

Saga of Kingfisher

by Dr.Sreehari Chava

01.00 Introduction

Captain Gopinath dreamt of bringing air travel within the reach of the common man and conceived Air Deccan which became the first low-cost airline to fly pan-India in 2003. The merger of Air Deccan with Vijay Mallya's Kingfisher Airlines in 2007 was hailed as the best fit merger for the Indian Aviation. However, the developments over the last two years are indicative of a disastrous situation.

This paper ventures to examine the saga of kingfisher covering the period from April 2003 to July 2013. The paper traces the back ground of the Kingfisher Airlines; examines its growth track; analyses the financial structure; discusses the financial engineering; and measures the brand value of the company in the light of the happenings during the period under review. The relevant data, for the analysis, has been taken from the respective annual reports of the company.

02.00 Back Ground

During the year 2003 Deccan Aviation Private Limited adopted the model of 'Low Cost Carrier Concept' and started a separate division of operations in the name and style of "Air Deccan". The route mix was a deft combination of virgin and existing routes. The company had also introduced a web based Reservation and Booking System apart from 24X7 call centre. The company gained a significant first mover advantage and was successful in extending air travel culture to new customers.

The company gradually pioneered the concept of low cost travel and offered air travel at peanut prices as low as one rupee per ticket. The company was, even, allowed to use R.K.Laxman's 'The Common Man' as the brand ambassador. By 2006 Air Deccan was perceived to have converted air travel into a mass commodity and thus changed the face of aviation sector in India. It was a story of massive growth and expanding the market.

In order to nurture the robust low cost business model and achieve further value addition, funds were infused into Air Deccan from U B Group of Vijay Mallya by allotting 26% of equity shares on preferential basis in June 2007. In essence it was a

merger of Air Deccan of Capt. Gopinath with Kingfisher Airlines of Vijay Mallya. The combined entity brought together a fleet strength of 72 planes and a market share of 33% and was construed to be the second biggest domestic aviation group (after Jet-Sahara) in the country.

By 2008 the entire commercial airline operations were consolidated into Kingfisher Airlines and brand Deccan was phased out into brand Kingfisher. The company carved out three travel modules viz. Kingfisher First for Premium Business Class; Kingfisher Class for Premium Economy Class; and Kingfisher Red for Low Fare Class. The synergies were assumed to result in decreased costs; increased efficiencies; and better financial results.

However, the entire venture turned out to be a catastrophic fiasco. The company has to resort to downsizing the operations starting November 2011. By October 2012, the company's license to fly has been suspended. Unpaid salaries and accumulated losses brought Kingfisher Airlines to a state of lockdown. Boss Vijay Mallya has been accused of missing in action ever since the crisis broke out, and has been tweeting how he is not an "absconder". **Lenders to the airline are reported to have directed the promoters to raise or commit at least a billion dollars by November 30.**

03.00 Growth Track

The growth track of Kingfisher airlines from April 2003 to March 2013 is analysed by means of three important parameters viz. Income from Operations, Gross Value Added and Effective Margin. Income from operations consists of passenger income, cargo income, and income arising from charter & other services. Gross Value Added represents the business surplus available for distribution amongst the participating factors of production. Simply stated, it aggregates to Factor Cost comprising Rent, Employee Cost, Depreciation & Amortization, Interest, and Entrepreneurial Surplus / (Deficit). Effective Margin resembles Entrepreneurial Surplus / (Deficit) and consists of Profit Before Tax and Extraordinary Items. The formulae adopted for the analysis are as follows:

$$\text{Gross Value Added (GVA)} = (\text{Income from Operations} + \text{Other Income}) - (\text{Fuel Expenses} + \text{Lease Rentals} + \text{Other Operating \& General Expenses})$$

$$\text{Effective Margin} = (\text{Gross Value Added}) - (\text{Factor Cost})$$

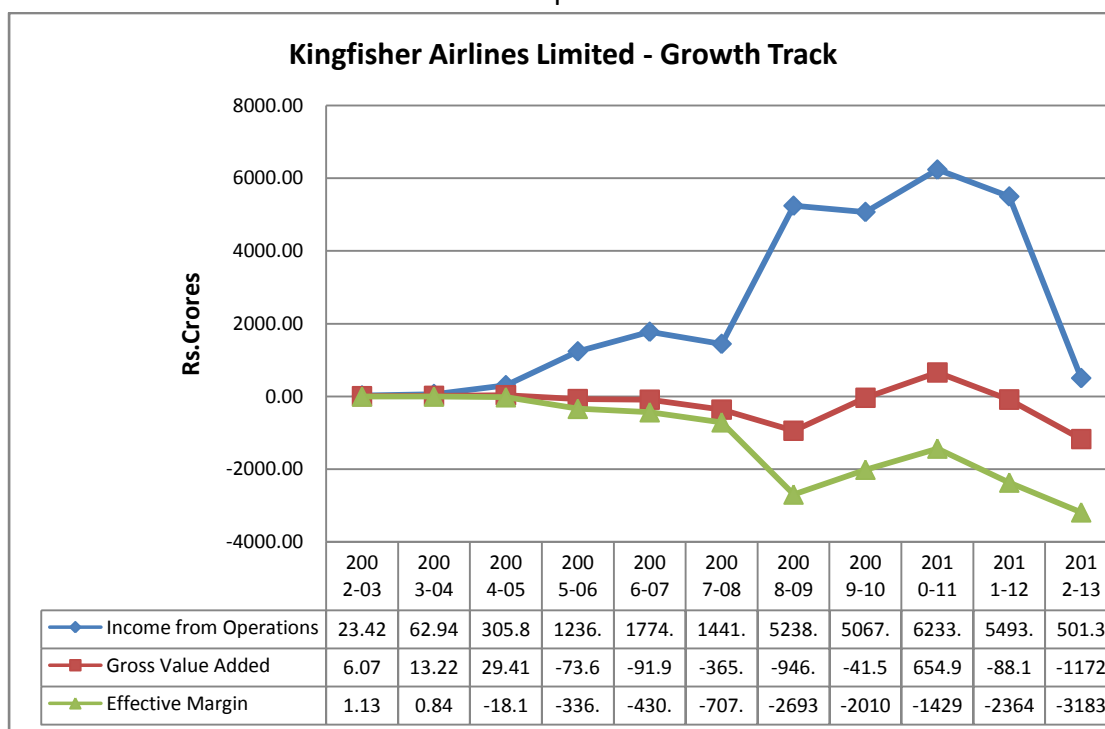
Table 1 provides the data relating to Income from Operations, Gross Value Added and Effective Margin of the company for the period from 2002-03 to 2011-13. Graph 1 exhibits the pictorial depiction of the trend.

Table 1
Growth Track of Kingfisher Airlines Limited

| | Rs.Crores | | |
|---------|------------------------|-------------------|------------------|
| Year | Income from Operations | Gross Value Added | Effective Margin |
| 2002-03 | 23.42 | 6.07 | 1.13 |
| 2003-04 | 62.94 | 13.22 | 0.84 |
| 2004-05 | 305.88 | 29.41 | (18.10) |
| 2005-06 | 1236.38 | (73.62) | (336.82) |
| 2006-07 | 1774.54 | (91.99) | (430.28) |
| 2007-08 | 1441.40 | (365.18) | (707.04) |
| 2008-09 | 5238.98 | (946.87) | (2693.19) |
| 2009-10 | 5067.91 | (41.57) | (2010.06) |
| 2010-11 | 6233.38 | 654.97 | (1429.55) |
| 2011-12 | 5493.41 | (88.14) | (2364.46) |
| 2012-13 | 501.38 | (1172.82) | (3183.32) |

Note: Figures in brackets indicate negative values

Graph 1



As may be observed from the table and the graph, the increase in the income from operations during the nine year period from 2002-03 to 2010-11 is phenomenal; wherein an income of Rs.23. 42 crores in 2002-03 of Deccan Aviation Private Limited has sky mounted to Rs.6233.38 crores of KAL by 2010-11. The year 2011-12, witnessed a dip to Rs.5493.41 crores culminating in a drastic fall to Rs.501.38 crores in 2012-13.

Gross Value Added was marginal during the first three years and turned negative in 2005-06 and remained negative throughout but for 2010-11. Effective Margin remained negative from 2004-05 onwards. The Effective Loss was mounting huge from 2008-09 viz. Rs.2693.19 crores for 2008-09; Rs.2010.06 crores for 2009-10; Rs.1429.55 crores for 2010-11; Rs.2364.46 crores for 2011-12; and the abysmal Rs.3183.32 crores for 2012-13.

The elements of GVA comprising rent, employee cost, depreciation & amortization, and interest are generally pre-committed and tend to remain fixed for any given period. It is expected that any enterprise shall generate adequate gross value to service at least all of its fixed commitments to the participating factors of production. GVA, in other words, is the Survival Margin. The failure of the company to generate even this Survival Margin as far ago as from 2005-06 is quite alarming.

The annual report of the Deccan Aviation Private Limited for 2003-04 projects the future outlook by stating "The Country has experienced an economic growth of 7% which will translate into increased earnings and revenues for the travel sector. Additionally, the Government is gradually liberalizing the Civil Aviation Policy which will help to remove various visible and invisible barriers for private airline operations." And here begins the story.

The outlook statement of the Report of the Directors for 2011-12 of Kingfisher Airlines Limited states that "The Indian airline industry is currently exposed to one of the toughest operating environments and is expected to struggle with profitability pressures, with one of the highest prices for Jet Fuel across the world, given tax structure, recent depreciation of the rupee, and the high cost of borrowing. The Government of India is in the process to usher in fiscal measures and reforms that will make the operating environment more conducive for profitable business....."

The report goes on to add “Your Company will continue to closely monitor key market trends as well as macro-economic environment in the Country from a global perspective linked to the recovery plan.” And here **ends** the expected recovery.

Similar sugar coated statements, projecting a rosier picture to the stakeholders, may be traced in several of the annual reports of the company. The incessant run on the margins of the company and the resultant value erosion are camouflaged by hopeful future outlook which could not be achieved.

As the facts would have it, the airline was able to garner the market, but was unable to convert the market advantage into viable margins.

04.00 Financial Structure

Financial Structure of the company is analysed by computing the net worth and the borrowings. The data relating to net worth and the borrowings of the company for the period from 2002-03 to 2012-13 are provided in table 2 whereas the pictorial depiction of the trend is shown as graph 2.

Table 2

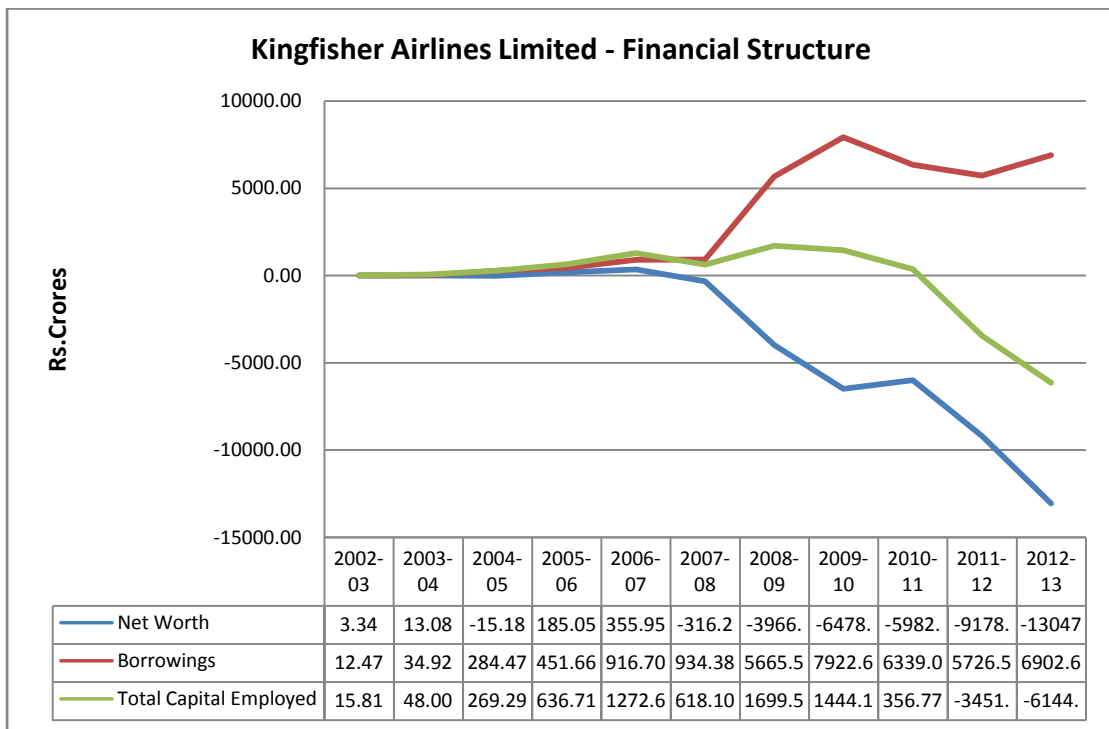
Financial Structure of Kingfisher Airlines Limited

Rs.Crores

| Year | Net Worth | Borrowings | Total |
|-------------|------------------|-------------------|--------------|
| 2002-03 | 3.34 | 12.47 | 15.81 |
| 2003-04 | 13.08 | 34.92 | 48.00 |
| 2004-05 | (15.18) | 284.47 | 269.29 |
| 2005-06 | 185.05 | 451.66 | 636.71 |
| 2006-07 | 355.95 | 916.70 | 1272.65 |
| 2007-08 | (316.28) | 934.38 | 618.10 |
| 2008-09 | (3966.05) | 5665.56 | 1699.51 |
| 2009-10 | (6478.43) | 7922.60 | 1444.17 |
| 2010-11 | (5982.24) | 6339.01 | 356.77 |
| 2011-12 | (9178.47) | 5726.50 | (3451.97) |
| 2012-13 | (13047.22) | 6902.62 | (6144.60) |

Note: Figures in brackets indicate negative values

Graph 2



The company fell into the trap of negative net worth of Rs.15.18 crores for the first time in the year 2004-05; went positive in the years 2005-06 and 2006-07 because of the fresh equity infusions; fell back negative in 2007-08; and was unable to recover thereafter. Negative GVA, evidenced year after year, had multiplied into negative margins which in turn dented and depleted the net worth of the company severely.

The borrowings of the company have grown year after year and outnumbered the net worth many a fold. Debt turned out to be the basic means of finance for most of the period. The burden of debt turned riskier & murkier every year. As of 31st March 2012, even the “Total Capital Employed” turned negative. Eventually, the airline had to be grounded. .

The most important constraint of the company as of 31.03.2013 happens to be its negative net worth of Rs.13047.22 crores; debt burden of Rs.6902.62 crores; and the astounding negative capital of Rs.6144.60 crores. It is big puzzle as to why a business wizard of Vijay Mallya’s stature tolerated such erosion of net worth culminating into a huge negative capital. It looks like that the moment negative GVA was noticed; Capt. Gopinath diluted his investments to Dr. Vijay Mallya – a good move for the captain, but a bad beginning for the doctor.

05.00 Financial Engineering

The chosen measures for the evaluation of Financial Engineering of the company consist of Debt to Equity, GVA Leverage and Current Ratio.

Debt to Equity and Current Ratio are conventional measures whereas GVA Leverage is an innovation. GVA leverage serves the purpose of monitoring the servicing aspect pre-committed factor costs. GVA leverage is derived by taking of GVA as numerator and Effective Margin as denominator. The formula reads as:

$$\text{GVA Leverage} = (\text{Gross Value Added} / \text{Effective Margin})$$

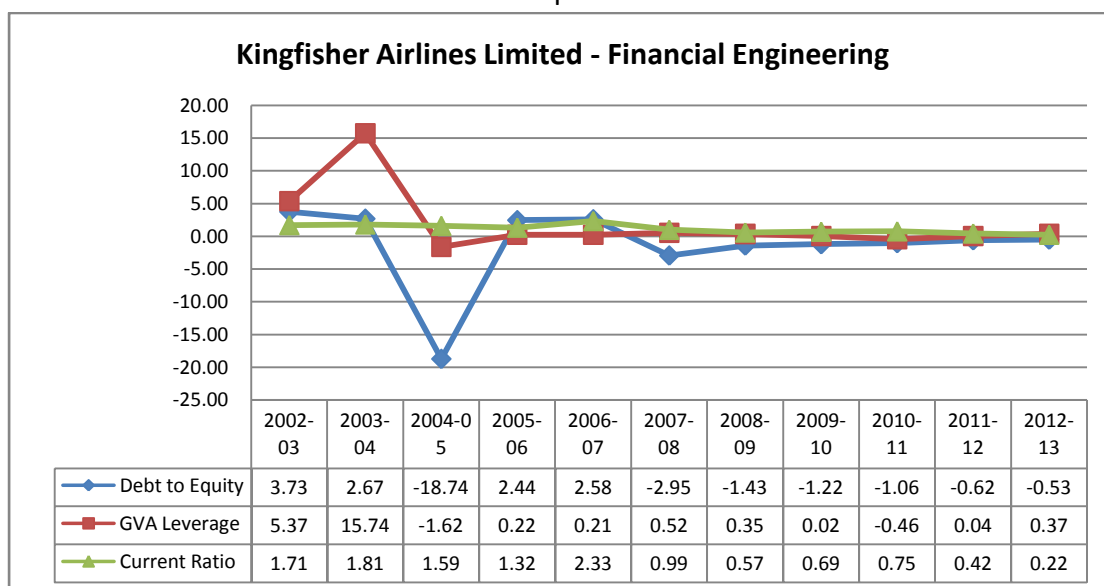
Table 3 provides the data relating to Debt to Equity, GVA Leverage and Current Ratio of Kingfisher Airlines Limited for the period from 2002-03 to 2012-13. Graph 3 exhibits the pictorial depiction of the trend.

Table 3
Financial Engineering of Kingfisher Airlines Limited

| Year | Debt to Equity | GVA Leverage | Current Ratio |
|---------|----------------|--------------|---------------|
| 2002-03 | 3.73 | 5.37 | 1.71 |
| 2003-04 | 2.67 | 15.74 | 1.81 |
| 2004-05 | (18.74) | (1.62) | 1.59 |
| 2005-06 | 2.44 | 0.22 | 1.32 |
| 2006-07 | 2.58 | 0.21 | 2.33 |
| 2007-08 | (2.95) | 0.52 | 0.99 |
| 2008-09 | (1.43) | 0.35 | 0.57 |
| 2009-10 | (1.22) | 0.02 | 0.69 |
| 2010-11 | (1.06) | (0.46) | 0.75 |
| 2011-12 | (0.62) | 0.04 | 0.42 |
| 2012-13 | (0.53) | 0.37 | 0.22 |

Note: Figures in brackets indicate negative values

Graph 3



The table and the graph pinpoint the web trauma and erratic behaviour of all the three measures of performance of financial engineering. It is disheartening to note that none of these parameters displays a rational behaviour.

Because of negative net worth, debt to equity is negative for most of the period. **The aspects of negative net worth and mounting debt have already been highlighted while discussing the financial structure.** Negative debt to equity pinpoints bad solvency. The significance of GVA Leverage is belittled by the fact that the company had negative GVA from 2005-06 onwards and negative Effective Margin ever since a year before that. **The aspects of negative GVA and negative effective margin have been covered while discussing the growth track.** Current Ratio remained afloat the standard norm of 1.5 till 2006-07, but fell down below the danger level of one thereafter. Current ratio of below unity implies bad liquidity. By all means, this can be categorized as an instance of bad financial engineering which is why Kingfisher Airlines could never take off.

06.00 Brand Value

Brand value, in financial parlance, may be inferred as the confidence reposed by the shareholders in the entity. One way of measuring it could be construing it as the excess of market price of the share over its book value. Kingfisher Airlines Limited, having been listed in 2006, table 4 lists out the book value, market price and brand value of the company for the period from 2005-06 to 2012-13 and graph 4 depicts the trend.

Table 4

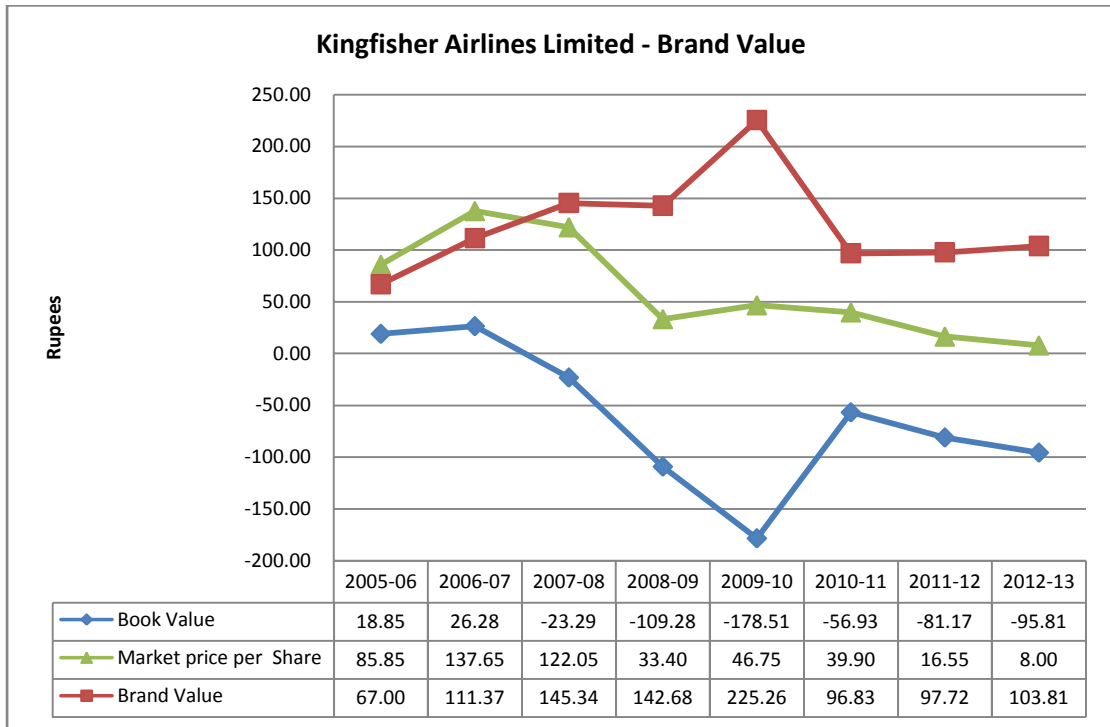
Brand Value of Kingfisher Airlines Limited

Rupees per Share

| Year | Book Value | Market Price | Brand Value |
|-------------|-------------------|---------------------|--------------------|
| 2005-06 | 18.85 | 85.85 | 67.00 |
| 2006-07 | 26.28 | 137.65 | 111.37 |
| 2007-08 | (23.29) | 122.05 | 145.34 |
| 2008-09 | (109.28) | 33.40 | 142.68 |
| 2009-10 | (178.51) | 46.75 | 225.26 |
| 2010-11 | (56.93) | 39.90 | 96.83 |
| 2011-12 | (81.17) | 16.55 | 97.72 |
| 2012-13 | (95.81) | 8.00 | 103.81 |

Note: Figures in brackets indicate negative values

Graph 4



The key observation that may be drawn from the table and graph is that despite a negative book value from 2007-08, the market price continues to be positive and the brand value computes to an astonishing Rs.103.81 as of March 2013. In spite of so many happenings, thereafter, the brand value remains to float around Rs.100/- in August 2013.

Evidently, this is the confidence that the stakeholders repose in Dr.Vijay Mallya. The million dollar question, however, is “ Can Mallya keep up the confidence reposed in him?”.

07.00 Prospective Scenario

Vijay Mallya has struck a deal, in the first week of November, to sell the majority of his stake in United Spirits to Diageo, the world's largest spirits company, for \$2.04 billion, or Rs 11,000 crore. One expectation was that the money is meant for the revival of Kingfisher Airlines. But, market reports indicate that the transaction is unlikely to give Mallya the cash he needs to revive Kingfisher.

Experts believe that Kingfisher would be looking for some direct equity participation either from a foreign carrier or from a fund that would pick up a sizeable stake in the airline.

As stated in its annual report for 2011-12, the company's plan of action towards the revival includes:

- Planning for phased capacity re-induction;
- Transitioning to a single brand offering;
- Strengthening route structures and reconfiguring aircraft for productivity;
- Reviving sales and distribution reach;
- Improving aircraft utilization and scheduling efficiency;
- Focusing on driving revenue premium through yield management;
- Optimizing human resources utilization; and
- Comprehensively reviewing costs across all key function.

The annual report also draws support to the following fiscal measures initiated by the Government of India:

- Approving direct import of jet fuel by airlines.
- Allowing External Commercial Borrowings (ECB) to the extent of USD 1 billion to be used as working capital.
- Opening the international market to private carriers by taking away the right of first refusal from the national carrier.
- Process of modifying the Foreign Direct Investment (FDI) policy that will allow foreign airlines to invest in Indian carriers.

The plan, coming from an airline that has piled up thousands of crores of liabilities spanning over a decade, has to be taken with a big pinch of salt. In all such ventures, it is generally forgotten that non-promoter share holders have also risked their investments on par with the promoters like Mallya. The promoters are, at least, partly compensated because of the perquisites and other comforts they draw from the company whereas the investments of the general shareholders are drowned completely. The confidence betrayal meted out to the general shareholders is in the nature of worst of the economic offences which is never taken into cognizance.

Everything said and unsaid, the revival plan of Kingfisher Airlines sounds theoretical, but for the Residual Credible Mallya factor. And there continues the Saga!