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Change in the Air

Aviation sector gets onto a steady course after a challenging spell

India is poised to become a global leader in the aviation space. The industry has been witnessing a slew of positive developments such as investments in airport expansion, construction of big-ticket greenfield airports, and the announcement of the Drone Shakti initiative. The government recently removed price caps on domestic airfares, giving airlines a much-needed breather. *Indian Infrastructure* presents the views of leading experts on the state of the aviation sector, recent developments, and the future outlook for the industry...

What has been the progress in the aviation sector over the past one year?

Paramprit Singh Bakshi

Financial year 2021-22 was a mixed bag for the aviation sector in India, wherein the first half of the year was severely impacted due to the second wave of Covid. During the year, the total traffic rebounded 70 per cent year on year to 106.3 million, from 62.6 million in 2020-21, but was still 48 per cent lower than the pre-Covid number of 204 million. Domestic passenger traffic reached 84.2 million, a 60 per cent year-on-year increase compared to 52.5 million in 2020-21, but it was still 39 per cent below the pre-Covid domestic traffic of 137.5 million in 2019-20. A similar trend was witnessed in international traffic, which saw a stronger-than-expected recovery of 22.1 million during 2021-22, a 119 per cent year-on-year improvement over 2020-21. While passenger demand plummeted due to Covid, cargo operations were a relatively bright spot. All the Indian carriers witnessed strong contributions from cargo during 2020-21 and 2021-22. Perhaps the most important strategic development was the acquisition of Air India by the TATA Group.

Dr Vasudevan S.

We have witnessed a significant recovery in both domestic and international air traffic over the past 12 months. The air freight business has also seen good growth in the past year, with improved margins and potential for growth in a new world order, shaped by unprecedented global events. We still handle less than 4 million tonnes of air freight in India and the gov-



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ernment's vision is to triple that throughput in this decade.

The overall growth outlook looks positive as well with more flights being introduced, increased passenger preference for both domestic and international travel, the opening up of international destinations and the deregulation of domestic fares. We are already the third largest domestic civil aviation market in the world although our air traffic penetration is much lower than the US and China, which enjoy far greater passenger volumes than us. Our commercial aircraft fleet is still below 700 and even after doubling that fleet, which is expected to happen in this decade, we will have less than one-fourth of the current operating fleets in the US and China. This reflects the true potential of the Indian aviation industry, waiting to be unlocked.

Atul Sharma

The past couple of years have seen the Indian aviation sector pass through a turbulent phase, especially during Covid-19. However, various initiatives introduced recently will provide the necessary shot in the arm to the sector. The government has removed the price cap on domestic airfares with effect from August 31, 2022, which means airlines can now set their fares on their own, which, in turn, will allow them to increase passenger load factors and adopt the optimum fare strategy.

Major policy decisions also include the promulgation of the New Drone Rules, 2021, which aim to ease the process of using drones for non-commercial purposes and to make India a global hub by 2030 for research, development, testing, manufacturing and operation of

"Airlines have massive funding requirements to not only wipe out the red ink on their balance sheets but also to ensure future growth." Paramprit Singh Bakshi

drones. Later, in May 2022, the GARUD platform was launched to grant fast-track exemptions for the deployment of drones. The government also introduced projects such as Drone Shakti and Kisan Drones for crop evaluation, land record keeping and spraying of fertilisers.

The RCS Udan Scheme, which is now in its fifth year, has also helped air traffic grow, with new routes being awarded, and more and more airports being operationalised.

To attract more investments in the sector, the government introduced a new maintenance, repair and overhaul (MRO) policy, with an aim to make India a global MRO hub. Eight airports have been identified to set up MRO facilities, including Begumpet (Telangana), Bhopal (Madhya Pradesh), Chennai (Tamil Nadu), Chandigarh, Delhi, Maharashtra, Kolkata (West Bengal) and Tirupati (Andhra Pradesh).

The Extra Credit Line Guarantee Scheme (ECLGS), introduced to provide financial guarantee cover for industries disrupted by the Covid-19 pandemic, has been extended to the aviation sector as well. Besides extending the cover of ECLGS scheme until March 2023, the borrowing power of the airlines has also been increased under the scheme.

Some positive steps have also been taken to bolster aircraft leasing and financing ecosystem in the International Financial Services Centre (IFSC). IFSC would help achieve, in the near future, localisation of aircraft sale and lease back transactions preferred by aircraft lessors and lessees. The recent union budget also announced the setting up of Institutional Arbitration Centres at the Gujarat International Finance Tech-city IFSC.

The introduction of the Aircraft Objects Bill (Cape Town Convention Bill) by the Ministry of Civil Aviation is another welcome step, which, once enacted, will result in the creation of a legal regime to administer justice and protect the interests of each of the stakeholders involved in

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an aircraft leasing and finance transaction.

The sale of Air India to the Tata Group was concluded by the government in October 2021. This disinvestment is expected to re-energise the industry as well as instill confidence among the stakeholders.

What has been the impact of the key initiatives taken by the government?

Paramprit Singh Bakshi

The government took some key initiatives during 2020-21, as the first wave of Covid-19 began in the country:

- Price floors and caps were introduced on domestic fares, which provided a form of indirect ring-fencing for weaker airlines.
- **Air bubble agreements:** Much of the international traffic was carried under air bubble agreements instead of scheduled international services under bilateral air service agreements. Under many such agreements, airlines were not permitted to carry sixth freedom traffic. The emphasis on third/fourth freedom traffic resulted in Indian carriers significantly increasing their share of international traffic from 34.2 per cent in 2019-20 to an estimated 53 per cent in 2020-21.
- **Capacity restrictions:** During 2020-21, the government imposed restrictions on the volume of capacity that airlines could deploy. Capacity curbs were reduced in a staggered manner and finally lifted in October 2021. The intention was to match capacity with demand, with the ministry closely tracking pas-

senger volumes to determine when to trigger the next increase in capacity.

Dr Vasudevan S.

The government has been proactive in ushering in reforms since 2019. Some of these initiatives such as tax reforms, route development and infrastructure augmentation will make a difference to both the growth and profitability of aviation businesses in India with results likely to be seen within this decade. The new drones policy announced in August 2021 will also change the landscape of air-borne services significantly. We can look forward to more airports, including facilities for seaplane operations, more carriers, more private investment in airport infrastructure, including cargo terminals and commercial services, more MRO facilities and more flying schools to address future demand. We could also possibly have at least three major airport gateways in India handling a fair share of international transfer traffic in the next 7-10 years.

Atul Sharma

The various policy initiatives taken by the government have catalysed a resurgence in the sector towards a path of gradual and accelerated recovery.

What are the key challenges that remain un-addressed?

Paramprit Singh Bakshi

Airlines have massive funding requirements to not only wipe out the red ink on their balance sheets but also to ensure future growth. The funding cost cycle is turning after having hit its bottom and aviation businesses are faced with a double whammy of lack and higher cost of funds. The government, on its part, must remove all structural barriers to viability, and intro-

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duce fiscal, policy, regulatory and institutional reforms. The Ministry of Civil Aviation has to review and reform the sector urgently. Best practice regulations should be introduced - for example, financial fitness and solvency tests for airlines to be able to renew their air operator permits, including mandatory liquidity requirements. Similarly, start-ups should have sufficient cash as a condition of being granted a no-objection certificate.

Dr Vasudevan S.

Airports have never been challenged in terms of financing and growth opportunities because of a strong and mature policy and regulatory framework. India's airline sector has seen much more volatility in business with many carriers succumbing to the pressures of operating in a cost-intensive, cash-guzzling and highly competitive industry with no guaranteed market, profits or returns. Entrepreneurs have continued investing in this business, largely because of the low air traffic penetration in India, the opportunity it provides to build businesses across the value chain, and the pure passion of an aviator.

The post-Covid aviation world is exhibiting some fundamental changes in the landscape of aviation risks and there is a lot more that needs to be done for us to emerge as a global aviation hub. The immediate challenges posed by the worsening climate change issue are the need to transition to green aviation fuels and the need to provide enabling infrastructure. The costs of both transition and compliance will be high, impacting airports, airline tariffs and customer preference. Sustainability of locally produced green fuels will be another challenge that will need to be addressed as we subscribe to and embrace global policies and regulation on emission controls and standards. At the same time, the greening agenda will also open up newer opportunities for transforming aviation businesses and customer experiences, where technology is expected to play a big role.

Atul Sharma

One of the key challenges during the Covid period has been the enforcements of "hell or high water" clauses under aircraft lease agreements, which make rent payments mandatory, notwith-

standing non-utilisation of aircraft by the operator for reasons not under its control. This led to enormous losses being accumulated by the airlines. Non-payments also resulted in a financial crunch for the aircraft lessors not allowing them to service their financial obligations towards the aircraft financiers.

These issues only witnessed increasing scrutiny from various courts, not only domestically but also internationally, which, even today, continue to raise an important challenge for aircraft leasing and the aviation industry as a whole.

Another major issue for the aviation industry is its oversized accumulation of debt, with the pandemic causing nearly two years of reduced flying. With a high debt burden comes the struggle to maintain the required safety flying standards, as recently witnessed in not one but a few airlines operating across the country.

What is the sector outlook for the next one to two years?

Paramprith Singh Bakshi

Although the traffic situation has improved, the operating environment for the industry has become more challenging and is expected to remain this way in the near term. Apart from posing potential threats to demand, many factors could result in a structurally high-cost environment for the sector.

- **Traffic:** For 2022-23, domestic traffic is expected to reach 130-140 million passengers, perhaps remaining slightly lower than the 2019-20 levels. International traffic is expected to reach 55-60 million passengers.
- **Fleet:** Indian airlines are projected to operate over 700 aircraft by the end of 2022-23.
- **Financials:** In 2022-23, the operating revenue of Indian airlines is forecast to rebound to 116 per cent while the operating expenditure is forecast to rebound to 121 per cent of the pre-Covid-19 level. Hence, the Indian carriers are expected to report a loss before tax of \$1.4 billion-\$1.6 billion in 2022-23. The industry will also require recapitalisation of around \$2 billion-\$2.5 billion.
- **Airports:** In 2022-23, the passenger throughput at Indian airports is predicted to recover to 315-330 million. Indian airport oper-

ators are forecast to generate \$2.9 billion in revenue for 2022-23, representing a 94.4 per cent recovery against the pre-Covid-19 levels. Operating expenses in 2022-23 are likely to touch the pre-Covid-19 levels for Indian airports. Indian airport operators are expected to report a modest profit of \$420 million. However, if the revenue share for 2020-21 and 2021-22 is to be paid in 2022-23 the industry may end up breaking-even. Also, the government is expected to continue to move ahead with its proposed asset monetisation plan for 25 AAI airports under the National Monetisation Pipeline till 2024-25.

- **Consolidation:** The long-term impact of Covid and likely losses in 2022-23 will make it very difficult for some businesses in the sector to raise funds. Consolidation is expected in the airport sector possibly in the near term.

Dr Vasudevan S.

We are looking at a decade that is likely to catapult India into being the second largest aviation market in the world, if we get our policies and business initiatives right. The next two years will be an inflexion point that could determine the new normal for the aviation industry globally. The market is certainly there for the taking, but the success of aviation businesses and our ability to leverage the growth opportunity will depend on how well we use innovation, technology, people and policies to steer our journey towards becoming a global market leader.

Atul Sharma

A growing demand, backed by the expanding middle-income group and a working population, rising domestic and international travellers and tourists, a strong growth in external trade coupled with supporting policy initiatives, increased liberalisation and an open-skies policy have made the aviation sector poised to grow further with strong projected returns.

With the Airports Authority of India also driving large-scale modernisation, development, expansion and upgradation of both greenfield and brownfield airports, this sector will only witness increasing private sector participation and investments. ■

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