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EQUITY, DERIVATIVES, CURRENCY, COMMODITY, DEPOSITORY, MUTUAL FUNDS, INSURANCE* & NBFC*

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SECTOR REPORT

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Civil Aviation: Expect some cost pressure

India's civil aviation industry is on a high-growth trajectory. India civil aviation sector soared in 2017 as passenger traffic continued to rise on the back of more regional flights and higher disposable income levels. India aims to become the third-largest aviation market by 2020 and the largest by 2030. The Civil Aviation industry has ushered in a new era of expansion, driven by factors such as low-cost carriers (LCCs), modern airports, Foreign Direct Investment (FDI) in domestic airlines, advanced information technology (IT) interventions and growing emphasis on regional connectivity. India is the ninth-largest civil aviation market in the world, with a market size of around US\$16 billion. India is expected to become the third largest aviation market by 2020. The world is focused on Indian aviation – from manufacturers, tourism boards, airlines and global businesses to individual travellers, shippers and businessmen.

During April-December period of FY 2018, Domestic passenger traffic grew 16.7% to 1,771.7 lakh and international passenger traffic gained 10.1% to 481.9 lakh, thus, total passenger traffic advanced 15.2% to 2,253.6 lakh, Total passenger traffic advanced 18.3% to 2,649.9 lakh in FY 2017 as compared growth of 17.6% to 2,236 lakh passengers lakh in FY 2016. Domestic aircraft movement grew 12.9% to 13.84 lakh and international aircraft movement gained 9.4% to 3.26 lakh, thus, total aircraft movement advanced 12.2% to 17.10 lakh movements during April-December period of FY 2018. Total aircraft movement advanced 14.1% to 20.49 lakh movements in FY 2017 compared with growth of 11.9% to 17.93 lakh in FY 2016.

Prime Minister Narendra Modi government's policy reforms resulted in an equitable and inclusive growth for the sector. Government policies like Udan, which aims to connect regional airports and make flying more affordable, investment in airport infrastructure to boost capacity and tax benefits to India's maintenance, repair and overhaul industry. The government's decision to privatize national carrier Air India could also lead to significant structural changes depending on who buys it.

Ahead of the Union Budget 2018-19, the industry expected that the government would offer Zero Rating for Maintenance, Repairs and Overhaul Industry. Maintenance Repair and

Overhaul (MRO) industry is engaged in the business of providing engineering support to the local airline companies by undertaking repair and maintenance of aircraft and related components. The prevailing rules continue to allow import of such aviation MRO services from foreign based MROs on duty/tax free basis, whilst Indian MRO companies are required to conform to the tax/duty regime, thereby increasing the cost of same services by Indian MRO companies by 20% to 25%. This has resulted in shutting down of around 30% of units in India over the last few years. Due to the adverse tax regime, no investment has taken place in the last few years in this sector. The rate of Aviation Turbine Fuel (ATF) needs to be taxed maximum at 2% and minimum at 1% under regional connectivity.

ATF prices increased for January 2018

Oil marketing companies (OMC) increased aviation turbine fuel (ATF) price for sixth straight month in January 2018. A kilolitre of ATF will cost Rs 111, or 0.2%, more at Rs 57,460 in Delhi from 1 January 2018, according to Indian Oil Corp, the nation's largest fuel retailer. ATF will now cost Rs 384, or 0.6%, more at Rs 62,083 per kilolitre (kl) in Kolkata and up by Rs 382, or 0.6%, to Rs 60,640 per kl in Chennai. ATF price increased Rs 497, or 88%, to Rs 57,133 per kl in Mumbai. Rates at different airports vary because of differential in local sales tax or value-added tax (VAT).

India's ATF consumption increased 8.4% to 6.41 lakh tonnes in November 2017 over November 2016, according to data from Petroleum Planning & Analysis Cell, a division of the Ministry of Petroleum & Natural Gas, government of India. ATF consumption increased 9% to 49.32 lakh tonnes in the April-November period of FY2018. ATF consumption increased 12.8% to 70.19 lakh tonnes in FY2017 as against ATF consumption growth of 11.5% to 62.20 lakh tonnes in FY2016

About Civil Aviation Industry

India was the world's fastest growing aviation market driven by economic growth in the Indian subcontinent. The Indian middle class flier, with an increasing level of disposable income, now frequently chooses air travel over road and rail

transport, because of the convenience, competitive pricing and shorter journey time.

As per Airbus, the number of households in India with discretionary income greater than USD7,500 are expected to almost treble to 180 million households by 2030 and the number of households in India with discretionary income greater than USD20,000 are expected to grow 4.8 times by 2030.

India has become the third largest aviation market in terms of domestic passenger traffic, beating Japan, according to aviation think-tank CAPA. India's domestic air passenger traffic stood at 100 million in CY 2016 and was behind only the US (719 million) and China (436 million). India acquired the third spot globally by unseating Japan, which flew 97 million domestic passengers in CY 2016. Domestic air traffic has shown a consistent growth of 20 to 25% throughout 2015 and 2016, peaking in January this year at 25.13%.

India had 131 million passengers, of which nearly 100 million were domestic. The government expects the domestic airlines' fleet size to double over the next decade. The Government of India has started a new regional connectivity scheme (RCS) called Ude Desh ka Aam Nagrik (UDAN) under which fares will be capped at Rs 2,500 (US\$ 37.5) for half the seats in an one-hour flight. A new UDAN scheme introduced by the government this year is likely to boost regional connectivity.

According to data released by the Department of Industrial Policy and Promotion (DIPP), FDI inflows in air transport (including air freight) between April 2000 and March 2017 stood at US\$ 1.01 billion.

In the Union Budget 2017-18, the Civil Aviation Ministry received a substantial increase of over 22% in budgetary allocation at Rs 5,167.60 crore (US\$ 775.14 million) for the next financial year.

The Ministry of Civil Aviation along with Airports Authority of India (AAI) plans to develop small airports with frugal facilities, and encourage private airlines to bid for routes connecting these small airports with existing larger airports, thereby increasing regional air traffic.

AAI plans to increase its capital expenditure for 2017-18 by 25% to Rs 2,500 crore (US\$ 375 million), primarily to expand capacity at 12 airports to accommodate rising air traffic.

The Ministry of Civil Aviation has revised its air services agreement with Netherlands, which would enable air carriers from both the countries to operate up to 28 flights each week, up from current weekly limit of 21 flights, which would benefit regional carriers as well as enhance connectivity between the countries.

Air traffic for December 2017: AAI

The Airport Authority of India's (AAI) operational performance data for December 2017 showed that all operational airports

(taken together) handled 2.06 lakh aircraft movements (excluding general aviation movements), 282.2 lakh passengers and 2.82 lakh tonnes of freight. Aircraft movement (excluding general aviation movements) grew 15.1% in December 2017 over a year ago. Meanwhile, passenger traffic (domestic+ international) rose 16.1% and freight traffic rose 13.8% during the period.

Passenger traffic: Total passenger traffic at all Indian airports grew 16.1% to 282.2 lakh in December 2017. International passenger traffic grew 11.7% to 61.1 lakh and domestic passenger traffic increased 17.4% to 221.1 lakh. The share of domestic passenger traffic in total traffic accounted for 78.3% in December 2017 as against 77.5% in the corresponding previous month. In April-December period of FY 2018, Domestic passenger traffic grew 16.7% to 1,771.7 lakh and international passenger traffic gained 10.1% to 481.9 lakh, thus, total passenger traffic advanced 15.2% to 2,253.6 lakh, Total passenger traffic advanced 18.3% to 2,649.9 lakh in FY 2017 as compared growth of 17.6% to 2,236 lakh passengers lakh in FY 2016.

Aircraft movement: Total aircraft movement at all Indian airports (excluding general aviation movements) grew 15.1% to 2.06 lakh in December 2017 over December 2016. International aircraft movement grew 9.8% to 38840 and domestic aircraft movement jumped 16.4% to 1.67 lakh. In April-December period of FY 2018, Domestic aircraft movement grew 12.9% to 13.84 lakh and international aircraft movement gained 9.4% to 3.26 lakh, thus, total aircraft movement advanced 12.2% to 17.10 lakh movements. Total aircraft movement advanced 14.1% to 20.49 lakh movements in FY 2017 compared with growth of 11.9% to 17.93 lakh in FY 2016.

Cargo movement: International cargo movement gained 16.5% to 1.79 lakh tonnes in December 2017 over a year ago and domestic cargo movement at airports fell 9.6% to 1.03 lakh tonnes. As result, the total cargo movement (international and domestic) rose 13.8% to 2.83 lakh tonnes. Domestic cargo movement grew 9.1% to 9.17 lakh tonnes and international cargo movement inclined 18% to 16.09 lakh tonnes in April-December FY 2018, resulting in total cargo movement growing 14.6% to 25.25 lakh tonnes. Total cargo movement grew 10.1% to 29.79 lakh tonnes in FY 2017 after registering a growth of 7% to 27.04 lakh tonnes in FY 2016.

Regional routes power India's Civil Aviation sector (2017 in Retrospect)

India civil aviation sector soared in 2017 as passenger traffic continued to rise on the back of more regional flights and higher disposable income levels. Prime Minister Narendra Modi government's policy reforms resulted in an equitable and inclusive growth for the sector. "In the aviation sector, government have brought in policy changes that have

enabled even a 'hawai chappal' (slipper)-wearing person to avail the benefits of air travel. Besides augmenting passenger traffic growth, the Rs 2,500-an-hour flight services launched under the regional air connectivity — UDAN — scheme also expanded the country's aviation infrastructure.

In the first phase, contracts to five companies were awarded to operate flight services on 128 routes to 70 airports. Till recently, RCS-Udan operations to 13 airports had commenced, with an additional 12 ready to receive flights. Apart from enhanced services to non-metro cities, the sector has also benefited from the rise in domestic disposable income levels and lower jet fuel prices, all of which accelerated passenger traffic growth in 2017. According to the latest data from the Directorate General of Civil Aviation (DGCA), passenger traffic during January-November 2017 zoomed 17.27 per cent to 105.9 million. The rise in passenger traffic aided airlines to post healthy quarterly figures and also place new aircraft orders in anticipation of future growth.

CAPA: Air traffic volume to fly past 150 million in FY19 from 125 million this year

According to a projection by the Centre for Asia Pacific Aviation (Capa) India, domestic passenger volumes are poised to touch 125 million in FY18, growing 18-20 percent and may clip at the same rate and reach the 150 million-mark by FY19. According to the aviation regulator DGCA data, as many as 117 million passengers flew in the calendar year 2017. The number of international passengers is expected to increase by 12 percent reaching around 65 million by March 2018 and may touch 75 million by March 2019, according to CAPA. Capa says the domestic airlines are

expected to induct 124-130 aircraft by March 2019, an increase of 25 percent. Of this, around 22 aircrafts will be utilised for regional connectivity scheme (Udan) and around 25 aircraft are expected to be used for international operations.

Outlook

India civil aviation sector brightened in 2017 as passenger traffic continued to rise on the back of more regional flights and higher disposable income levels. Prime Minister Narendra Modi government's policy reforms resulted in an equitable and inclusive growth for the sector. Government policies like Udan, which aims to connect regional airports and make flying more affordable, investment in airport infrastructure to boost capacity and tax benefits to India's maintenance, repair and overhaul industry. The government's decision to privatize national carrier Air India could also lead to significant structural changes depending on who buys it. Indian domestic aviation market is growing at 20% a year and to keep up with that, the airlines, have ordered an additional 1,000 planes. The aviation industry is entering a sweet spot with traffic expected to grow at a compound annual growth rate of 14.5% over the next three years, according to HSBC Global Research. According to a projection by the Aviation consultancy firm Centre for Asia Pacific Aviation (Capa) India, domestic passenger volumes are poised to touch 125 million by March 2018, growing 18-20% and may continue to next year as well with volumes likely to fly past the 150-million mark in FY19. However, a continued increase in ATF prices could lead to some cost pressures in the very near term.

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