

Shree Airlines Private Limited: [ICRANP] LBB-/A4 assigned; ratings placed on watch with negative implications

July 06, 2020

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Ratings
Long-term loans; fund-based	2,748.4	[ICRANP] LBB-@**; assigned and placed on watch with negative Implications
Short-term loans; fund-based	1,354.4	[ICRANP] A4@; assigned and placed on watch with negative Implications
Short-term loans; non-fund based	220.0	
Total (NPR million)	4,322.8	

* Instrument details are provided in Annexure-1

**@ Denotes rating placed on watch with negative implications

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBB-@ (pronounced ICRA NP L double B minus) to the long-term loans of Shree Airlines Private Limited (SAPL). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4@ (pronounced ICRA NP A four) to the short-term loans of SAPL. These ratings are on watch with negative implications.

Rationale

The ratings assignment, including the watch with negative implications, factor in the expected impact of the Covid-19 pandemic on the Nepalese aviation industry. The global pandemic, starting from early 2020, followed by the worldwide travel restrictions and lockdowns, will create significant pressure on the revenue performance, financial profile, cash flows and debt-servicing capacity of the Nepalese aviation sector players. Due to the pandemic, Nepal has announced air travel restrictions from March 24, 2020 till July 21, 2020 (as per the latest Government announcement). This has severely impacted operations and thus the revenue metrics for the sector. This is likely to lower passenger flow over the medium term and hence increase the financial risk profile.

Nonetheless, the assigned ratings factor in the company's long track record of operations in the rotary wing sector (since 1999). This has provided extensive aviation industry experience to the promoter/management, before venturing into the fixed wing sector from August 2017. Hence, the company was able to quickly gain a substantial share of ~16% in the domestic fixed wing industry in CY2018, thereby becoming the third largest player. The rating draws further comfort from the company's diverse revenue streams comprising scheduled fixed-wing operations as well as chartered rotary-wing operations. Unlike most players in the sector, SAPL does not carry USD-based loan obligations, which augur well in terms of foreign exchange (forex) risks, amid the expected lowering of USD-based revenues over the medium term.

The pandemic is likely to result in negative operating leverage over the medium term, given the expected reduction in passenger volumes. This would weaken the company's operating profit margins and coverage indicators, thereby increasing its financial risk profile. The ratings are also constrained by the company's high leverage and sub-par coverage ratios. Although SAPL's interest cover has remained fairly comfortable (~2.2x for FY2019), DSCR has remained barely adequate at ~1.1x for FY2019. Given the likely impact of the pandemic, SAPL has sought a deferral of bank loan obligations for FY2021. ICRA Nepal expects continued support from the promoter through further equity injections, in case of exigencies. Any significant deviations from the expected debt deferrals and/or delays in promoter support would have a bearing on the debt service capability and hence could impact the ratings assigned. Furthermore, the Nepalese aviation industry has been facing rising price competition, following major capacity enhancements by the key industry players in recent years. The aviation industry also remains fairly cyclical/seasonal with large chunks of revenues generated in two major tourist seasons (September-November and February-April). This could pose a challenge in meeting the regular bank obligations, especially during periods of weak demand, like the present. Going forward, SAPL's ability to optimally

utilise the increased capacity, manage the cash flow streams and maintain comfortable debt coverage indicators amid the pandemic will remain the key rating sensitivity.

Key rating drivers

Credit strengths

Long track record of operations in the rotor wing sector; experienced promoter/management – The company has been providing charter services in the rotor wing sector since 1999 and is one of the leading players in this sector. Over these years, the promoter/management team has garnered vast experience in the Nepalese domestic aviation sector. This has helped the company in penetrating the competitive fixed wing sector, after the start of scheduled flights from August 11, 2017.

Ability to gain a substantial share in the domestic fixed wing industry – Despite a limited track record in the scheduled services, SAPL has been able to emerge as the third largest player in the sector, in terms of fleet capabilities and passenger volume. SAPL has gained a good market share of ~16% in CY2018 (also ~16% in FY2018) in terms of passenger volume. It started operations through the Jet aircraft, which flew mostly to farther destinations due to its inherent limitations. Hence the company has relatively better market share in sectors like Nepalgunj and Dhangadhi. Furthermore, with the addition of two new turboprops in July 2019, SAPL would now also fly to lucrative and closer destinations like Pokhara, Bharatpur etc, which have a better share of the high margin USD fare revenues. This is expected to further aid the company's market share growth and support its profitability.

Diverse revenue streams – The company has a diverse range of fleet in its fixed-wing as well as rotary-wing operations, which are suited for a wide range of operations. In the fixed-wing sector, it recently started operating chartered international cargo flights, amid the global air travel restrictions. However, continuity of this demand trend remains to be seen. The share of revenues from the fixed-wing operations remained high at ~80% for FY2019. In the rotary wing sector, the company provides chartered helicopter services for logistic support, search and rescue services, medical emergency evacuation and tourist expedition flights. SAPL has also been providing long-term charters to various national and international agencies. The diversity in the company's revenue stream is expected to mitigate revenue volatility to an extent.

Credit challenges

Expected impact of the Covid-19 pandemic – The ongoing global pandemic is expected to have a significant negative impact on the company's operating metrics, resulting in negative operating leverage over the medium term. FY2020 and FY2021 are expected to record low passenger volume due to the likely reduction in travel and tourism activities. Though the revenue performance was good till last fiscal, the pandemic has created a scenario of uncertainty over SAPL's future revenue momentum.

Weak financial profile with high leverage and sub-par coverage ratios – SAPL had a paid-up capital of NPR 800 million as of mid-June-2020, of which NPR 50 million is ordinary shares while the rest is non-cumulative preference shares. As compared to the conventional equity, hybrid equity instruments like these preference shares are relatively less predictable source of credit support under financial stress. Hence, ascribing 30% credit to the same (as per ICRA Nepal methodology; 30% calculated as a percentage of total calculated equity, including its own equity credit), SAPL's gearing was very high at ~47 times as on mid-June 2020 (also fairly high at 4.8 times even if the preference shares are considered as equity). The company's gearing levels have steadily increased with its increasing fleet size, which were financed through ~80% term loans. While its interest coverage ratio has remained comfortable in the last couple of years (interest coverage of ~2.2x for FY2019), the DSCR has remained barely adequate (DSCR of ~1.1x for FY2019).

Furthermore, the ongoing elongated operational disturbances due to Covid-19-induced air travel restrictions and the likely reduction in passenger volume in FY2021 is expected to increase the financial risk profile. Liquidity might remain under stress over the medium term, given the high debt obligations from the recent capex. Hence, timely equity injection might remain critical, in case of exigencies. The track record of capital infusion in recent years (albeit as preference

shares) provides comfort. SAPL has also sought a deferral of all principal payments for FY2021, along with interest deferrals too, in case of an extension of the direct/indirect impacts of the pandemic. ICRA Nepal would also continue to monitor the stance of the banking sector regulator in supporting the pandemic-impacted units.

Intense price competition in the industry – Major players in the domestic aviation industry, including SAPL, have expanded their fleet in recent years, factoring the expected growth in domestic air passenger volume. This has led to intense price competition in the industry and lower yields for the players. Furthermore, SAPL has relatively lower yield among its peers (~NPR 13.1 for FY2019) as it has been mostly flying to sectors with low USD-revenue possibilities as high share of USD-based revenues benefit the yields of the other industry leaders. SAPL witnessed a reduction in operating profit margins after entry into the fixed wing sector (operating profit margins of ~22-26% since FY2018, as against as high as ~47% in FY2015). The margins are expected to remain under pressure amid the sizeable capacity enhancements in the industry and the likely fall in passenger volume.

Inherent cyclical nature of the industry – The cyclical/seasonal nature of the tourism industry could create volatility in SAPL’s revenue growth and cash flow pattern. Large chunk of revenues is generated in two major tourist seasons (September-November and February-April). This could pose challenges in meeting the regular bank obligations, especially during the periods of weak demand, like the present.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

About the company

Incorporated in 1999, Shree Airlines Private Limited (SAPL) is a domestic airline company which operates in both the domestic trunk routes and helicopter charter services in the country. It currently operates with a fleet of six Bombardier aircraft (four Jet engines and two turboprops) in the fixed-wing sector. In the rotor wing sector, it operates with six Mi-8 helicopters and two relatively smaller Airbus helicopters. The company’s central office is in Tripureshwor, Kathmandu. Mr. Sudhir Mittal is the sole owner and the chairman of the company.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	11M FY2019 (Provisional)
Operating income (OI; NPR million)	219	1,675	2,581	2,086
OPBDITA/OI (%)	-3.14%	22.78%	21.87%	25.53%
Total debt/Tangible net worth (TNW; times); reported	2.98	3.47	3.50	4.83
Total debt/Tangible net worth (TNW; times) *	14.49	37.64	40.08	47.01
Total outside liabilities/TNW (times); reported	4.76	5.07	4.28	6.43
Total outside liabilities/TNW (times)*	21.40	51.44	47.18	60.12
Total debt/OPBDITA (times); reported	-237.92	6.28	5.03	6.82
Total debt/OPBDITA (times)*	-297.18	7.88	6.31	8.06
Interest coverage (times)	-0.17	1.65	2.19	2.20
DSCR (times)	0.72	1.18	1.06	1.17
Net working capital/OI (%)	93%	19%	17%	17%

* Adjusted calculation as per ICRA Nepal Methodology; ascribing a credit of 30% of total equity to the preference shares and counting the rest as debt.
Source: Company data

Annexure-1: Instrument details

Instrument	Rated Amount (NPR million)	Rating Action
Fund-based facilities; Long-term		
Term Loans	2,743.0	[ICRANP] LBB-@; Assigned
Hire Purchase Loan	5.4	[ICRANP] LBB-@; Assigned
Total Fund-based-Long term (A)	2,748.4	
Fund-based facilities; Short-term		
Overdraft	180.0	[ICRANP] A4@; Assigned
Demand Loan	165.8	[ICRANP] A4@; Assigned
Short-term loans - existing	690.6	[ICRANP] A4@; Assigned
Short term loans - proposed	318.0	[ICRANP] A4@; Assigned
Trust Receipt (within LC limits)	(18.0)	[ICRANP] A4@; Assigned
Total Fund-based-Short term (B)	1,354.4	
Non-fund-based facilities; Short-term		
Letter of Credit (LC)	20.0	[ICRANP] A4@; Assigned
Bank Guarantee	200.0	[ICRANP] A4@; Assigned
Non-fund-based facilities; Short-term (C)	220.0	
Grand total (A+B+C)	4,322.8	

@ Rating placed on watch with negative implications

Analyst Contacts

Mr. Kishor Prasad Bimali (Tel No. +977-1-4419910/20)

kishor@icranepal.com

Mr. Rajib Maharjan (Tel No. +977-1-4419910/20)

rajib@icranepal.com

Relationship Contacts

Ms. Barsha Shrestha (Tel No. +977-1-4419910/20)

barsha@icranepal.com

About ICRA Nepal Limited

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

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For more information, visit www.icranepal.com



ICRA Nepal Limited

Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.

Phone:+977 1 4419910/20

Email: info@icranepal.com

Web: www.icranepal.com

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