IPO Note

Deccan Aviation Ltd.(DAL)

May 16, 2006

Issue Snapshot:
Issue period: May 18 – May 23 2006
Price band: Rs 150 – Rs 175 per share

Issue Size: Rs 368.2cr – Rs 429.5 cr.
Issue Size: 24,546,000 equity shares
QIBs : 12,273,000 equity shares
Non - QIBs: 3,681,900 equity shares
Retail Portion: 8,591,100 equity shares

Face Value: Rs 10
Book value: Rs 7.05 (as on Mar 05)
Bid size: 35 equity shares and in multiples thereof

100% book building process

Capital Structure:
Pre issue Equity: Rs 736.3 mn
Post issue Equity: Rs 981.8 mn

Listing: BSE & NSE
Lead Managers: Enam Financial Consultants & ICICI securities

Shareholding Pattern

	Pre-issue %	Post issue %
Promoters	30.10	22.57
Subria CIPEF	19.05	14.29
The Western India Trustee & Executor Company (IAF)	19.05	14.29
Others	31.81	23.86
Public	0.00	25.00
Total	100	100

Objects of issue:

Purpose	Amount (Rs. Mn)
Setting up training center	656.69
Setting up hangar facility for basic & medium level maintenance checks at Chennai	400.20
Setting up infrastructure at airports	170.83
Market development initiatives	452.20
Debt repayment	1327.50
Other expenses	674.48
Total	3681- 4295

Financials:

Rs. Mn	Mar-04	Mar-05	Nov-2005 (8)
Income			
Sale of Airline tickets	314.18	2669.46	4458.98
Helicopter charter	315.21	386.08	324.45
Net Sales	***629.39***	***3055.54***	***4783.43***
Other Income	44.18	147.29	399.42
Total Income	673.57	3202.83	5182.85
Total Expenditure	605.17	3,193.98	6,154.28
PBIDT	*68.40*	*8.85*	*-971.43*
Interest	38.69	102.14	114.18
Gross Profit	*29.71*	*-93.29*	*-1,085.61*
Depreciation	21.03	87.84	130.54
PBT	*8.68*	*-181.13*	*-1,216.15*
Current Tax	0.64	0	0
Deferred Tax	2.07	-13.24	22.49
PAT	*5.97*	*-167.89*	*-1238.64*
OPM%	*10.87*	*6.00*	*-20.31*
NPM%	*0.95*	*-5.49*	*-25.89*
Equity Share Capital	155.27	161.99	462.57
Equity Shares O/S	15.53	16.199	46.257
EPS for the period	**0.38**	**-10.36**	**-26.78**

Background & Operations:

Deccan Aviation Ltd, operates a low-cost scheduled commercial airline "Air Deccan" and a private helicopter and airplane chartering service "Deccan Aviation" in India. Air Deccan is India's first airline to follow a no frills, low-cost scheduled passenger airline business model.

Air Deccan follows a two aircraft type fleet strategy – one is using the ATR and the other is using the Airbus. Air Deccan uses ATR turboprop aircraft, in both a 48-seat size and a 72-seat size, for its regional routes, which have lower passenger volumes per sector and involve shorter flights than its trunk routes. On its

Please read important disclosures on the last page trunk routes, Air Deccan uses the 180-seat Airbus A320 jet aircraft. As on Mar06, it had 11 Airbus A320 and 18 ATR turboprop aircraft. It operates 226 flights daily and had a market share of 14.2%. It services 52 locations including the six metros – Mumbai, Delhi, Chennai, Kolkatta, Bangalore and Hyderabad.

DAL has placed orders for 96 aircraft which are to be delivered in a phased manner by December 2012. In FY07, between 15 and 19 aircraft are to be delivered.

Helicopter charter and other services contributed about Rs.30 cr of revenues out of the total revenues of Rs.518 cr for the eight months ended Nov 2005.

The following table sets forth certain information relating to Air Deccan's load factors and revenues for the periods indicated.

	Yr ended Mar-04	Yr ended Mar-05	Eight Months 30-Nov-05
Available seats flown	244091	1292738	2177630
Passengers flown	152910	987104	1589511
Passenger Load Factor	62.64%	76.36%	72.99%
Revenues (Rs Mn)	314.18	2669.46	4458.98
Revenues per Passenger (Rs)	2055	2704	2805

Comparison between different fliers:

Description	Air Deccan	Jet Airways	Air Sahara	Indian Airlines	Spicejet	Kingfisher	Goair	Paramount
	Pvt low cost carrier, operates principally on domestic routes	Pvt service carrier, operates principally on domestic routes & select international routes	Pvt service carrier, operates principally on domestic routes & select international routes	Govt owned full service carrier, operates principally on domestic routes & select international routes	Pvt low cost carrier, operates principally on domestic routes	Pvt cost carrier, operates principally on domestic routes	Pvt low cost carrier, operates principally on domestic routes	Pvt cost carrier, operates principally on domestic routes
Yr of issue of operators permit	2003	1995	1996	1953	2005	2005	2005	2005
Fleet size	29	53	27	70	5	9	2	1
Fleet type	ATR42, ATR72 & AirbusA320	AirbusA340, Boeing737 & ATR72	Boeing737 & CL 600	AirbusA300, A320, D228	Boeing Dorneir737	Airbus A320	Airbus A320	Embraer
No of destinations	52	43	24	58	11	15	15	6
No of domestic flights	226	306	134	294	67	88	28	17

Highlights:

Industry: Compared to other countries, the growth of the domestic aviation sector in India (fuelled by a fast-growing economy and rising consumerism) has been relatively resilient in the face of regular international disruptions, such as terrorist attacks in various countries, health hazards and natural disasters. The sector maintained a CAGR of 15.67% from fiscal 2002 to fiscal 2005 in terms of domestic passengers. The key demand drivers for the industry will be:

High economic growth- Growth in air transport (passengers and cargo) is closely associated with growth in GDP and could grow at roughly twice the rate of GDP growth. With Indian GDP expected to expand at a rate of 7.5% for 2005-2007, one can expect the air traffic in India to grow approximately 15% for the same period.

Increasing consumerism and affordability **-** Corporate travellers, who fly at the expense of their employer or client, have historically formed the majority of the domestic air travel market in India. However, with increasing income levels and the emergence of flexible fare schemes and low-cost carriers, the middle to high income leisure travelers and business travelers paying their own travel costs are likely to shift more from premium class travel in trains to air travel.

Growth in tourism **-** The Indian tourism market has been growing at a significant pace over the last few years, with the Government giving impetus to the industry through various schemes and organised events. The domestic tourists visits in India grew by 19% from 309.0 m to 367.6 m in fiscal 2004. During the same fiscal domestic air travel has grown by 13% while in fiscal 2005 domestic air traffic registered a growth of approximately 27%. Travel and tourism expenditure in India is expected to achieve an annualized real growth rate of 8.8% over the 10-year period from fiscal 2004 to fiscal 2014.

The emergence of low-cost carriers - Low cost carrier airlines in the United States (such as Southwest Airlines and JetBlue) and in Europe (such as Ryanair and easyJet) has created a revolution in the aviation sector. These airlines have sought to provide lower, if not the lowest, fares along with relatively high margins, by providing no-frills service; careful route selection to optimize passenger loads and yields; minimized costs on various aspects of business; innovative use of Internet and other communications technology to avoid the high cost of traditional airline reservations and communications systems.

Removal of infrastructure bottlenecks – With the proposed moves to modernize the Mumbai and Delhi airports and work in Bangalore, the infrastructure bottlenecks like airport congestion, landing rights, parking slots that have hampered the growth of aviation sector, should be a thing of the past in a couple of years.

Business model: The business model of Air Deccan also helps it to gain an extra advantage over other players. These include offering low fares to stimulate demand, selecting routes to stimulate demand, reducing costs and utilization, providing a safe and on time services and increasing ancillary services.

Strengths: Some of the factors that help Air Deccan enjoy competitive strengths over others are:

First mover advantage: Air Deccan retains the advantage of being known the longest as a no-frills, low-cost carrier and having had the longest time to adopt/refine its low cost carrier strategies. By moving earlier, Air Deccan has also had an easier time getting desirable flight slots and building its operations in other ways. It is well positioned to use the low-fare concept to stimulate demand in the new and established routes alike.

Simplify: Air Deccan follows a strategy of simplifying its operations to help keeps its costs down, its fares as affordable as possible and its services as easy for customers to evaluate, purchase and use as possible.

Strong management team: The Air Deccan team is bolstered by a COO who worked as Head of UK and Europe Operations at Ryanair and by others with extensive experience at Ryanair and JetBlue Airways.

Load factor and yield management through dynamic pricing: Air Deccan seeks to maximize revenue from ticket sales by attempting to achieve the best possible ticket price by filling as many seats as possible. Air Deccan uses dynamic pricing to help optimise its load factors and yields. Optimising load factors and yields allows an airline to better approach a maximum level of revenues consistent with the preservation and increase of market share. Using dynamic pricing, Air Deccan can vary its ticket prices for a given flight over a wide range of possible prices, for many weeks prior to that flight, in order to capture more revenue while also seeking to extend its market. Air Deccan is in the process negotiating an agreement for implementing Navitaire software, for conducting its dynamic load factor and yield management, which is used by many leading no-frills, low-cost airlines around the globe for their revenue management.

Enhancing ancillary revenues: DAL aims to notch up 3-5% of revenues from ancilliary services like allowing advertising on storage space, headrests, tray tables, baggage and outside surfaces of aircraft.

Concerns:

- Aircraft fuel expenses account for 34% of DAL's revenues for the period ended Nov 2005, up from 27% in FY05. Continued surge in ATF prices (which are up 11% since Nov 2005) could adversely impact bottomline of DAL going forward, especially in the absence of proper and adequate hedging of this cost.
- Entry of new players in the low cost carrier market could lead to a price war affecting the profitability of all players. However increased consolidation (like the one seen in Jet-Sahara case recently) could mitigate this risk to some extent.
- Demand for air travel could get impacted by economic fundamentals (economic downturn), geopolitical variables (like Indo-Pak standoff) and external events like SARS, bird Flu etc
- Terrorist attacks, accidents and excessive Govt intervention could also lead to a fall in the demand for aviation.
- Managing fleet growth by carriers like DAL could be an issue. High utilization of aircraft and maintaining operating costs at a low level is essential for improved financials. Shortage of trained resources like pilots and cabin crew could lead to poaching and rise in staff costs.
- Almost 24% of the post issue equity (2.37 cr equity shares) was issued by way of conversion of convertible debentures to two institutions at Rs.60.37 (10 + 50.37) in Dec 2005. The monies for these were received by DAL in fiscal 2005 (Rs.121.76 cr) and in HY06 (Rs.21.3 cr).

Conclusion:

Compare DAL with its listed peer Jet Airways. Jet reported Q4 net profit, at Rs 2.27bn (up 71% YoY) largely due to sale and lease-back of aircraft, which added Rs 2.7bn to pre-tax income. Operationally, Jet continued to disappoint, with EBITDAR declining 29% YoY impacted by higher than expected staff and SG&A expenses, and soaring fuel costs. Jet quotes at P/E of 17.5x FY07E and on EV/EBITDAR, at 7.8x FY07E. Asian Airlines companies quote at a Median FY06 P/E 13.1 and Mean FY06 P/E 17.2 and on a FY06 EV/EBITDAR Mean of 7.7 and Median of 6.2. As DAL has not earned profits in eight months of FY06 and is not expected to earn profits for another more than 4 quarters, it is difficult to compare its valuation with either Jet or the Asian peers on either the P/E or the EV/EBITDAR basis.

The two peers of DAL i.e. Jet Airways and Spicejet have underperformed in the rally. At a price of Rs.175, DAL is valued at Rs.1,700 cr. Spicejet, a much smaller company is valued at Rs.1,300 cr. Jet Airways which has a market share of 35% has a market cap of Rs.8,200 cr while DAL which has a market share of 14% is valued at Rs.1,700 cr. This would mean that theoretically DAL could either rise to breach this gap or Jet Airways could fall in the meanwhile.

While growth in revenues for DAL could be robust, the moot question could be whether and how soon DAL will start making profits. This could be achieved over time as the proportion of new routes to mature routes falls. The capital intensive nature, the volatile nature of the business and increasing competition in the Indian landscape mean that the risks associated with such IPOs are higher than normal.

Depending on the over subscription in the QIB portion and the sentiments prevailing at the time of its listing, the DAL IPO could generate listing gains. However, otherwise, it is appropriate only for investors who can assume risk and look for returns over the medium term as there is a chance of the stock price dipping below the offer price after the initial euphoria is done with.

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