Impact of COVID-19 on Indian Aviation

1st Update

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Impact of COVID-19 on Indian Aviation

COVID-19 is having an unprecedented impact on global aviation, including in India

A gathering series of travel restrictions imposed by governments around the world is reducing air traffic to a trickle on most routes. This now consists primarily of passengers seeking to return to the relative safety of their homes in advance of borders closing. Discretionary travel for business, leisure, social, education, employment or religious reasons has all but evaporated.

This has resulted in airlines taking extraordinary and hitherto unimaginable decisions with respect to their operations. As the table below indicates, carriers in all regions have announced plans to drastically reduce operations over the next few weeks, in some cases even temporarily suspending services entirely. The situation remains highly fluid with further deep cuts possible.

Examples of planned airline capacity reductions over the coming weeks

Airline	Domestic capacity reduction	International capacity reduction
Europe		
Air Baltic	Suspending operations	
Austrian Airlines	Suspending operations	
Brussels Airlines	Suspending operations	
Finnair	Up to 90% capacity reduction	
IAG	At least 75% capacity reduction	
LOT Polish	Suspending operations	
Lufthansa	Up to 50% capacity reduction	
Ryanair	Up to 80% capacity reduction	
Scandinavian Airlines	Suspending most operations	
Virgin Atlantic	Up to 80% of flights cancelled	
Asia Pacific		
Air New Zealand	30% capacity reduction	85% reduction on long haul
Cathay Pacific	n/a	Up to 90% capacity reduction
Qantas/Jetstar	60% capacity reduction	90% capacity reduction
Singapore Airlines	n/a	50% capacity reduction
North America		
Air Canada	50% capacity reduction	
American Airlines	30% capacity reduction	75% capacity reduction
United Airlines	50% capacity reduction	
WestJet	50% capacity reduction	Suspending operations
Latin America		
Azul	35-50% capacity reduction	
Gol	50-60% capacity reduction	90-95% capacity reduction
LATAM	40% capacity reduction	90% capacity reduction

Source: CAPA India research and analysis

Earlier this week, CAPA – Centre for Aviation had stated that by the end of May-2020, most airlines in the world will be bankrupt. IATA analysis concurs with this view and shows that the typical airline had two months of cash at the start of this year.

Given this dire situation, airlines will increasingly be turning to governments for assistance. Submissions are being drafted and some relief packages have already been approved. The anticipated bailout request from US carriers alone is around USD58 billion, and this is a region that has been highly profitable in recent years. The total global requirement could exceed USD200 billion.

Examples of government assistance likely to be requested or already approved

Sector	Nature of assistance
US passenger airlines	USD50 billion request expected
US cargo airlines	USD8 billion request expected
US aerospace companies	USD60 billion request expected
UK airlines	USD9 billion request expected
European Union airlines	State aid rules have been relaxed
Australian airlines	USD0.43 billion relief package approved

Source: CAPA India research and analysis

The outlook for Indian aviation is of serious concern

We do not wish to be alarmist and are presenting views based on data and analysis. But the situation is evolving extremely rapidly, with the global measures in place today dramatically more restrictive than this time last week. There remains a very high probability that conditions will continue to deteriorate.

The speed and scale of developments is so significant that it is impossible to have visibility on the likely impact beyond the next few weeks, and even that is challenging. Further clarity on the longer-term outlook may emerge by early April.

COVID-19 comes after what has already been a difficult FY2020 for Indian aviation

The current financial year started with the closure of Jet Airways, India's largest international and second largest domestic carrier. This, combined with the subdued demand due to the slowdown in the Indian economy, means that there has been virtually no growth in traffic over the last 12 months.

Furthermore, the sector has experienced several operational challenges during the year, including the temporary closure of Pakistani airspace which impacted westbound international operations; the grounding and suspension of deliveries of MAX aircraft; and continuing issues with Pratt & Whitney engines on NEO aircraft.

The challenges in FY2020 compounded the underlying weakness of Indian carriers resulting from historic issues that Indian airlines have had to grapple with for many years. These include a negative fiscal regime with particularly punitive levels of taxation on Aviation Turbine Fuel; a restrictive regulatory framework; a shortage of skills; and limited access to capital.

As a result, even before COVID-19 appeared on the scene, most Indian carriers already had very strained balance sheets and almost no liquidity. This latest shock will once again expose the vulnerability of India's aviation system as happened during the fuel price spike in 2008. But on that occasion the shock was short-lived, even if its impact reverberated for several years. This time, the shock itself will be far deeper and much longer.

CAPA India's preliminary estimates for the near-term impact on the Indian industry are presented below. <u>However, it should be noted that the situation could deteriorate quickly and significant downward revisions to these estimates are possible.</u>

- Initial weakness in the domestic market emerged in February, with some carriers experiencing a 5-10% year-on-year decline in yields, although others were able to maintain similar levels to last year. But during 1-15 March the yield decline has accelerated across the board to around 12-15%, and as per CAPA estimates forward bookings are down 30%+ relative to last year.
- With new advisories and restrictions being announced every day, and with the Indian government urging people to avoid all non-essential travel, demand is expected to weaken substantially, with a drop of 40-50% or quite possibly even higher being possible in the near-term, as is being seen in other markets. Yields may also come under further pressure and could deteriorate by 25% or more. However, given the structural reason for the decline in demand, reducing fares will not stimulate traffic, but will simply dilute yield on those passengers that clearly have an urgent need to travel regardless.
- Based on the latest cancellations, international capacity is currently estimated to be down by 60-70% year-on-year, although the situation is evolving on daily basis. India has banned entry by all foreign nationals (with some very limited exceptions) until at least 15-Apr-2020. Foreigners account for around 25% of international air travellers to/from India. However, India has also blocked the entry of its own nationals from the European Union and several other countries, and has advised its citizens not to travel overseas. International traffic could therefore soon approach a state of suspense.
- As a result of the significant reduction in flying, Indian carriers may initially ground around 150 aircraft (including almost all of the international fleet), with this number expected to increase as more domestic operations are curtailed over the coming weeks. If the decline in traffic continues to be severe, the majority of the fleet could be grounded by April.
- By extension, the reduced scale of operations could impact the requirement for around 30% of airline staff and up to 50% of ground handing staff. For the first couple of months this could potentially be handled through mandatory leave and leave-without-pay initiatives for 1-2 months. But should the situation continue

beyond a few weeks, it will quickly result in short-term retrenchment - with the prospect of re-employment once the situation improves. And an extended downturn will inevitably lead to significant redundancies.

- Any shrinking of the airline industry will have a cascading impact across the aviation value chain, particularly on 3rd party MROs, ground handing companies and private airport operators.

- These extraordinary conditions are expected to impact all of 1QFY2021, with the strong possibility of extending into 2QFY2021. The political consensus increasingly suggests that the impact of COVID-19 will not simply be a short-lived disruption but could extend for up to six months or more.

- In light of these circumstances, all Indian airlines will report significant losses in 1QFY2021, even with oil prices at around USD30/barrel. If operations have virtually ground to a halt, low fuel prices will provide no benefit. At an industry level, consolidated losses are estimated to be in the range of USD500-600mn for the quarter (excluding Air India). However, these are very preliminary estimates and are subject to further downward revision. In the absence of serious and meaningful government intervention, such an outcome could lead to several Indian airlines shutting down operations by May or June due to a lack of cash.

A number of government and industry responses are possible in the short-term

- Some airlines may choose to temporarily shut down their operations by design – as is currently the case with several European carriers – on the basis that demand is so low that such action will result in reduced losses than if they continue to operate.

- Airlines will seek to adjust aircraft deliveries scheduled for 1QFY2021 and may cancel some orders. Indian carriers have 50 aircraft due for induction between now and 30-Jun-2020. But delaying deliveries may impact the liquidity of some carriers that are reliant on sale-and-leaseback margins on aircraft inductions to generate cash. And the availability of financing for deliveries may also be compromised if some lessors come under financial pressure themselves.

- To mitigate the severe financial crunch that airlines will experience, the Ministry of Civil Aviation is likely to recommend that short-term financial assistance be extended to the sector.

- The privatisation process for Air India will be further delayed. The submission date for Expressions of Interest has already been pushed back by six weeks. As a result, the government will need to commit significant and immediate interim funding of USD300-400 million for the national carrier, to ensure that it is able to operate at least in its current condition until such time as the sale transaction is concluded. The government must also have a fall-back plan to regroup and continue to operate the airline for the medium-term if the privatisation process is unable to proceed.

Likely outcomes if the severity of the impact increases and extends beyond a couple of months

- Regardless of any fiscal concessions and support that the government may offer, most airlines will have to shrink their operations, and the more vulnerable carriers may shutdown. This will in turn impact the entire aviation value chain, resulting in rationalisation and job losses across airports, ground handling companies, MROs, travel companies, as well as hotels and tourism operators. The prospect of defaults on aircraft lease payments is also likely.
- If there is a virtual cessation of air travel, then whatever support the government offers, there is little that can be done to sustain operations.

CAPA India recommends that the government implement the following measures as soon as possible to mitigate the short-term impact of COVID-19

- Include Aviation Turbine Fuel under the GST framework so that airlines can benefit from tax credit on their largest input cost item.
- Revise Aviation Turbine Fuel prices on a weekly basis so that airlines can take advantage of lower rates as soon as they become available.
    - That said, whilst both of the above-mentioned fuel-related benefits will be critical for recovery, they will make less of a contribution towards survival in the short-term since airlines will have limited expenditure on fuel due to curtailed operations.
- Implement a short-term moratorium or extended credit terms for payments due to fuel companies and the Airports Authority of India; and similarly for interest and principal payments to banks on working capital loans.
    - Within the private sector, PPP airport operators will need to consider a temporary revision to the terms of concession agreements for duty free, retail and food & beverage operators. In several cases concessionaires are currently required to pay a fee, in advance, based on the revenue projected in the business plan. With international operations practically coming to a halt, such operators will face a severe cashflow constraint. Airport operators will either need to extend a moratorium on payments or revise the calculation of the fee to be based actual revenue rather than planned revenue.
- All of the above may still not be enough, and there could be a requirement for banks to extend working capital loans, secured against future sales or sale-and-leaseback incentives.

Longer-term, the airline system will require a re-set

- Following the first wave of airline deregulation in the 1990s there were multiple airline failures but given the nascent status of the market at that time they were relatively small. However, since 2012 we have seen two major airline closures since (Kingfisher and Jet Airways) which left a residual impact of USD5-6 billion on the aviation system, with a third exit only averted at the last minute when SpiceJet was rescued by Ajay Singh.

- Airlines continue to remain vulnerable but are now of a scale where a repetition of such failures has a very damaging impact not only on all aviation stakeholders, but also on the national economy. We can no longer celebrate profitless growth. There is a need to relook at the entire system in terms of the policy, regulatory and fiscal frameworks in which aviation operates. This must address the entire industry and not just airlines and airports.
- One of the recommendations that CAPA India has regularly proposed is the introduction of a regulatory requirement for airlines to hold cash balances that can support six months of operations in the absence of revenue, in order to be able to both obtain and to renew an AOP. When airlines expand without the balance sheet strength to support their growth, this results in excess capacity and loss-leader pricing which destabilises the entire industry. Incumbent airlines will of course need to be given adequate time to comply with this requirement, but this will be an important step in ensuring that they are better placed to withstand the shocks that regularly visit the industry.

This is the first of regular updates that CAPA India will release on the impact of COVID-19. In the next update, we will include a special focus on the impact on airports

About CAPA India

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Our strategic consulting and advisory services are unique in being able to combine local, on-the-ground insights and networks with global expertise.

Over close to 17 years, CAPA has completed almost 200 projects in South Asia, right across strategic, commercial, operational, technical, financial, planning and regulatory issues.

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