Ask The Expert: Why is Spicejet in a Hand-to-Mouth Situation?

India's budget carrier airline, SpiceJet, presently operates nearly 630 daily flights to various domestic and international destinations. It has an impressive fleet size of 118 aeroplanes, comprising 82 Boeing 737, 32 Bombardier Q-400s and four B737 freighters.

SpiceJet has recently signed a codeshare agreement with the Gulf carrier, Emirates. Code-sharing enables an airline to book its passengers on its ally carrier and present seamless travel to destinations where it does not operate.

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This is the first-ever codeshare agreement signed by SpiceJet. The codeshare will permit opening of new routes and destinations for the passengers of both the air carriers. An initial agreement between the two airlines was signed in April 2019. Thus, travellers from all over the world can book a single ticket with lucrative rates to any of Emirates' nine points across India and connect onwards to 172 domestic routes on which SpiceJet operates.

However, the overall financial health of SpiceJet does not present a rosy picture. The company is facing a liquidity crunch. It has very low amounts of cash shown on its books. Media reports have said that the SpiceJet is bolstering its balance sheet with a fundraise through a qualified institutional placement (QIP), it is in talks with potential investors. SpiceJet has denied such reports. The so-called potential investors are missing too.

The fact of the matter is:
-As on 30 September, SpiceJet had cash and cash equivalents worth ₹93 crore.
-It had a net worth of about ₹850 crores (*negative*).

On the other hand, Spicejet's competitor, IndiGo run by InterGlobe Aviation Ltd had cash and cash equivalents worth about ₹18,736 crores and a net worth of about ₹6,200 crores. SpiceJet's free cash flow was ₹115 crore compared to IndiGo's ₹3,111 crores for the first half of FY20.

IndiGo is India's largest airline by market share. SpiceJet is India's second-largest airline by market share after IndiGo.

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In six months ending 30 September, SpiceJet lost ₹200 crores. It did not expect such a loss. It had assumed that the operating environment will not remain bad. When Jet Airways shut operations in April 2019, other airlines like Spicejet assumed that they will benefit greatly. However, that did not pan out as per their expectations, yields did not show any marked improvements. SpiceJet expanded rapidly in recent times, taking advantage of Jet's closure to take up over 30 of Jet's former 737 NG planes, flying more passengers and raising fares. SpiceJet has also received some of Jet's domestic and international airport slots.

In SpiceJet's case, the grounding of Boeing 737 MAX planes did hurt to some extent. SpiceJet seems to have placed very high hopes on the so-called virtues of the MAX, like 12-15% lower fuel consumption and 10% lower maintenance costs. It made the cardinal sin of assuming this as the key to profitability.

Most aviation analysts view this as an almost a hand-to-mouth situation for SpiceJet. Things may worsen further if Spicejet does not apply a course correction. A saving grace is a fact that the fuel prices haven't increased too much.

When a company is viewed as financially strong, it is in a better position to get better deals from suppliers, vendors and aircraft makers. Even for a fundraising exercise, the investors investigate its finances and then invest.

SpiceJet and other airlines like SpiceJet are not presently able to pass through such rough weather. They invariably have low cash on their books because they allow their businesses to heavily depend on variables beyond their legitimate control like fuel prices and competitive pressures. They are neither aware of the true value of their net worth nor they are able to make the optimum utilisation of their resources – which is quite strange. Most of the time, they find themselves very difficult to sustain.

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IndiGo has much higher cash holdings, it can sustain longer, it need not resort to lame excuses when things (fuel prices, currency fluctuation, or competition) become severe for the aviation sector. IndiGo's secret is open. Its business model is different from others. Apart from generating revenue from aircraft operations, it also has additional sources of revenue. Sale-purchase and leaseback of aircraft form a major source of revenue for IndiGo. A robust cash holding position enabled IndiGo to order over 100 aeroplanes in 2006-07.