Summit Air Private Limited: [ICRANP] LBB/A4+ assigned; ratings placed on watch with negative implications

September 15, 2020

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Ratings
Long-term loan limits	764.68	[ICRANP] LBB@**; assigned and placed on watch with negative Implications
Short-term loan limits	718.74	[ICRANP] A4+@; assigned and placed on watch with negative Implications
Total (NPR million)	**1,483.42**	

** 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) to the long-term loans of Summit Air Private Limited (Summit). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4+@ (pronounced ICRA NP A four plus) to the short-term loans of Summit. These ratings are placed on 'Watch with negative implications'.

Rationale

The ratings assignment, including the 'Watch with negative implications', factors 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, has created significant pressure on the revenue performance, financial profile, cash flows and debt-servicing capacity of the Nepalese aviation sector players. Due to the pandemic, the Nepal Government has announced domestic air travel restrictions from March 24, 2020 till September 20, 2020 (as per the latest announcement). This has severely impacted operations and thus the revenue metrics for the sector. The pandemic is also likely to lower passenger flow over the medium term even if the domestic flights are resumed shortly, and this is likely to increase the company's financial risk profile.

Nonetheless, the assigned ratings factor in the company's adequate track record of operations in the domestic aviation industry (since 2010) along with its sizeable market share in the short take-off and landing (STOL) aviation segment. The ratings further take comfort from the company's experienced and resourceful promoters and directors who have long experience in the aviation/ tourism sector and are additionally present in other diverse sectors. The ratings also consider Summit's modest capitalisation with gearing of 1.83 times and total outsider liabilities to tangible net worth of ~3.3 times as of mid-July 2020. ICRA Nepal also takes note of the adequate regulatory support to the sector, from the Fiscal and Monetary Policies, to combat the pandemic effect. These include payment deferrals, concessional loans, restructuring/rescheduling opportunities, among others, which are likely to support the cash outflows over the pandemic impact period.

However, the pandemic is likely to result in negative operating leverage over the medium term, given the expected reduction in passenger volumes. This would sharply weaken the company's operating profit margins and coverage indicators, thereby increasing its financial risk profile. Although Summit's interest cover and DSCR had remained comfortable in the past (4.9 times and 5.5 times respectively, for FY2019), these ratios remained negative for FY2020, because of the sizeable losses. However, debt restructuring is yet to be finalised, which could comfort these indicators over the near to medium term. ICRA Nepal also expects adequate support from the promoters, in case of exigencies. Any significant deviations from the expected debt deferrals and/or delays in promoter support would impact the debt service capability and hence could have a downward pressure on the ratings assigned. The company also has sizeable unhedged foreign currency loans and liabilities, which exposes it to foreign currency risks. The pandemic has significantly impacted the USD-based revenues arising from the visiting foreign tourists and are priced at a premium. Forex income could further decline, depending upon the outcome of regulatory initiation to ensure equitable fares for the Nepalese and the non-Nepalese passengers and hence remains a rating concern. The ratings are further constrained by Summit's history of crashes in the recent past, which could impact its demand outlook. Its increased dependence on its top three routes, with ~78% of its 9M FY2020 revenues being derived from these, also impacts the ratings. The aviation industry also remains highly seasonal with large chunks of revenues generated in two major tourist seasons (September-December and March-May). This could pose a challenge in meeting the regular bank obligations, especially during periods of weak demand, like the present. Going forward, Summit's ability to increase its market share and improve the profitability indicators as well as manage the cash flow streams and maintain comfortable debt coverage indicators amid the pandemic will remain the key rating sensitivities.

Key rating drivers

Credit strengths

Adequate track record of operations in the aviation sector; experienced promoters/management – The company has been operating in the domestic STOL aviation sector since 2010 (as Goma Air till 2016) and is the second largest player in the segment. Similarly, the key promoters/management team have also garnered vast experience in the sector, apart from the presence in other business segments, including leading insurance companies.

Satisfactory operational profile – Summit's operational performance has remained good with average load factor of ~87% for the last three fiscals, despite the seasonality in demand. Summit's revenue per available seat kilometre (RASK) slightly declined in FY2019 to NPR 62 from NPR 65 in FY2018. However, this was compensated by a commensurate decline in cost per available seat kilometre (CASK) and hence the RASK-CASK spreads were largely stable at ~NPR 5. Amid the regular flight restrictions, Summit was also able to garner chartered revenues accounting for ~13% of 9M FY2020 revenues against zero chartered revenues in the earlier years.

Modest capitalisation – Summit has maintained modest gearing so far which stood at 1.83 times as on mid-July 2020, while the total outside liabilities to tangible net worth was 3.31 times as on the same date. However, the gearing is likely to increase to an extent due to likely losses and capitalisation of interest under restructuring. Though the company is yet to finalise the restructuring terms with the bankers, the overall capital structure is expected to remain satisfactory, despite some deterioration.

Adequate regulatory support for the sector to combat pandemic impact – Fiscal and Monetary Policies for FY2021 have provided various support measures to the tourism sector to mitigate the economic effects of the Covid-19 pandemic. Major relaxations include repayment deferrals for loans falling due till mid-July 2020 (up to 12 months or longer, as per necessity) and restructuring/rescheduling opportunities for the entire loan. Additionally, the concessional loans (at 5%) for business continuity/salary payments, refinancing possibilities for a chunk of loans at 5% and provision ensuring additional 20% working capital limits are also likely to help recover units like Summit from the pandemic impact.

Credit challenges

Increased financial risk profile – Summit's net profitability has generally remained subdued despite good operating margins (average of ~32% from FY2017 to FY2019). This was mainly on account of the increased depreciation and finance charges, both of which were a result of on account of its strategy of using largely new debt-funded aircraft. The net profitability reported high fluctuations over the years, with net loss of 0.4% reported in FY2016 and minimal profit of 1% in FY2018. However, the reported net margins were much higher at ~35% and ~43% for FY2017 and FY2019, respectively. The spike in profitability in these years was mainly due to the gains on insurance receipts as compensation for the crashed aircraft. Amid the operational disturbances for around four months in FY2020, Summit has reported a net loss of ~38% for the year. However, the company is yet to utilise the moratoriums/rescheduling facilities (including interest capitalisation), which could lower the quantum of losses. Declining fuel prices and cost reduction measures are also likely to provide some support to future profitability.

Apart from the ongoing elongated operational disturbances due to Covid-19-induced domestic air travel restrictions, likely reduction in passenger volume in FY2021 and FY2022 could further increase the financial risk profile. Liquidity might remain under stress over the medium term, given the increasing debt obligations as the credit period for purchase of latest aircraft is expiring in October 2020 (unless extended further). Hence, timely financial support from the promoters might remain critical. However, Summit's working capital borrowings usually remain much lower than its drawing power (~40% as of mid-July 2020), which also could provide some support in the liquidity management.

Reduced market share in CY2019, primarily from loss of aircraft – From CY2017 to CY2019, Summit lost two of its aircraft through crashes in May 2017 and April 2019. While the loss of aircraft is adequately covered by insurance, its market share among the three key players in the STOL segment notably declined to ~25% in CY2019 from ~34% in CY2018. This was mainly because the last crashed aircraft was only replaced in December 2019, leading to loss of revenues in two major seasons. Hence, the company's ability to recover its lost market share amid the pandemic impact, remains to be seen.

High dependence on top routes – The company remains highly dependent upon its top routes with ~43% of its 9M FY2020 revenues derived from flights between Kathmandu and Lukla (~52% in FY2019). This is followed by flights to Simikot and Jomsom, contributing an aggregate of ~35% to its 9M FY2020 revenues. Increased dependence on these tourist sectors increases the vulnerability of Summit's revenues to events impacting the tourism sector in Nepal like the current pandemic. Since these sectors report relatively better gross margins, a possible increase in the presence of other players in these sectors also remains a concern. Being a STOL-based airlines company, Summit's operations also remain susceptible to unpredictable weather conditions in these routes, which has resulted in accidents, sometimes involving aircraft crash as well.

Forex risks due to sizeable unhedged USD liabilities; decline in USD revenues would have broad-based impact – Summit has sizeable USD loan obligations for purchase for aircraft as well as for other operational expenses. As these liabilities remain unhedged, it has incurred forex losses in the past. The company's USD revenues used to remain adequate to cover the USD loan liabilities and other USD expenses till FY2019. However, with the pandemic impact on earnings, USD revenues remained inadequate to cover the FY2020 obligations. Additionally, the USD airfare (currently priced at a premium) might decline depending upon the final outcome of the Government's initiative for maintaining equity in airfare for Nepalese and foreigners. In the event of any unfavourable regulatory instruction, USD revenue base would further shrink, thereby increasing the forex risks.

Inherent cyclicality of the industry – The cyclical/seasonal nature of the tourism industry could create volatility in Summit's revenue growth and cash flow pattern. Large chunks of revenues are generated in two major tourist seasons (September-December and March-May). Furthermore, operational disturbances during the peak season are also likely, considering the unpredictable weather conditions as well as constraints from airport capacities. This could pose challenges in meeting the regular bank obligations, especially during 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 August 2010, Summit Air Private Limited (Summit) is a domestic airlines company which operates in short take-off and landing (STOL) destinations with a fleet of four aircraft. Summit operated under the name Goma Air from its inception till 2016, after which it was renamed to its current name. Summit's fleet is mostly based on Tribhuvan International Airport, with secondary hubs at the Surkhet and the Nepalgunj airports. The company operates scheduled flights as well as cargo/chartered flights. Mr. Bikash J.B. Rana is currently the chairman of Summit. The company's central office is in Tinkune, Subhidanagar, Kathmandu.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Provisional)
Operating income (OI; NPR million)	599	890	975	585
OPBDITA/OI (%)	36.3%	32.4%	27.4%	-0.9%
Total debt/Tangible net worth (TNW; times); reported	2.3	2.7	1.0	1.8
Total outside liabilities/TNW (times); reported	2.7	3.1	1.2	3.3
Total debt/OPBDITA (times); reported	5.6	3.9	3.2	-162.1
Interest coverage (times)	4.3	4.6	4.9	-0.1
DSCR (times)	6.2	2.3	5.5	-0.1
Net working capital/OI (%)	97%	22%	47%	39%

Source: Company data

Annexure-1: Instrument details

Instrument	Rated Amount (NPR million)	Rating Action
Long-term loan limits		
Fund-based; Term Loans (USD 6.34 million)	760.80*	[ICRANP] LBB@; Assigned
Fund-based; Hire Purchase Loan	3.88	
Total Fund-based-Long term (A)	**764.68**	
Short-term loan limits		
Fund-based; Overdraft and other Working Capital Loans	115.00	[ICRANP] A4+@; Assigned
Non-fund-based; Letter of Credit (LC) (USD 4.55 million)	546.24*	
Fund-based; Bridge Gap Loan- within LC (USD 4.095 million)	(491.40)*	
Non-fund-based; LC and Bank Guarantee	57.50	
Fund-based; Trust Receipt (within LC limits)	(36.00)	
Total Short term (B)	**718.74**	
Grand total (A+B)	**1,483.42**	

@ Rating placed on watch with negative implications

**USD limits have been converted to NPR taking exchange rate of 1USD=NPR 120.*

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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.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

For more information, visit www.icranepal.com

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