



India Equities
Aviation Sector

SPECIAL REPORT

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Kingfisher, a UB Group Company, operate as a Full Cost passenger service Carrier

Deccan Aviation is a largest charter aviation company in India

Deccan set to fly higher

Company Overview

Kingfisher Airlines

Kingfisher Airlines (Kingfisher) is a Bangalore based private airline company of the UB (United Breweries) Group. UB Group started its aviation business with launching of Kingfisher in 2005. UB Group currently operates different lines of businesses such as beverages, alcohol, pharmaceutical, media, research and development, international trading, fertilizers and infrastructure development. Kingfisher is operating its passenger and cargo transport service between different cities in India. The company operates as Full Service Carrier (FSC). On 23rd November 2007, the company has announced its expansion of routes network with three new services and additional two new destinations such as Lucknow and Khajuraho. With the launch of these new services, Kingfisher operates 218 flights a day serving 37 destinations with a fleet of 36 new aircrafts as on 23rd November 2007.

Deccan Aviation

Deccan Aviation Ltd. (DA) is a Bangalore based India's largest private heli-charter company. DA provides scheduled and unscheduled air passenger services, including helicopter charter services. DA is the largest charter aviation company with a network base of seven locations across the country. The company uses a fleet of 9 helicopters and 3 fixed-wing aircraft across its bases at Bangalore, Mumbai, Delhi, Bhubaneswar, Hyderabad, Surat, Katra (J&K), and Sri Lanka. Air Deccan, a part of DA, is the first Low Cost Carrier (LCC) company in India. Air Deccan was established in 2003 and started its operation with regular scheduled flight from Bangalore to Mangalore and Hubli. Air Deccan was the first airline in India to link second rung cities like Hubli, Madurai and Visakhapatnam to metros like Bangalore and Chennai.

The company mainly involved in providing charter air services which includes:

- Corporate charter service
- Emergency services
- Offshore oilfield Logistic support services
- Helicopter services to tourist location and pilgrimage centers

Apart from charter air service, the company also provides passenger air transportation service.



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With the liberalization of Indian aviation sector, aviation industry in India has undergone a rapid transformation

Excessive regulation and high cost of air travel were the main reasons for sluggishness in Indian aviation sector in the past

Boeing has raised its 20-year market forecast for Indian commercial aircraft purchases to \$86bn from \$72bn last year

Industry Overview

Indian Aviation industry is one of the fastest growing aviation industries in the world. With the liberalization of the Indian aviation sector, aviation industry in India has undergone a rapid transformation. From being primarily a government-owned industry, the Indian aviation industry is now dominated by privately owned FSCs and LCCs. Private airlines account for approximately 75% share of the domestic aviation market. Earlier air travel was a privilege only a few could afford, but today air travel has become much cheaper and can be afforded by a large number of people due to introduction of LCCs in the Indian aviation sector. However, Indian aviation is currently approximately 1.1% of the estimated global industry size (in operating revenue terms) of US\$ 500bn.

The Indian aviation sector has been a laggard relative to its potential in the past. Excessive regulation and high cost of air travel were the main reasons for this sluggishness. However, all this is now changing and the sector has shown an explosive growth over the last few years. Booming economy, growing proportion of consuming class, deregulation and acceptance of the private carriers have been the main drivers of this growth. Growth has accelerated with the entry of the Low Cost Carriers (LCCs) who are giving price based competition to the incumbents.

Airports are the major infrastructure requirement for airline services. Given the current level of congestion and expected increase in passenger traffic, we expect airports to be a critical bottleneck for Aviation industry going forward.

Industry Outlook

With major upgradations of the national airports and their modernization that India is undertaking at an estimated US\$9bn by 2010, we expect an even paced capacity addition in the airline sector. Much of the growth will emanate from regional distribution of passengers and international traffic growth. India is one of the fastest growing tourism destinations in the world. The World Travel & Tourism Council has estimated that India's tourism economy will emerge as the world's 3rd fastest growing over 2007-16, growing at over 8% per annum in real terms. Robust economic growth, higher disposable incomes, and growth in tourism & business travel, are the major demand drivers. The long-term potential of the industry is immense and we expect a strong growth in demand over the next few years as the growth drivers fall into place. According to our estimates, the demand for domestic air travel is expected to grow at above 25% for the next five years.

The number of domestic air passengers grew at a healthy 38.5% with 35.3mn passengers flying in FY2007 against 25.5mn in FY2006. The Centre for Asia Pacific Aviation (CAPA) has predicted that the domestic traffic would grow at 25%-30% annually until 2010, taking the overall market to more than 70mn passengers. Aircraft manufacturer Boeing has raised its 20-year market forecast for Indian commercial aircraft purchases to \$86bn from \$72bn last year.

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Trend of consolidation in the domestic aviation sector

We believe consolidation will help Indian Aviation industry to increase passenger yield

GDP growth in India will remain robust on the back of good industrial production forecast

Competitive scenario

Recently there has been a consolidation in the domestic aviation sector. From a fragmented sector with more than 10 players, today there are 3 major players, and a couple of other smaller players in the LCC space. These three together have a combined market share of approximately 80%. We believe consolidation would help the industry to increase passenger yield and match passenger demand.

Current Competitive Position

Company	Fleet Size	Market share (%)
Indian Airline & Air India	19.8	132
Jet Airways & Sahara (JetLite)	29.4	86
Kingfisher & Deccan	28.9	75
Indigo	8.4	12
SpiceJet	8.3	13
Other	5.2	14

Source:DGCA (Director General of Civil Aviation, India)

Number of passengers carried has seen increasing trend over the past years for all the Indian airlines. The demand for airline service or passenger travel depends upon demand for business travel and leisure travel. An increase in country's economic activity is directly linked to the demand for business travel and an increase in general income level is directly linked to the demand for the leisure travel.

Total passenger carried (in mn)

Company	2003-04	2004-05	2005-06
Air India	3.8	4.4	4.9
Indian Airlines	7.4	8.6	8.8
Jet airways	6.9	8.1	9.5
Air sahara	1.9	2.7	2.9
Air Deccan	0.1	1.0	3.0
Kingfisher Airline	N.A	N.A	1.2
SpiceJet	N.A	N.A	1.1
Go Air	N.A	N.A	0.2
Paramount Airways	N.A	N.A	0.1

Sources: DGCA

We believe macro economic performance of India, in terms of per capita GDP, will remain robust on the back of good industrial production forecast as well as comfortable levels of inflation.



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Comparative Valuation

Deccan Aviation has lowest current EV/ TTM sales multiple

Company	Current Share price	Current EV	Price/ book value	Current EV/TTM Sales
Deccan Aviation	169.95	2407.2	4.99	1.29
SpiceJet	67.65	2612.9	5.84	2.29
Jet Airways	28.9	11170.7	2.59	1.48

Source:company data

We believe that currently Deccan Aviation is trading at very attractive valuation. As we expecting big development in airport infrastructure on the back of Government expenses in airport development and committed FDIs from big companies such as ETA Star, etc. In addition to this, we also expect growth in passenger travel on the back of aggressive capex plan of airline companies and expected growth in GDP of the country.

Merger of Kingfisher and Deccan Aviation

On 28 December 2007, Kingfisher's stake has increased to 45.97% after additional purchase through its subsidiary

On 31st May 2007, DA announced its intention of approving its 26% stake transfer to UB Group for Rs550cr. Kingfisher cannot fly overseas yet, because of rules in India, which allow only carriers with five years of experience on domestic routes to do so. After acquiring controlling stake in DA, which runs the largest low-fare carrier in the country, Kingfisher has decided to merge into the company in the next three months. Deccan will complete five years of operations by August and the merger will allow both brands to fly coveted overseas routes. After its initial purchase of 26% of stake in DA, UB Group has continuously increased stake in DA. On 28 December 2007, UB Group has purchased 2.95% stake through its subsidiary 'Kingfisher Radio'. With this additional purchase, UB Group reached to 45.97% stake in DA.

After merging itself with DA, Kingfisher can fly in the international market as DA will get permission in the beginning of August, this year.

On 22 January 2008, both the companies has approved the merger

On 22nd January 2008, both the companies has approved the merger and expects that it will complete by 1st April 2008 with the majority stake of UB Group. According to the merger terms, DA will remain publicly traded but name will changed to Kingfisher Airline Ltd. In addition to this, Mr. Vijay Mallya will be the chairman & CEO and Capt. GR Gopinath will be the Vice-chairman and their business models will remain largely intact.



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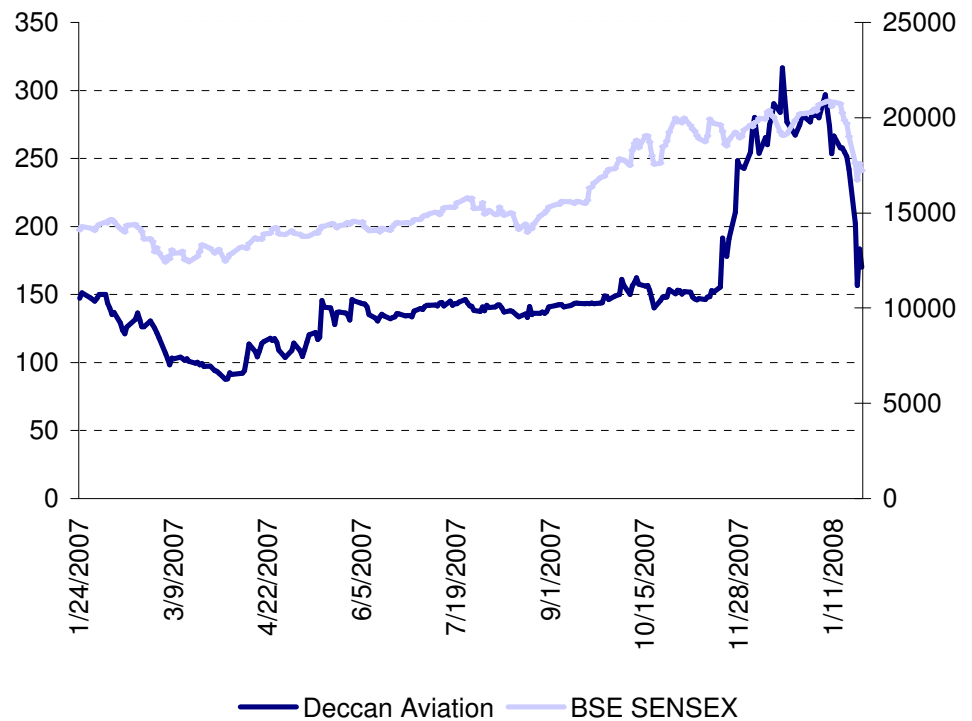
DA plans to list its charter division separately

Proper routes and network strategies can improve load factor of the merged entity

DA has planned to hive off its charter division as separate company and will not be affected by Kingfisher's stake in the company. The company has also informed to list it separately as the charter division contributes only marginal revenue but it has full potential to grow as expected by the management of DA. We believe separate listing of the company will unlock the share holder's value in the medium to long term horizon of 6 to 12 months.

In addition to the above, we expect following synergies from merger:

- Sharing of physical resources both on ground and in air could potentially spread fixed cost over a larger base and hence lower unit cost
- Both the companies can rework on route and network strategies formation so that both the airlines benefit together as they have same flights between two destination
- After building their route and network strategies, they can increase their passenger load factor.
- Fleet expansion can be optimized to increase Available Seat per kilometer (ASKs) as they will have more option to choose aircraft for short and long haul operation accordingly.





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Glossary:

DGCA: Director General of Civil Aviation, India; Regulator of Indian aviation companies which formulates and regulates policies related to Indian aviation companies

ASK: Available Seat Kilometer; the total number of seats available multiplied by the number of kilometers those seats are flown.

Load factors: Number of seat occupied by the passenger

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