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AIRLINES | #2 Meeting of Minds: An Expert Perspective | 30 April 2021

Time for airline fleet consolidation; near-term pain to persist

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We hosted Kiran Koteshwar, ex-CFO of SpiceJet, for a perspective on the Indian aviation industry. According to Kiran, the industry can generate consistent profits only if it is more disciplined in adding capacity, upgrades its revenue management skills and raises focus on cargo and international business. Demand could remain subdued in the near term and profitability would hinge on better fleet utilisation, with some fleet consolidation likely. Government intervention is required to promote infrastructure growth and reduce costs.

Multiple factors behind poor pricing power: According to Kiran, excessive capacity addition, lack of adequate human skill sets and shallow revenue management are prime reasons for the airline industry's weak pricing power. Capacities can be expanded at lower capitalisation (lease model). Instead, undisciplined additions result in fleet buildouts ahead of demand, eroding pricing power.

Profits volatile despite significant industry consolidation: The fall of Kingfisher and Jet Airways did allow incumbents to gain market share. However, the industry is largely to be blamed for its inability to raise prices post consolidation, as injudicious fleet additions have outpaced available airport infrastructure and the resulting price wars continue to hurt profitability.

Wet lease model does not allow for stable profitability: Kiran believes sustainable profitability can only be generated through dry leases, which are more carefully planned and executed. While the wet lease model addresses near-term demand, the cost structure is too erratic to generate consistent profits.

Cargo business has a rosy future in India: Cargo transport is an essential strategy for any domestic and global airline. While the business requires working capital, it generates healthy profits and cash flows. It is highly underplayed in India currently and has significant scope for growth.

Our view: Looking at the current climate of subdued demand, a depreciating rupee (impacting 65-70% of costs including fuel), rising ATF prices and daily cash burn, we continue to have a negative stance on the aviation industry.

Meeting of Minds

– **An Expert Perspective**

This is the second in our 'Meeting of Minds' series where we host experts and leaders in various fields to discuss key events and trends in the Auto and Aviation sectors.

REPORTS IN THIS SERIES

SN	Title
#1	Auto: Rubber prices headed for a structural bull run

Other takeaways

- **On Air India's privatisation and GoAir's IPO:** Air India's privatisation will be good for the industry, according to Kiran. The acquirer will focus on international routes – a key asset of Air India – and shed non-profitable domestic routes, which will result in better pricing for all players. For GoAir, the equity capital raise will lend a new lease of life to the airlines and enhance its longevity as well as profitability.
- **On SpiceJet's cash crunch and IndiGo's expansion:** Both companies have a strong, profitable domestic flying network. But SpiceJet will need to garner some liquidity either through a new partner or by raising capital, resolve litigations and focus on balance sheet strength. IndiGo, on the other hand, being a market leader and a strong player, needs to focus on ancillary revenues – viz. the cargo and international business.
- **Lessors typically accommodative of defaults:** Aircraft lessors across the globe are more than accommodative, even of defaulters, as (a) they look to maintain their global balance of fleet, and (b) a flying aircraft even at a defaulting client is much better maintained than one grounded in a hangar for non-payment. Lessors acquire an asset post default only if they have another lessee ready for the aircraft.
- **Government intervention needed for sustainable growth:** The industry has long asked for a review of duties on engines sent out for repairs and also for ATF to be brought under GST to level the playing field with other industries. Government intervention is also required to ramp up India's airport infrastructure, privatise airports, rationalise air routes and make cheaper credit available to the industry.
- **Demand and profitability outlook:** Kiran expects demand to remain at 80% of normal levels for two years following the pandemic and profitability to improve once international travel normalises. In his view, higher aircraft utilisation, systematic revenue management and disciplined capacity adds will go a long way toward sustaining profits in the growing Indian market.

About the Speaker: Kiran Koteshwar

Kiran Koteshwar is currently the CFO of Lagos-based airline Green Africa and was most recently CFO at SpiceJet, India's second-largest budget airline. Kiran is a veteran in the aviation industry with vast knowledge in building and scaling a value airline in a challenging market. He was instrumental in the successful turnaround of SpiceJet and was also involved in two major funding exercises for the airline. Prior to SpiceJet, he played a key role in launching GoAir where he held several commercial and financial leadership positions.

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