Yeti Airlines Private Limited: [ICRANP] LBB/A4+ assigned

June 24, 2019

Summary of rated instruments

Instrument*	Rated Amount (Million)	Rating Action
Facilities Rated in NPR Million		
Long-term loans; fund based	743.57	[ICRANP] LBB (Assigned)
Short-term loans; fund based	1,460.00	[ICRANP] A4+ (Assigned)
Short-term loans; non-fund based	644.00	[ICRANP] A4+ (Assigned)
Total (NPR Million)	**2,847.57**	
Facilities Rated in USD Million		
Long-term loans; fund based	10.66	[ICRANP] LBB (Assigned)
Short-term loans; non-fund based	6.23	[ICRANP] A4+ (Assigned)
Total (USD Million)	**16.88**	

** Instrument details are provided in Annexure-1*

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 Yeti Airlines Private Limited (Yeti or the company). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to the short-term loans (including non-fund based limits) of Yeti.

Rationale

The assigned ratings factor in the long track record of Yeti of more than 16 years in the Nepalese domestic aviation industry with a stable market share of ~24% over the last three years, despite the entry of new players and overall market growth. Yeti is a part of the Thamserku Group, which has a presence across a diverse range of tourism-related businesses including aviation, hospitality, travel agencies, etc. This has created synergies at the Group level and has aided the company's business generation. Yeti has been able to post good growth in revenues (~12% per annum in the last three fiscals), supported by healthy growth in domestic air passengers (CAGR of ~27% during CY2015 to CY2018). The company has added four ATR-72 aircraft over the last two years, factoring in the anticipated rise in tourist flow for the Visit Nepal Year 2020 campaign of the Government of Nepal. This is expected to provide adequate growth opportunities to Yeti. The ratings also consider the fuel economies that these aircraft offer compared to the existing Jet-streams of the company, which are likely to aid the profitability indicators going forward.

The ratings are, however, constrained by the intense price competition in the industry, leading to a decline in the revenue per available seat kilometre (RASK) in recent periods. Given the recent fleet addition by major players, the competitive landscape is likely to remain intense over the near term. Though Yeti's ability to maintain a high passenger load factor (PLF), in excess of 90% during CY2016-CY2018, provides some comfort, the sustainability of the demand growth momentum remains to be seen. The ratings are also constrained by the high debt-funded purchase of the aircraft, which has led to a weak gearing of 8.0x as of mid-January 2019 (3.7x in mid-July 2017) and a stressed debt service coverage ratio (DSCR) of 1.1x for H1 FY2019 (1.7x for FY2017).

Yeti is also considering the acquisition of its financially inferior sister concern, Tara Air P. Ltd. (Tara), which might create further stress on these indicators and could hence remain a rating monitorable. The company also has sizeable foreign currency loans and finance lease liabilities, which expose it to foreign currency risks. It also remains highly dependent on the top two routes, with ~41% of FY2018 revenues being derived from flights between Kathmandu and Pokhara and mountain flights. Being a domestic airline, Yeti's operations are limited within Nepalese geographies, exposing it to the risks emanating from any economic and political turmoil in the country. Going forward, Yeti's ability to attain healthy sales growth, commensurate with the fleet addition, maintain comfortable debt coverage indicators while withstanding competitive pressure, and improve the overall financial profile will remain the key rating sensitivity.

Key rating drivers

Credit strengths

Long track record of operations in Nepalese aviation industry – Since its establishment in 2002, Yeti has overcome several adverse conditions impacting the Nepalese tourism sector, including armed domestic conflicts and political turmoil. Its long experience in the domestic aviation industry and established brand presence in the market are expected to provide the company with adequate growth opportunities, going forward.

Government plans for 2020 likely to boost aviation industry growth – The tourism sector is one of the priority sectors for Nepal and accordingly, the Government has declared 2020 as Visit Nepal Year 2020, to boost tourist inflow. The Government has been undertaking several initiatives over the last few years, including the construction of two new international airports and the promotion of other infrastructure like hotels and roads. Notably, past initiatives like Visit Nepal Year 1998 and 2011 had witnessed an increase in tourist inflow. This time, the target is to attract two million tourists against around one million arrivals in 2017. This is a positive for the entire Nepalese tourism industry.

Steady market share; expected to be aided by recent fleet addition – Yeti is the second largest company in the domestic Nepalese aviation industry in terms of number of passengers carried, with its market share remaining largely constant at ~24% in the last three years despite rising competition. The demand outlook for Yeti is also positive, backed by an expected increase in domestic passengers as well as foreign tourists. The addition of the larger ATR-72 aircraft (compared to the earlier Jet-streams) to Yeti's fleet could aid further market penetration. However, the ability to increase its market share, commensurate with its fleet addition, remains to be seen.

Experienced promoters; operational synergies as a part of Thamserku Group – Yeti is a part of the Thamserku Group, which is a pioneer in the Nepalese tourism sector since the last 25 years. The Group has a presence in diverse tourism-related businesses including domestic and international aviation, expeditions, adventure travel, trekking, hotels/lodges, travel agencies, etc. The network of related businesses has aided Yeti's revenue generation and also provided cross-selling opportunities to the Group. The diverse presence of the Group's units in Nepal and abroad has also aided Yeti in generating sizeable USD revenues (~36% in FY2018), which offer better RASK compared to NPR revenues. The experience of the promoters/management and the relationships built over the years are likely to aid the revenue growth momentum, going forward.

Improving operating profit margins – Yeti's operating profit margin improved to ~23% in FY2018 from ~11% in FY2015. This was mainly supported by lower fuel prices during this period as well as a shift to fuel-efficient aircraft. However, the sharp increase in finance costs led to a lower increase in the net profit margin to ~3.3% in FY2018 from ~1.3% in FY2015.

Credit challenges

Intense price competition in the industry – Major players in the domestic aviation industry, including Yeti, have expanded their fleet in recent years, factoring in the expected growth in tourism. This has led to intense price competition in the industry and hence lower RASK (~NPR 15 in FY2018 from ~NPR 19 in FY2014). However, the decline in cost per available seat kilometre (CASK), mainly contributed by the shift to the fuel-efficient ATR-72 aircraft, has led to better RASK-CASK spreads. Nonetheless, the sustainability of the same over a longer time frame would remain a challenge, given the rising competition.

Debt coverage indicators likely to remain stretched over the medium term – Given the sizeable debt-funded recent/proposed fleet addition (~80-90% of the total cost of an aircraft), Yeti's coverage indicators are likely to remain subdued over the medium term. The company's gearing deteriorated to 8.0x as of mid-January 2019 while the DSCR declined to 1.1x in H1 FY2019 from 1.7x in FY2017. Hence, the debt service indicators are likely to remain stretched if the cash flows are lower than expected. The company's ability to sustain revenue growth, in line with the fleet addition, would remain crucial for its overall credit profile and is a key rating sensitivity.

High dependence on top two routes in domestic aviation industry – In line with earlier years, Yeti derived ~41% of its FY2018 revenues from flights between Kathmandu and Pokhara, and the mountain flights operating from Kathmandu. These flights mostly cater to tourists. Hence, high dependence on these sectors increases the vulnerability of Yeti's revenues to events impacting the tourism sector in Nepal. Since these sectors report relatively better margins, a possible increase in the presence of other players in these sectors also remains a concern. Additionally, the under-construction Pokhara International Airport might bring in international airlines directly to Pokhara, once completed, and could affect Yeti's profitability.

Decline in ASKM and RPKM per aircraft despite fleet addition – Yeti reported a decline in the available seat kilometres (ASKM) per aircraft to ~18 million in FY2018 from ~20 million in FY2016, despite the addition of larger ATR-72 aircraft. Similarly, the revenue passenger kilometres (RPKM) per aircraft also declined to ~17 million from ~19 million during this period. Yeti's ability to derive cost economics from its shift towards larger aircraft, while ensuring the optimal utilisation of its fleet and a healthy PLF, would remain a major driver to improve its overall financial profile.

Sizeable liabilities and expenses in USD; proper forex cash flow management to remain crucial – As of now, ~35% of Yeti's revenues are in USD, which, however, are vulnerable to the seasonality in the business. Since the company avails sizeable loans in USD and also carries sizeable finance lease liabilities (~USD 20 million as of mid-January 2019), its ability to manage the dollar cash flows would remain crucial, going forward.

Inherent cyclicality of the industry with high working capital intensity – The cyclical/seasonal nature of the tourism industry could create volatility in Yeti's revenue growth and cash flow pattern. This could pose challenges in meeting the regular bank/finance lease obligations, especially during periods of weak demand. In addition to the sizeable long-term loans, Yeti's high working capital intensity (~30% in H1 FY2019) necessitates high working capital debt. This remains a concern, given the interest rate volatility in the market.

Proposed acquisition of smaller and financially inferior sister concern could pressurise financial indicators – The Thamserku Group has two units in the domestic aviation industry viz. Yeti and Tara, with the units catering to trunk and short take-off and landing (STOL) routes, respectively. Yeti is now considering the acquisition of Tara for better operational and financial efficiencies. However, the timeline and modalities of the same remain to be finalised. Since Tara has a high debt burden as well as low coverage ratios, the acquisition could pressurise Yeti's financial indicators and could have a bearing on the assigned ratings. ICRA Nepal will continue to monitor the developments in this regard.

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

Yeti Airlines Private Limited is a domestic airlines company incorporated in 2002, with its registered office in Tilganga, Kathmandu. It is currently the second largest company in the industry in terms of the number of passengers carried. Yeti currently operates flights to eight trunk routes and mountain flights through a fleet of five Jet-streams (J-41) and four ATR 72-500 aircraft. Yeti belongs to the Thamserku Group, which has a presence in multiple tourism-related sectors including domestic and international aviation, expeditions, adventure travel, trekking, hotels/lodges, travel agencies, etc. The company was promoted by Mr. Lhakpa Sonam Sherpa and the Late Ang Tshiring Sherpa, both renowned tourism sector entrepreneurs of Nepal. Mr. Lhakpa Sonam Sherpa is currently the Chairman of Yeti while Mrs. Chanda Sherpa is the Managing Director.

Key financial indicators

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	H1 FY2019 (Provisional)
Operating income – (OI; NPR million)	1,826	2,443	3,135	1,782
OPBDITA/OI (%)	2.6%	15.1%	23.3%	22.7%
Total debt/Tangible net worth (TNW; times)*	5.3	3.7	7.6	8.0
Total outside liabilities/TNW (times)	6.6	5.2	8.9	9.3
Total debt/OPBDITA (times)	31.7	4.1	5.9	6.2
Interest coverage (times)	0.4	2.7	2.0	1.8
DSCR (times)	0.5	1.7	1.6	1.1
Net working capital/OI (%)	37%	28%	38%	30%

Source: Company data

** TNW excludes revaluation reserves created by revaluing the existing fleet of Jet-streams in FY2017; diminishing balance of revaluation reserve deducted in each period thereafter*

Annexure-1: Instrument details

Instrument	Currency	Limits to be Rated (Amount in Million)	Rating Action
Non-fund based facilities; Short term			
Non-fund based – Short term (Bank guarantee)	NPR	2.00	[ICRANP] A4+
Non-fund based – Short term (Letter of credit)	NPR	642.00	[ICRANP] A4+
Non-fund based – Short term (Letter of credit)	USD	6.23	[ICRANP] A4+
Fund-based facilities; Short term			
Fund based – Short term (Demand loan)	NPR	1,118.00	[ICRANP] A4+
Fund based – Short term (Overdraft)	NPR	342.00	[ICRANP] A4+
Fund-based facilities; Long term			
Fund based – Long term (Term loans)	NPR	743.57	[ICRANP] LBB
Fund based – Long term (Term loans)	USD	10.66	[ICRANP] LBB
Total limits (NPR Million)	**NPR**	**2,847.57**	
Total limits (USD Million)	**USD**	**16.88**	

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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 licenced 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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