrative business has collected USD 6.6bn in the first half of 2018, and will reach an all-time high for the year if loan issuance continues at this pace. However, concerns were raised on whether the race would bring new and greater risks as underwriters have already been piling more leverage onto companies and watering down various protection for investors**.** Fed's leveraged-lending guidance asserts that any leveraged-buyout that adds debt more than six times of a firm's EBITDA would attract scrutiny. (Bloomberg)

Turkey faces ticking bomb with energy loans of USD 51bn

Jul 11. Some Turkish companies in the energy industry – the fourth-most bank loans-intensive industry – are not making enough to finance their debts in foreign currencies as lira crumbles. As the sudden depreciation causes costs to skyrocket, power producers, amounting energy loans to USD 51 billion since 15 years ago, are unable to cope with this rise due to nation's regulation and price ceilings being put in place. Power generators that are efficient and fulfil certain standards, however, will receive government's compensation should they earn less than what they spend. Although it may not be a full compensation for the loss, it does help alleviate the loss incurred largely. (Bloomberg)

Elliott, Pimco said to be among bidders for Banco BPM bad loans (Bloomberg)

Deutsche Bank wins nod to underwrite corporate bonds in China (Business Times)

Samurai bond sales at fastest pace since global financial crisis (Business Times)

Regulatory Updates

Global regulators warn banks must abandon reliance on Libor

Jul 12. On July 12, global market regulators issued stern warnings that informed banks to speed up in abandoning Libor as the “risk-free” benchmark interest rate. In accordance to the warnings, UK Financial Conduct Authority and US Commodity Futures Trading Commission also emphasize the certainty of Libor’s discontinuation. They argue that the four-decade-old benchmark no longer reflects actual bank funding activity and needs to restore public trust after a series of manipulation scandals. Policymakers would like to switch market’s reliance on Libor to overnight rates, which are believed to resemble actual transactions and are less susceptible to manipulation. In order to increase the pace of the transition, transactions that involves Libor as the reference will be discouraged. (FT)

ECB unveils compromise solution for banks' soured loan problem

Jul 11. European Central Bank (ECB) will provide euro zone banks additional time to save enough cash to counter their high bad debt situation. The ECB announced a list of rules with the aim to reduce EUR 721bn worth of bad debt mainly concentrated in Greece, Cyprus, Portugal and Italy, largely carried over from the recession between 2008 and 2012. Under the new rules, the ECB’s Single Supervisory Mechanism (SSM) will determine “bank-specific supervisory expectations” for the provision of non-performing loans (NPLs), according to certain guidelines including comparable banks’ current NPL ratio and financial features. The objective is to accomplish similar coverage for both old and new NPLs. (Reuters)

Saudi Arabia: Bankruptcy law to take effect in August (Al Arabiya)

India bankruptcy law pushes firms to pay up debts (Business Times)

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