

"A man is
great by
deeds, not by
birth"

-Chanakya

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Case Study

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Jet Airways: What to Concern?

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It was a monsoon month of August 2018, Naresh Goyal, the promoter of Jet Airways, is on his way to corporate office at Mumbai to attend an important meeting scheduled with senior management team. Driving through rains, he found himself in an uncertain condition over the future of his company. Jet Airways, then the second largest domestic airline by market share in India, was facing serious cash-crunchⁱ and regulatory probe over alleged lapses in timely disclosure of default risk of loans worth rupees 11,000 croreⁱⁱ. The aviation sector itself was stressed facing a double whammy of increase in crude oil prices and a falling rupee in the highly competitive industry. Further, Jet Airways had in the previous week deferred announcement of its earnings for the June quarter and was yet to announce a date for the same. Amidst all the frenzy, the media brought to light that the audit firm BSR & Co declined to sign the airline's first quarter earnings over differences with the management with regard to the ability of Jet Airways to continue as a going concernⁱⁱⁱ. Naresh Goyal had to work with the senior management team to bail Jet Airways out of the audit fiasco and also evaluate various funding options to meet liquidity requirements on priority.

Airline Industry

Directorate General of Civil Aviation (DGCA) indicates that India had 13.9 crore domestic air travelers in 2018 thereby registering a growth of 18.6% from 2017. In 2018, the low-cost carriers accounted for about 70% of the domestic seats in India. Yet, almost every Indian airline was struggling during the same period. Indian airline industry is growing fast amid huge challenges^{iv}

While Jet Airways had suffered losses in three consecutive quarters of 2018, SpiceJet was also in the red for two quarters and IndiGo declared its first quarterly loss in the same year since going public in 2015^v. The problems stemmed from higher fuel prices and lower ticket prices, in a market suffering from over-capacity. The Passenger Load Factor (PLF) of airlines had hit a record 90% in February 2018, but the prices were pushed down by aggressive competition to fill the excess capacity added by airlines through new aircraft purchases. After adjusting for inflation, average domestic fares had fallen by more than 70% since 2005. The frequent losses posted by the carriers led to significant working capital debt in the industry. Add to the troubles, there was the exorbitant value added tax charged on the Aviation Turbine Fuel (ATF)^{vi}.

Huge government intervention was also a cause for major concern in the sector. The government aimed to connect smaller Indian towns and making short-haul flights profitable as a part of its UDAN initiative. However, the price cap of Rupees 2,500 fare for one hour journey approximately 500 km on such routes made operations uneconomical due to which only a few airlines were interested in the scheme^{vii}. Then there was an overstaffed and inefficient Air India which casted a malign influence on the sector as a whole. It was tough for any private airline to raise fares when one of its competitors seems to have no real budget constraint and can keep fares at whatever seems politically acceptable.

Jet Airways

Jet Airways was founded by Mr. Naresh Goyal on April 1,1992 as a private company. In May 1993, it was started operating as air taxi with a fleet of four leased Boeing 737-300 aircraft. The company was granted scheduled airline status on January 14,1995. It become

public company on December 28, 2004^{viii}. Mr. Naresh Goyal wanted the company to have a combination of Swiss precision, German engineering, American technology, Asian services and Indian hospitality.

Jet Airways commenced its international operations in the year 2004 with a flight connecting Chennai and Colombo. The airline commenced operations to the UK in the year 2005 and to the US in the year 2007. Jet Airways belongs to the category of full-service carriers and in fact, in the early 2000s, it was known for its premium quality service offered to the business class passengers. Jet Airways became the first Indian airline to set up a hub abroad when it launched its hub in Brussels in the year 2007. Also, in the same year, the company acquired Air Sahara for rupees 1450 crore. When the Indian Government allowed the foreign airlines to have a stake in the domestic airlines, Jet Airways sold its 24% stake to Etihad airways for rupees 2050 crore in November 2013.

As on March 31, 2018, Jet Airways had a fleet of 112 aircraft. It had a market share of 12% on international operations to and from India in 2018^{ix} and this feat was achieved through the use of wide-bodied aircraft on long haul routes. The company's share in the domestic market stood around 15.1% in July 2018^x.

Over the period, Jet Airways made some of the critical decisions like the acquisition of Air Sahara airlines which suffered from integration issues due to cultural differences. Moreover, the airline confused its passengers when it rebranded Air Sahara first into Jet Lite and then Jet Konnect. In 2016, Jet Airways shifted its base from Brussels to Amsterdam even when the former airport was bustling^{xi}. Jet also went from its single-aircraft fleet model to multiple-aircraft fleet which increased the airline's operating economics. Its strategic planning was based on full-service airlines as competitors, when the real threat to the company was from low-cost airlines.

Competitors

As per data from the DGCA, Indigo was a market leader in the Indian airline industry with a market share of 40.9% in May 2018. Jet Airways, in the same month, came second with a 13.7% market share. Likewise, Air India occupied 12.8% market share while SpiceJet registered a 12.3% market share.^{xii} The Passenger Load Factors (PLF) of SpiceJet, IndiGo, AirAsia India and GoAir were 94.8%, 91%, 89.7% and 89.2% in May 2018 respectively.

In 2018, domestic scheduled services were offered by 15 airlines (see Table 4). During the year 2018-19, the figure for the number of domestic scheduled departure stood at 10.55 lakh while the same for international scheduled departure stood at 3.91 lakh. IndiGo was the market leader in terms of the domestic market share and catered to 44% of the domestic passengers during 2018-19. Jet Airways occupied around 12% market share in both the domestic and international markets during 2018-19. See Table 4, Figure 1 and 2 for industry and competitor analysis.

Jet Airways: Concern or No concern

On August 2018, audit firm BSR & Co, an affiliate of KPMG India, due to difference of opinion over the interpretations of some accounting principles and rules, denied to sign the

first quarter financial results of Jet Airways^{xiii}. BSR & Co raised some issues with regard to Jet Airways ability to function as a going concern. The main disagreement between the management and the auditors was based around the issues of negative net worth, high leverage and large repayment due in the subsequent years. While assessing the business viability in the short period that is next 12 months, Jet Airways was found to have Rs. 3,120.3 crore due in FY19, Rs 2,444.5 crore due in FY20 and Rs 2,167.9 crore due in FY21^{xiv}. As per the note issued by BSR & Co while signing the third quarter financial results, indicated that

‘Jet Airways has incurred a loss of Rupees 3,208 crore during the nine months ended December 31 2018 and current liabilities exceeds its current assets by Rs 9,610 crore. These events or conditions, among others show that a material uncertainty exists that may cause significant uncertainty on the company's potential to operate as a going concern^{xv}’.

As per Chairman Naresh Goyal, weakening of the dollar-rupee ratio, around 16% rise in Brent crude rates because of rise in fuel costs and the industry’s inability to pass on increased costs to the customer with a proportionate increase in ticket fares was responsible for the poor financial performance of the company in FY 2018. The worsening financial condition of the company is further evident in the fact that the management had asked the pilots and engineers to take a pay cut in July 2018^{xvi} and it was reported that the airline had enough money to last only 60 days.

The principle of going concern implies that there is no threat of liquidation for the company in the foreseeable future, which is usually perceived as a period of time lasting for 12 months. Also, as per IndAS 1, management should consider initiatives planned by the company or its ability to raise requisite finance in future to meet its obligations, over a period of 12 months or one year from the end of accounting reporting period.

Middle of the monsoon season, the meeting was started for key decisions. One of the members sought clarification on what is ‘Going concern’? How it is measured in general and specific to Airline Industries? How Auditors examine the compliance of this. How is the financial health of the company? Given the time pressure of issuing financial results, the management had to consider over the various ways through which the differences with the auditor could be resolved. They wonder what are implications of non-compliance of ‘Going concern’? For this, how the management should comply with the ‘Going concern’ issue raised by the auditors. Another concern was arranging for financing options to get over the liquidity crisis and allay any uncertainty over the company’s ability to service future debt repayment. Any decisions taken by the management should generate positive signals for turning around the erosion in stock prices triggered by the audit fiasco. What strategic decisions to be taken for compliance of ‘Going concern’? and keep the Jet Airways afloat.

Table 1: Balance Sheet of Jet Airways

(Amount in Rupees in Crores)

	2018-17	2017-16	2016-15
ASSETS			
NON-CURRENT ASSETS			
Tangible Assets	2,891.27	4,859.55	8,775.60
Intangible Assets	19.5	35.89	29.05
Capital Work-In-Progress	24.74	709.3	4.1
Other Assets	697.27	0	0
Non-Current Investments	696.7	696.67	696.19
Deferred Tax Assets [Net]	0	0	0
Long Term Loans And Advances	71.7	92.13	3,420.68
Other Non-Current Assets	1,046.60	919.79	38.23
<i>Total Non-Current Assets</i>	<i>5,447.78</i>	<i>7,313.33</i>	<i>12,963.85</i>
CURRENT ASSETS			
Current Investments	0	534.00	500.00
Inventories	481.1	498.76	1,049.71
Trade Receivables	1,279.35	1,333.62	1,625.48
Cash And Cash Equivalents	1,360.44	1,537.54	1,477.65
Short Term Loans And Advances	26.98	6.15	1,518.82
Other Current Assets	3,905.58	1,424.87	25.88
<i>Total Current Assets</i>	<i>7,053.45</i>	<i>5,334.94</i>	<i>6,197.54</i>
TOTAL ASSETS	12,501.23	12,648.27	19,161.39
EQUITIES AND LIABILITIES			
SHAREHOLDER'S FUNDS			
Equity Share Capital	113.6	113.6	113.6
Total Reserves and Surplus	-7,355.60	-6,589.47	-3,127.60
<i>Total Shareholders' Funds</i>	<i>-7,242.00</i>	<i>-6,475.87</i>	<i>-3,014.00</i>
NON-CURRENT LIABILITIES			
Long Term Borrowings	5,085.56	6,967.85	6,210.33
Deferred Tax Liabilities [Net]	0	0	0
Other Long Term Liabilities	46.32	78.06	903.53
Long Term Provisions	422.1	374.32	336.35
<i>Total Non-Current Liabilities</i>	<i>5,553.98</i>	<i>7,420.23</i>	<i>7,450.21</i>
CURRENT LIABILITIES			
Short Term Borrowings	209.56	252.52	3,021.06
Trade Payables	6,433.33	4,667.45	5,872.01
Other Current Liabilities	7,503.70	6,751.34	5,806.37
Short Term Provisions	42.66	32.6	25.74
<i>Total Current Liabilities</i>	<i>14,189.25</i>	<i>11,703.91</i>	<i>14,725.18</i>
Total Equity And Liabilities	12,501.23	12,648.27	19,161.39

Source: <https://www.moneycontrol.com/financials/jetairways/balance-sheetVI/ja01#ja01> - accessed on 19 March 2020

Table 2: Profit and Loss Statement of Jet Airways
(Amount in Rupees in Crores)

	2018-17	2017-16	2016-15
Income			
Net Sales	23,286.53	21,552.35	21,167.33
Other Income	671.84	1,488.52	822.47
Total Income	23,958.37	23,040.87	21,989.80
Expenditure			
Raw Materials	0	0	188.58
Power & Fuel Cost	6,953.25	5,473.78	5,015.73
Employee Cost	2,995.35	2,890.01	2,388.13
Depreciation	620.57	670.90	995.09
Interest	842.86	851.09	868.11
Miscellaneous Expenses	13,313.96	11,672.77	11,360.60
	24,725.99	21,558.55	20,816.24
Total Expenses			
Profit before tax	-767.62	1,482.32	1,173.56
Tax	0	-0.2	0
Profit After Tax	-767.62	1,482.52	1,173.56
Per share data (annualized)			
Shares in issue (lakhs)	1,135.97	1,135.97	1,135.97
Earning Per Share (Rs)	-67.57	130.51	103.31
Book Value (Rs)	-637.51	-570.07	-293.09

Source: https://www.moneycontrol.com/stocks/company_info/print_main.php - accessed on 19 March 2020

Table 3: Profit and Loss Statement of Jet Airways
(Amount in Rupees in Crores)

	2018-17	2017-16	2016-15
Cash flow from Operating Activities (A)	1,697.64	960.85	2,531.14
Cash flow from Investing Activities (B)	-359.15	1,644.87	-739.04
Cash flow from Financing Activities (C)	-1,554.96	-2,378.58	-2,437.59
A+B+C	-216.47	227.14	-645.49
End of Cash and Bank balances	320.50	536.97	309.83
Beginning of Cash and Bank balances	536.97	309.83	955.32

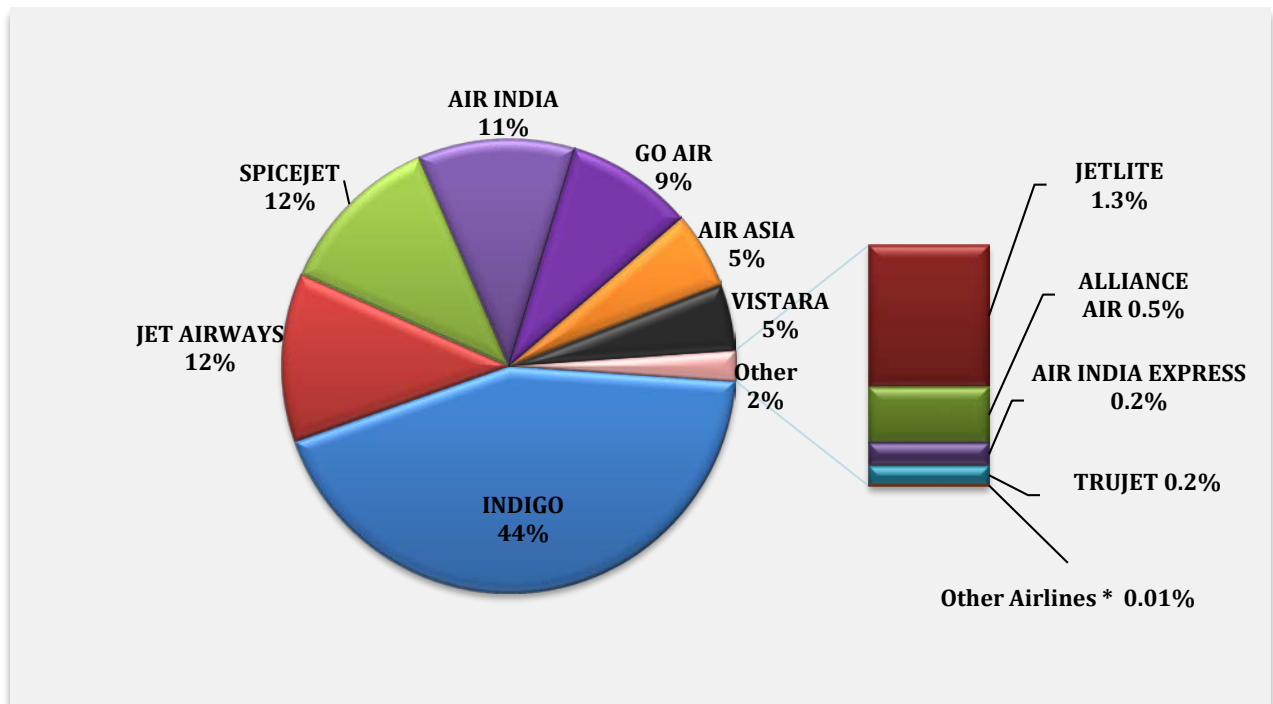
Source: https://www.moneycontrol.com/stocks/company_info/print_main.php - accessed on 19 March 2020

Figure 1: Stock Market Performance of Jet Airways during 2018-19



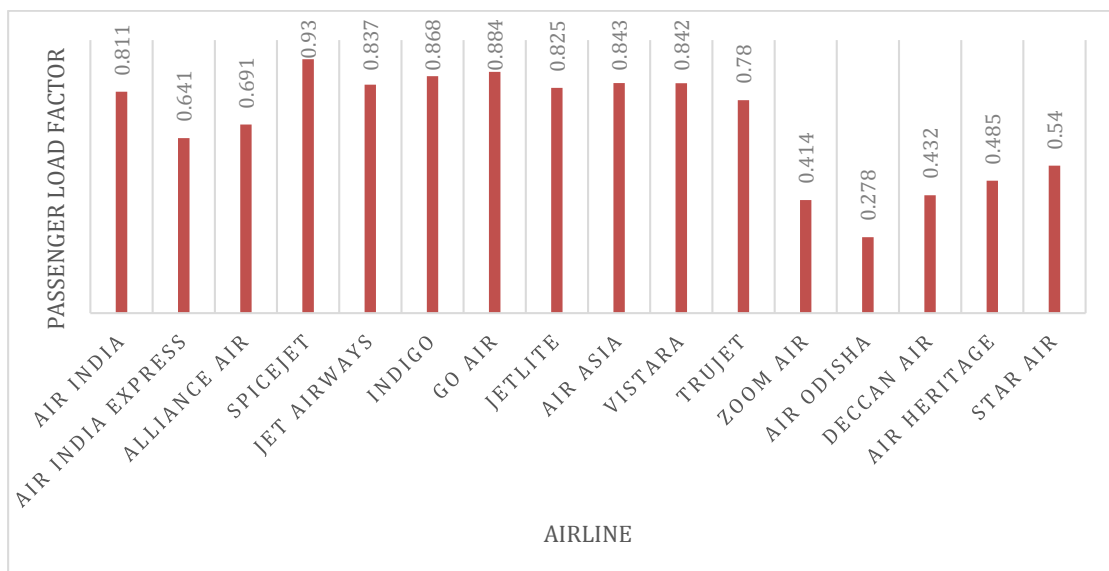
Source: <https://www.moneycontrol.com/india/stockpricequote/transportlogistics/jetairways/JA01> - accessed on 19 March 2020

Figure 2: Domestic airline market share (%) in terms of passengers carried, 2018-19



Source: Handbook on civil aviation statistics 2018-19

Figure 3: Domestic Passenger Load Factor (%) of Indian carriers during the year 2018-19



Source: Handbook on civil aviation statistics 2018-19

Table 4: Competitor Analysis during 2017-18

(Amount in INR million)

AIRLINES	Operating Revenue	Operating Expenses	Operating Profit
AIR INDIA	2,30,036.70	2,46,617.40	-16,580.70
AIR INDIA EXPRESS	36,196.80	30,725.40	5,471.40
ALLIANCE AIR	5,931.40	7,278.50	-1,347.10
JET AIRWAYS	2,32,570.40	2,39,784.50	-7,214.10
JET LITE (P) LTD.	12,937.60	13,149.80	-212.20
GO AIR	46,752.20	41,393.40	5,358.80
SPICE JET	77,950.90	72,735.70	5,215.20
INDIGO	2,30,208.90	2,04,442.50	25,766.40
AIR DECCAN	629.30	764.80	-135.50
BLUE DART	6,713.00	6,438.00	275.00
ZOOR AIR	174.00	165.90	8.10
AIR ODISHA	13.85	55.33	-41.48
AIR ASIA	18,011.30	19,425.70	-1,414.40
VISTARA	21,374.30	26,539.60	-5,165.30
TRUJET	1,956.80	2,808.20	-851.40

Source: <https://dgca.gov.in/digigov-portal/?page=jsp/dgca/InventoryList/dataReports/aviationDataStatistics/handbookCivilAviation/HANDBOOK2018-19.pdf>

-accessed on 19 March 2020

Appendix I

Under the provisions of the Company Act 2013, it is mandatory for the auditors of companies to comply with the Standards on Auditing (SAs) issued by the Institutes of Chartered Accountants of India (ICAI).

As per the Standard on Auditing 570(SA 570), “*under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.*”

The management needs to make a specific assessment of the entity’s ability to continue as a going concern during preparation of financial statements. Such assessment involves making a judgement regarding the company’s capability based on factors like degree of uncertainty, subsequent events and external factors.

A brief description of such events are specified in para A3 (page-7) of SA 570.

Source: <https://abcaus.in/icai/list-standards-auditing-applicable-audits-fy-2017-18-19.html> and<http://kb.icai.org/pdfs/PDFFile5b3b56f75d65b6.04883715.pdf> - accessed on 19 March 2020

Endnotes

ⁱ Why Jet Airways is facing a crippling Cash crunch - <https://www.bloomberquint.com/business/why-jet-airways-is-facing-a-crippling-cash-crunch> - accessed on March 13, 2020

ⁱⁱ Jet under lens for lapses in loan disclosure - <https://www.tribuneindia.com/news/archive/business/jet-under-lens-for-lapses-in-loan-disclosure-636841> - accessed on March 19, 2020

ⁱⁱⁱ Jet auditor BSR may quit if issues are not resolved - <https://economictimes.indiatimes.com/markets/stocks/news/jet-auditor-bsr-may-quit-if-issues-are-not-resolved/articleshow/65381983.cms> – accessed on 13 March 2020 – accessed on March 13, 2020

^{iv} Potential and challenges of Indian Aviation -<https://www.iata.org/en/pressroom/pr/2018-09-04-02/> - accessed on March 10, 2020

^v 'View: Why India's airlines keep struggling to take off' - <https://economictimes.indiatimes.com/industry/transportation/airlines/-aviation/view-why-indias-airlines-keep-struggling-to-take-off/articleshow/66904709.cms?from=mdr> – accessed on March 13, 2020

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^{vii} Ude Desh Ka Aam Naagrik: Civil Aviation Ministry's Regional Connectivity Scheme 'UDAN' launched - <https://pib.gov.in/newsite/printrelease.aspx?relid=151850> - accessed on March 15, 2020

^{viii} Company history – Jet Airways Ltd. - <https://economictimes.indiatimes.com/jet-airways-india-ltd/infocompanyhistory/companyid-4374.cms> - accessed on March 24, 2020

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^x IndiGo gains as AI, Jet lose market share - <https://timesofindia.indiatimes.com/business/india-business/indigo-gains-as-ai-jet-lose-market-share/articleshow/65481220.cms> - accessed on March 15, 2020

^{xi} <https://www.thehindubusinessline.com/economy/logistics/after-smooth-take-off-good-flight-jet-heads-for-hard-landing/article26357756.ece#> - accessed on March 15, 2020

^{xii} IndiGo remains top airline in India with 41% market share in May - <https://www.livemint.com> - accessed on March 19, 2020

^{xiii} <https://www.moneycontrol.com/news/business/companies/pressure-mounts-on-jet-airways-to-clear-the-air-on-financials-after-auditor-trouble-2829751.html> - accessed on March 13, 2020

^{xiv} ICRA downgrades Jet Airways' long-term bonds, NCDs - <https://economictimes.indiatimes.com/markets/stocks/news/icra-downgrades-jet-airways-long-term-bonds-ncds/articleshow/64362812.cms?from=mdr> - accessed on March 13, 2020

^{xv} Lenders rope in Ernst & Young as Jet Auditor - <https://economictimes.indiatimes.com/industry/transportation/airlines/-aviation/lenders-rope-in-ernst-young-as-jet-auditor/articleshow/68675965.cms> - accessed on March 19, 2020

^{xvi} Jet Airways to cut up to 25 percent of employees' salaries - <https://economictimes.indiatimes.com/industry/transportation/airlines/-aviation/jet-airways-asks-employees-to-take-up-to-25-pay-cut/articleshow/65220944.cms?from=mdr> - accessed on March 19, 2020

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