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India Research

Deccan Aviation

Neutral

CMP: Rs 109

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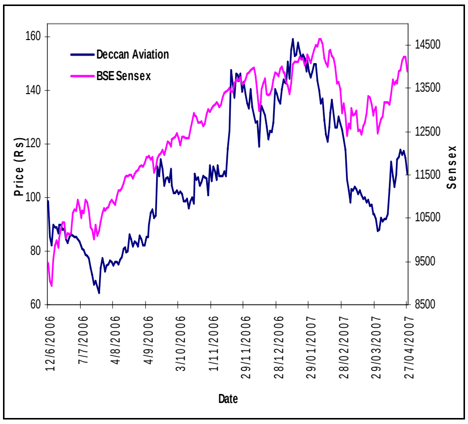
Sector	Aviation
Market Cap (Rs cr)	1,149
Beta	1.0
52 WK High / Low	159 / 64
Avg Daily Volume	543,667
Face Value (Rs)	10
BSE Sensex	13,909
Nifty	4,084
BSE Code	532747
NSE Code	AIRDECCAN
Reuters Code	DECA.BO
Bloomberg Code	DECA IN

Shareholding Pattern (%)

Promoters	22.1
MF/Banks/Indian FIs	37.5
FII/ NRIs/ OCBs	29.2
Indian Public	11.2

Share Price Vs Sensex



Q3FY2007 Result Update

Performance Highlights

- **Top-line declined 8% QoQ:** Deccan Aviations operating revenue QoQ declined by 7.8% to Rs 437.8cr (Rs 474.9cr). This was mainly due to decline in load factor during the month of March seen at 70% vis-à-vis around 83% registered during the December, on back of non-peak season and lower ASKMs.
- **Higher Maintenance costs:** During the quarter, the spend on maintenance was higher as 15-20% of the capacity were out for major checks, which not only increased the maintenance expenses but also muted the top-line growth with reduction in the ASKMs. Going ahead for the next 2-3 years, we do not expect the company to record a similar cost on maintenance.
- **Change in reservation system:** Deccan Aviation registered higher expenses on back of costs related to migration of the central reservation system. The new system comes with a host of additional functionalities enabling the airline to provide more user friendly and efficient features to travelers. The change in the system is expected to enhance the operational and financial performance in the coming quarters.
- **Net loss reported at Rs 213cr:** The company reported a net loss of Rs 213cr on back of 6% QoQ rise in expenditure and lower revenue by 8% QoQ. In the previous quarter, the company had posted a Net Profit of Rs 9.6cr on back of extra-ordinary income from aircraft purchase contract of Rs 133cr.

Exhibit 1: Key Financials

Y/ E June (Rs cr)	FY2005	FY2006	FY2007E	FY2008E
Net Sales	**305.6**	**1,236.4**	**1,779.4**	**2,829.9**
% chg	*385.5*	*304.6*	*43.9*	*59.0*
EBIDTAR	**29.7**	**(171.7)**	**(261.3)**	**316.3**
EBIDTAR Margin (%)	*9.7*	*(13.9)*	*(14.7)*	*11.2*
EBIDTA	**(13.8)**	**(388.0)**	**(673.2)**	**(119.7)**
EBIDTA Margin (%)	*(4.5)*	*(31.4)*	*(37.8)*	*(4.2)*
Net Profit/ (Loss)	**(16.8)**	**(340.5)**	**(348.4)**	**52.7**
EPS (Rs)	**(1.6)**	**(31.6)**	**(32.3)**	**4.9**
P/E (x)	(70.0)	(3.5)	(3.4)	22.3
P/CEPS (x)	(11.7)	(3.5)	(3.6)	14.4
ROE (%)	(185.0)	(201.4)	72.2	(9.4)
ROCE (%)	(4.3)	(57.2)	(192.8)	2.2
P/BV (x)	19.5	6.8	(2.4)	(2.1)
EV/Sales (x)	1.2	1.1	1.2	0.9
EV/EBITDAR (x)	12.7	(7.8)	(8.4)	8.0

Source: Company; Angel Research

Key developments during the quarter

The company added 50 new flights and 4 new destinations to its network, taking their flights per day to 350 and number of destinations served to 65. The current fleet comprises of 19 Airbus A320 and 24 ATRs, with a total of 43 aircrafts. The company has on order 80 new aircrafts to be delivered over the next 6 years.

Deccan Aviation tied up with Travelguru, India's premier online travel portal to provide budget hotel bookings and holiday packages through their website, enhancing their ancillary revenue stream.

Ancillary Revenue – to garner a higher share

During the quarter, the company cloaked 4.5% of sales through ancillary revenues. For an LCC ancillary revenue is much needed to reduce their net loss. Going ahead in next 2-3 years the company expects the contribution from ancillary revenue to be around 10% of sales.

Hedging Fuel Cost

The government has now allowed airlines to hedge their fuel cost. The company is still in the process of adopting hedging strategy for their fuel requirements. Although the hedging of fuel cost will not enhance the profitability of the company but will certainly aid the company manage their largest risk.

Foray into Air Cargo division

The Company is considering entering into air cargo division, to take advantage of the huge growth which is estimated to grow at around 15% p.a. The board has approved foray into this division through a wholly owned subsidiary and a company has been formed for the same.

Hiving off the Charter Division

The company's charter division is India's largest private sector charter aviation company with a network spanning seven locations across the country. Charter division has a fleet of 10 helicopter and 3 fixed-wing aircraft. There is huge growth potential that exist for this division. The contribution form this division for FY2006 has been around 5% of the revenue which the management expects is likely to grow at around 30% for the next few years. The demand is many folds from various segments like the heli-tourism, general transportation, Industrial requirement, and charter service to religious places. Deccan Aviation is looking at hiving off the charter division into a separate company and then going in for strategic investment in this division in order to be better able to take advantage of the growing demand.

MRO – as a separate entity

The company is looking at creating a separate entity for the MRO (Maintenance, Repair and Overhaul) services. Most of the airlines in Europe outsource the line maintenance and engineering requirements which aids them lower their cost. The MRO service that the company will set up, may also service aircraft of other carriers, giving additional income to the company.

Aircraft funding requirement

Deccan Aviation is looking at raising finance for the funding requirements for the aircraft acquisition. Although the details are still under way, but any equity dilution will impact our earnings estimate.

Outlook & Valuation

Deccan Aviation is able to register huge YoY growth in top-line but is not able to replicate the same in their bottom-line, attributing the loss to the industry dynamics which exist currently. With the two public sector airlines merger and then followed by Jet-Sahara merger, consolidation has begun in the sector. Although we have witnessed consolidation among the FSCs, but going ahead, we believe consolidation is eminent in the sector for LCCs too.

We expect the company to register profit at EBIDTAR (before lease rentals) level in FY2008, but would still incur loss at EBIDTA level. The company will be able to lock in extra-ordinary income from aircraft purchase contract to the tune of Rs 133cr in FY2008, thus registering a Net Profit of Rs 53cr.

Deccan Aviation adopts a business model with Pan-India presence, connecting more towns and flying to smaller cities / towns, where the growth potential exists. Although we believe the company is up trend to show huge top-line growth and *thus has a good long term potential*. But given the competitive scenario, high cost structure and the infrastructure constraints that exist in the industry, are creating bottlenecks to replicate the same in their bottom-line which is still in red. **Hence, with a view of one year, we do not see the stock would give a good upside to the investors and hence we maintain a Neutral view on the stock.** While any developments in the company and the industry, faster than our anticipation, would give an upside to our estimates.

Exhibit 2: Q3FY2007 Performance

Y/E March (Rs cr)	Q3FY2007	Q2FY2007	*QoQ %chg*	9MFY2007
Revenue	**437.8**	**474.9**	*(7.8)*	**1,271.4**
Expenditure	532.0	502.1	*6.0*	1,506.4
EBIDTAR	**(94.2)**	**(27.2)**	-	**(234.9)**
EBIDTAR Margin (%)	*(21.5)*	*(5.7)*		*(18.5)*
Aircraft Lease Rentals	109.2	101.6	*7.5*	297.2
EBIDTA	**(203.4)**	**(128.8)**	-	**(532.2)**
EBIDTA Margin (%)	*(46.5)*	*(27.1)*		*(41.9)*
Interest	17.4	12.4	*40.1*	39.3
Depreciation	11.0	10.4	*5.5*	31.5
Other Income	19.6	29.2	*(32.9)*	88.4
Profit /(Loss) Before Tax	(212.2)	(122.4)	-	(514.6)
Tax	1.0	0.7	*51.5*	2.5
Net Profit /(Loss)	**(213.2)**	**(123.1)**	-	**(517.0)**
Add/(Less): Extarordinary Items	-	132.7	-	270.6
Adj PAT	**(213.2)**	**9.6**	-	**(246.5)**

Source: Company, Angel Research

Note: Comparable numbers for last year corresponding period are not available

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