

INDIA LOW COST AIRLINE REPORT



PREPARED BY

CENTRE FOR ASIA PACIFIC AVIATION

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India LCC Outlook Report 2006/07

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PART 1: Introduction

Growing pains from “development compression”

Indian aviation approaches 2007 after a year of unprecedented activity. The past 12 months were marked by significant developments across all spheres of the sector, from continued liberalisation, rapid traffic growth, massive fleet orders, several new and proposed airlines and progress on airport modernisation.

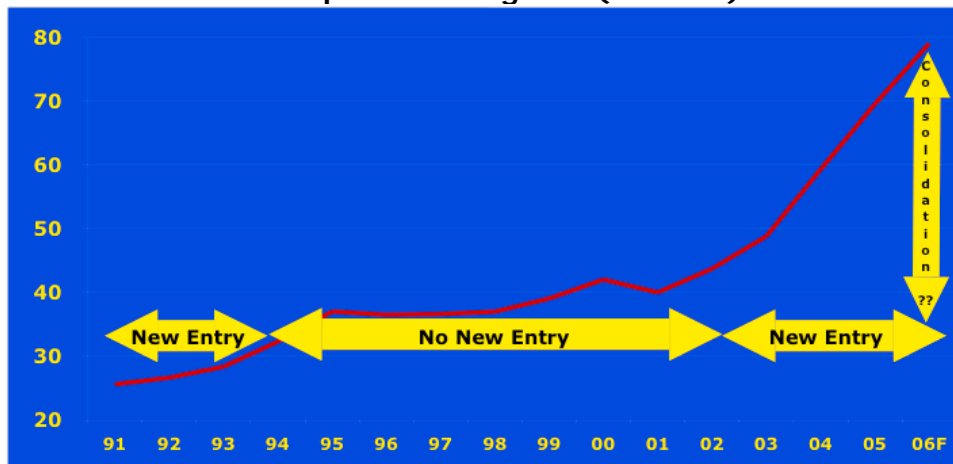
India’s aviation market stagnated during the 1990s due to a lack of new entry and investment and little policy encouragement. Only in the past three years, as the economy picked up, has there been a sudden surge of activity.

As India revamps its airports and simultaneously allows new airline entry, it is attempting to achieve in a handful of years what China achieved in 15. China in turn compressed 40 years of market evolution in Europe and North America into its “big bang” development.

India’s development compression is a key factor behind many of the growing pains the sector is experiencing today. Rapid new entry is depressing yields, but stimulating massive market growth, which in turn is placing enormous pressure on infrastructure.

India’s Market Evolution:

1992-2006F Total Airport Passengers* (millions)



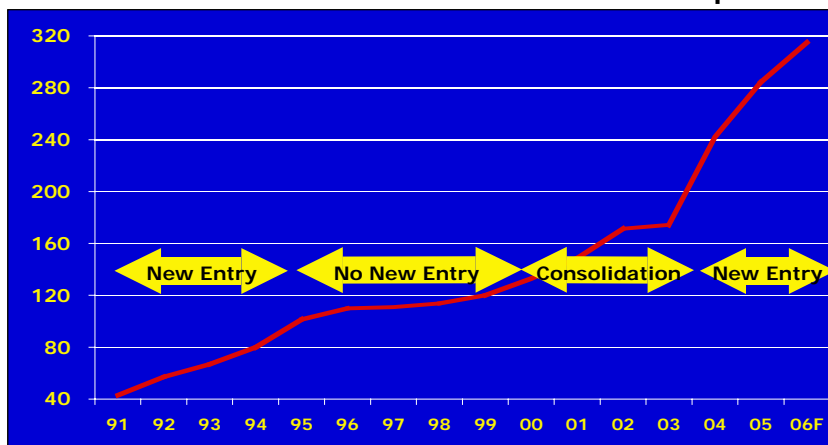
Source: Centre for Asia Pacific Aviation * Years ending 31-Mar of following year

India is also preparing to privatise its government-owned carriers (to fund overdue fleet expansion) within this congested timeframe – a process that took China eight years to achieve. (China Southern Airlines and China Eastern Airlines were partially privatised in 1997 and the process was completed with Air China’s IPO in late 2004).

India's market development can be viewed in the context of the precedent established by China over the past few decades. China has now entered a post-consolidation phase, following extensive airline mergers and acquisitions in recent years. This phase is characterised by rapid traffic growth stimulated by liberalisation and deregulation, and new airline entry.

Tracing the evolution, China's industry de-centralised back in 1985, then entered a highly competitive and expansive phase in the early 1990s, as new airlines were allowed to enter the market. This was accompanied by rapid fleet and network development.

China's Market Evolution: 1992-2006F Total Airport Passengers* (millions)



Source: Centre for Asia Pacific Aviation * Years ending 31-Dec

The CAAC stopped issuing airline licenses in 1994, by which time China had approximately 40 airlines in operation.

Destructive competition, following the deregulation of fares and the impact of the 1997 Asian financial crisis, triggered systemic losses in 1998. This, and the threat of rising international competition, led to a decision by Beijing to consolidate the sector.

Since the formal completion of the consolidation process last year, the CAAC has again been granting new operating licenses. The rapid acceleration in China's economy has stimulated strong underlying traffic growth, but its major carriers are struggling to convert this into profitability. High fuel prices, increasing debt levels and rising operating costs (including staffing costs) are impacting on earnings.

"As India revamps its airports and simultaneously allows new airline entry, it is attempting to achieve in a handful of years what China achieved in 15. China in turn compressed 40 years of market evolution in Europe and North America into its "big bang" development"...

Market fundamentals remain solid

New entry – and the competitive response by incumbents – is expected to drive further rapid market growth. As the Indian economy grows, its middle class is also expanding, with increased disposable income, which is another key driver of travel demand.

India's Growing Middle-Class

	Income	No of Households				Growth
	USD p/a	1995/96	2001/02	2005/06	2009/12	2005/06 to 2009/10
Deprived	<2,070	131,176	135,378	132,249	114,394	-3.6
Aspirers	2,070-4,600	28,901	41,262	53,276	75,304	9.0
Seekers	4,600-11,500	3,881	9,034	13,813	22,268	12.7
Strivers	11,500-22,990	651	1,712	3,212	6,173	17.7
Near rich	22,990-45,980	189	546	1,122	2,373	20.6
Clear rich	45,980-114,940	63	201	454	1,037	22.9
Sheer rich	114,940-229,890	11	40	103	255	25.4
Super rich	>229,890	5	20	53	141	28.1
Total		165,877	188,193	204,282	221,945	

Source: Centre for Asia Pacific Aviation & NCAER's report - "The Great Indian Middle Class" 2004-05

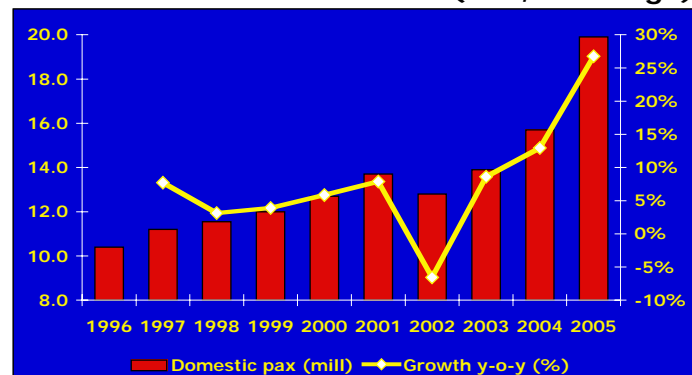
The higher income groups have also grown more rapidly in urban centres than in rural areas and led to increased levels of consumerism, including the consumption of air travel and travel related services. It is estimated only a small proportion of India's burgeoning middle-class travel by air, with rail the dominant travel mode. Encouraging more travellers to switch from rail to air travel is a key focus for many of the LCC entrants.

Jagson Airlines: "Only 5% of the estimated 300 million middle-class flies so there is a huge potential", Uttam Kumar Bose, President and CEO.
Source: Reuters, 01-Jun-06.

The domestic air travel surged by 28% % last year to 25.5 million. The Centre estimates the Indian domestic traffic market to increase to 50-60 million by 2010 and international passengers to reach 18-20 million by 2010.

Domestic traffic growth is expected to continue over 25% p/a and international traffic growth at 15% for the foreseeable future.

Domestic Growth 1996-2005 (mill,% change)



Source: Centre for Asia Pacific Aviation & DGCA

The key challenge for India's airlines will be to convert strong traffic and revenue growth into profits and this means yields have to stabilise. However, the next 12-18 months will see continuing pressure on yields and the LCCs, which have started to make corrections in their fare structures to push yields higher - with modest success to date - will have to re-double their efforts.

Air Deccan, for one, is not experiencing an easy ride having announced losses of USD74 million for the 15 months to 30 June. CAPA estimates that combined industry losses for the current financial year could exceed USD300 million.

The underlying longer-term demand will continue to support high growth levels, but for the existing airlines, the immediate challenge will be to bridge the cost-revenue gap.

GoAir: "Let's compare India's 1.1 billion population to that of China's 1.4 billion. We have 15 million seats as compared to 140 million in China being serviced by about 200+ aircraft as against 800 in China."

The middle class—a major market for LCCs—in India is about 300 million strong and 400 million in China, yet India has recorded a growth of 25% against China's 17%.

At 0.01 trips per capita, India is said to rank between Ethiopia and Nigeria, countries with a much lower per capita GDP. Malaysia, with a population of 28 million, has the same number of air passengers.

India's 200 aircraft may be compared with US-based LCC Southwest Airlines that alone has 417 aircraft.

These figures clearly show that India's civil aviation industry can only grow exponentially in the years to come and the belief in some quarters about over-capacity is plain and simple hogwash", Jeh Wadia, Managing Director. Source: Financial Express, 12-Sep-06.

PART 2: Airline Sector Review

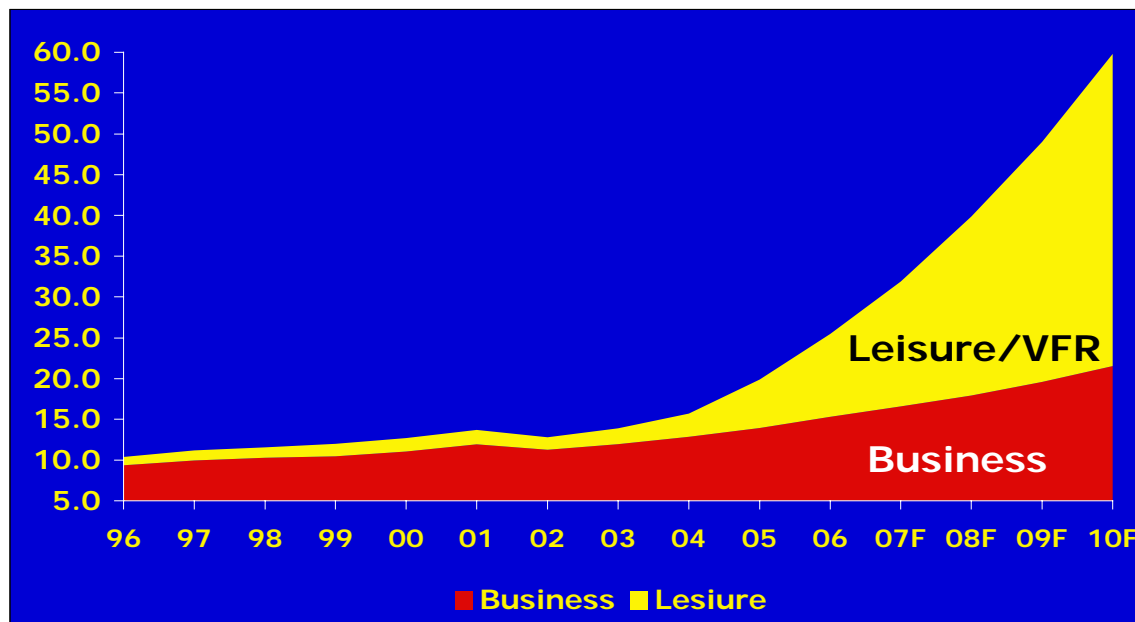
India's low cost future

Business travel – the bread and butter for the domestic airline business throughout its history – is expected a little above GDP growth levels for the next five years. But the spectacular increase in demand since 2004 has been at the leisure/VFR end of the market, representing one of the biggest growth opportunities in global aviation.

"Full service carriers are, on average, bleeding 1.5 percentage points of market share per month to LCCs...LCCs could therefore control over 35% of the domestic market by the end of 2006 and pass 50% some time in 2H07. By 2010, the LCC share could be as high as 70%..."

It is the emerging untapped leisure/VFR sector that will drive the domestic market to more than double over the next five years (growing at 25% annually) to around 60 million passengers by 2010.

Indian Domestic Market Forecast: Business vs Leisure/VFR (1996-2010F*, millions)



Source: Centre for Asia Pacific Aviation * Years ending 31-March

This leisure/VFR growth will mainly be captured by the new breed of LCCs entering the Indian market, all of which are seeking to sidestep competition where they can, by opening new point-to-point services across the country. Already, trailblazers like Air Deccan, Go Air and Spicejet are capturing a significant proportion of the market, at the expense of full service carriers like Jet Airways, Indian Airlines and Air Sahara.

Back in Oct-05, full service carriers (including Kingfisher for the purposes of analysis) commanded 84% of the market, while LCCs held just 16%, led by Air Deccan with 11%.

By Feb-06, the full service share slipped six percentage points to 78%, while the LCCs boosted their share to 22%, with Air Deccan taking a further three percentage points, at the expense of Indian Airlines, which dropped from 28% to 24% and Air Sahara, from 12% to 10%.

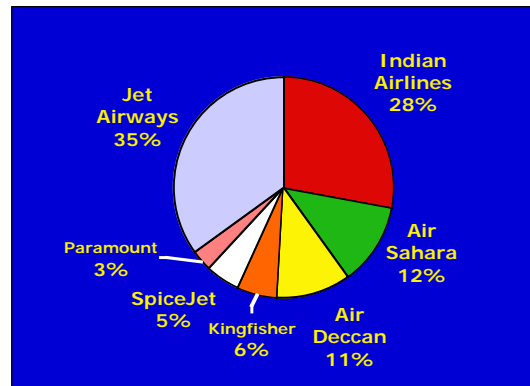
Indian Airlines had lost another three points by May-06, with Air Deccan picking up five points. Overall, LCCs commanded 27% of the market, with full service carriers holding 73%.

Reviewing the past eight months, full service carriers are, on average, bleeding 1.5 percentage points of market share per month to LCCs.

We do not expect this rate to slow in the short term, given the profile of current fleet orders. LCCs could therefore control over 35% of the domestic market by the end of 2006 and pass 50% some time in 2H07.

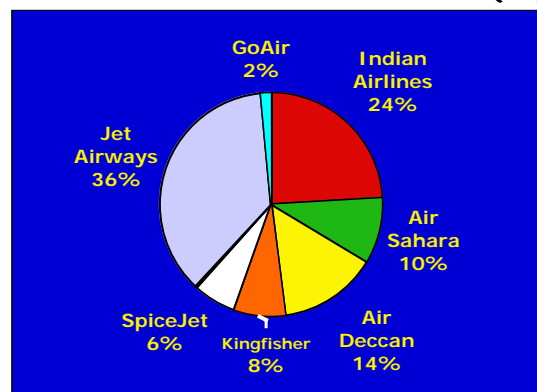
By 2010, the LCC share could be as high as 70%.

Domestic Market Share: Oct-05 (%)



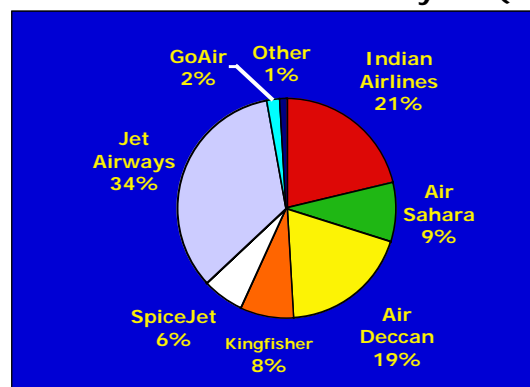
Source: Centre for Asia Pacific Aviation & DGCA

Domestic Market Share: Feb-06 (%)



Source: Centre for Asia Pacific Aviation & DGCA

Domestic Market Share: May-06 (%)



Source: Centre for Asia Pacific Aviation & DGCA

Manufacturers upgrade forecasts

Boeing has followed the Airbus lead and upgraded its forecast for aircraft sales for India over the next 20 years. 'Upgraded' is an understatement – Boeing's long-term sales forecast has surged 75% from last year's forecast, to 856 new aircraft. The projected value has risen 125% in a year to USD72 billion – or USD84 million per aircraft (up from USD65 million per aircraft in last-year's forecast).

In Dec-05, Airbus predicted India's fast-growing aviation sector would order between 800 and 1,000 aircraft over the next two decades, up from a year-earlier prediction of 570 (which in turn was 100 units higher than the previous year's outlook).

Under Boeing's forecast, almost 80% of total aircraft sales (676 units) are expected to be single-aisle aircraft (such as the B737 and A320 families), while twin aisle aircraft would constitute about 14% of market demand (120 units) and regional aircraft the remainder (51 units). Boeing expects there is "unlikely to be much demand for large jets", such as the B747 or A380.

According to Boeing's Senior VP Sales, Dr Dinesh Keskar, the revised forecast is based on the strong forecast for GDP growth, the advent of LCCs, new air services bilaterals signed by India, "and the fact that the country is increasingly becoming a tourist destination".

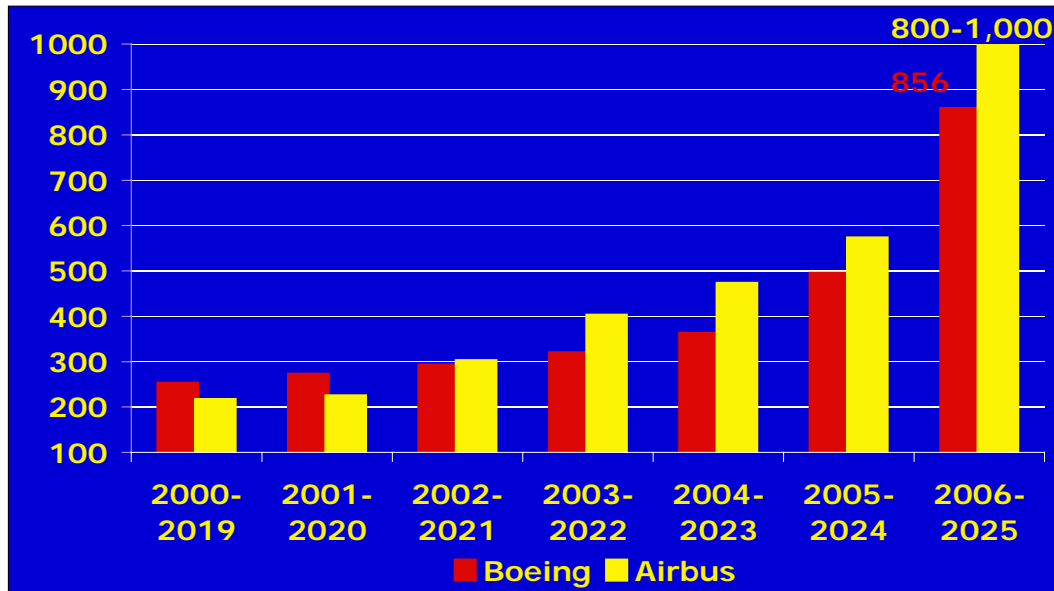
India – one of the best growth markets globally

Almost 80% of projected demand for aircraft in India would cater to market growth, while about 20% would be to replace ageing aircraft. This compares to Boeing's worldwide forecast, which sees 65% of projected aircraft sales to meet market growth and 35% to replace older aircraft.

Such has been India's transformation that each major manufacturer has been caught on the hop with its forecasts – see 'From the History Pages' box below. Just over two years ago, Airbus was projecting 4% p/a growth in India's domestic market over the next two decades. In the past two years alone, India's market has surged by almost 80%, and the rapid development rates are likely to continue for several years.

Boeing: "From last year to this year, we have doubled our forecast economic growth...The strong forecast for GDP, the advent of LCCs, new air services bilaterals signed by India and the fact that the country is increasingly becoming a tourist destination are among the reasons driving market growth here," Dinesh Keskar, Senior VP Sales South and Southeast Asia. Source: Reuters/Hindu Business Line, 28-Aug-06.

**Evolution, or Revolution? India 20-year aircraft order forecasts:
Boeing vs Airbus**



Source: Centre for Asia Pacific Aviation

But putting the dizzying forecasts aside for one moment, the increasing pressure on airline bottom lines – from human resources, fuel, constrained infrastructure and other factors - pose a real risk to market development. Boeing’s Dr Keskar acknowledges this, warning that losses in the airline industry must be addressed, or the industry could face a “potential disaster”.

From the history pages...

“Indian market takes off – CAPA comment, 23 December 2004

“From a standing start at the beginning of 2004, India's aviation market is clearly in take-off mode for 2005. As regulatory changes finally materialise, the domestic sector is already starting to show its potential. And further international liberalisation looks likely within a matter of weeks. “These changes have stimulated a flurry of aircraft orders - with more likely to follow.

“The Centre for Asia Pacific Aviation estimates Indian carriers will have purchased up to 200 new aircraft by the end of 2005. This is well ahead of manufacturers' forecasts for the market, causing manufacturers like Airbus to scramble to upgrade their market forecasts.

“Airbus' latest market forecasts, issued only this month, had projected just 4.0% average annual growth in the domestic Indian Subcontinent market over the next 20 years, compared to projected 8.7% annual growth in domestic China and 5.9% for the rest of Asia.

“The Centre forecasts total air traffic in India alone will rise by 5 million passengers each year over the next ten years. India's domestic and international markets are expected to expand by up to 30% this calendar year, to around 20 million passengers each.” - CAPA, 23 December 2004.

Major challenges and opportunities emerging

Intense pressure on earnings

Increasing pressure on airline bottom lines, led by higher human resources costs pose a major threat to market development. The pressures from massive wages and overtime increases, fuel and constrained airport/ATM infrastructure will provoke significant structural changes in the sector in the next 12 months.

India has flirted with the concept of consolidation – unsuccessfully to date – but that does not mean the issue will go away. On the contrary, some new partnerships between airlines must emerge in the months ahead, to address overcapacity, skills and airport capacity shortages - and to stop the bleeding. It is quite possible that a full service carrier may acquire an LCC within the next 12 months.

The losses being racked up by the sector are unsustainable and may well drive some new and potential entrants out – see box: *'Crunch time for Indian LCCs?'*.

Despite this challenging environment, up to 12 start-ups are awaiting permission to launch.

Now, unlike the early 1990s, the market is vibrant and expanding rapidly. Like any relatively free market, there will be casualties. This does not mean that the system is wrong; it needs time to find a dynamic equilibrium. But airline life in India will never be the same again; that is certain.

Crunch time for Indian LCCs?

The Indian airline industry will generate a combined loss of USD300 million this financial year (ending 31-Mar-07), according to CAPA estimates.

This means it is clearly crunch time for the Indian LCC sector. In a market where fares on most routes are probably 25% below sustainable levels, no-one can be fully insulated and only the best-funded will survive.

LCC first mover, Air Deccan, in the midst of its rapid expansion phase, has racked up losses of USD50 million in the 12 months ended 30-Jun-06. The short-term outlook for Air Deccan is for further deep losses, due to intense competition and more new entrants coming into the Indian market, according to research conducted by the Centre. The carrier has signed up for another USD100 million in debt financing to fund its continued expansion over the next 15 months, by which time the airline is hopeful of returning to profitability.

Deccan's Managing Director, Capt GR Gopinath, is optimistic, noting its strong market share of 21.2% in Jun-06 gives it a strategic advantage, as it will be the "springboard" for future expansion, growth and profitability, "besides insulating us from the turbulence in the domestic aviation industry".

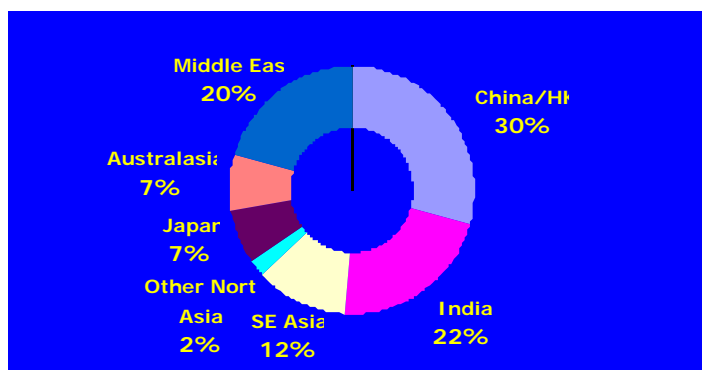
Pilot shortages will continue to constrain profitability

The rapid growth of the airline sector has been welcomed by the government as an important contributor to the country's economic development. However, the expansion has not been without its problems. Aircraft need pilots to fly them and bays to park at. Both are in increasingly short supply.

The pilot situation was particularly highlighted during the middle of the year when rampant poaching between carriers forced some airlines to ground aircraft due to a lack of crew. The situation has ameliorated slightly due to regulatory changes, such as increasing the retirement age, and the influx of foreign pilots. But with the huge number of aircraft due for delivery over the next five years, this will remain an ongoing issue for some time.

Airlines, aircraft manufacturers and private operators are planning to establish a number of pilot training academies across the country to meet this demand, but it may take some time for the supply situation to restore equilibrium. In the meantime, airlines are likely to face relatively high costs for both technical and cabin crew.

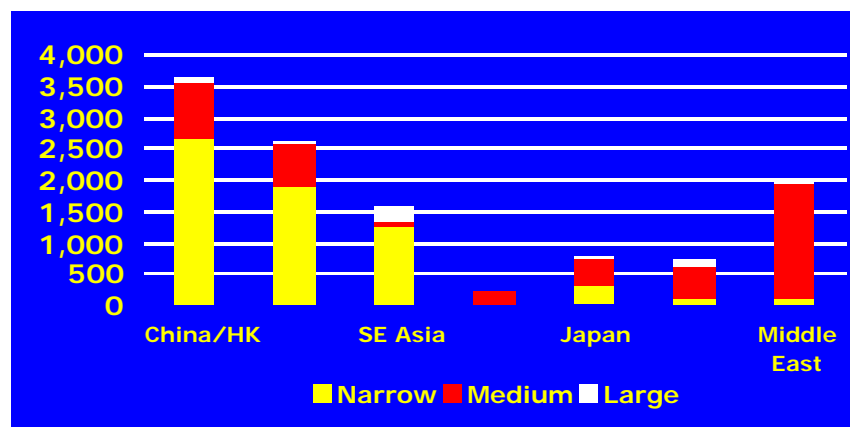
Estimated Pilot Demand by Region



Source: Centre for Asia Pacific Aviation

Latest CAPA latest demand projections show that India account for 23% of estimated total pilot requirements of 11,435 (on an adjusted basis). Most of these pilots will be needed over the next three to five years.

Estimated Pilot Demand by Region



Source: Centre for Asia Pacific Aviation *Adjusted for 5% pilot retirements; and 30% replacement rate for Medium and Large aircraft. It is assumed all narrow-bodied aircraft on order are for growth rather than replacement.

Distribution – The real battle is on the ground

It was no surprise when the heads of India's LCC sector predicted in Apr-06 (at the Centre's India Investor Summit) that distribution would be a key to success in the highly competitive market. A panel including Jeh Wadia, Managing Director of GoAir, Ajay Singh, Director of SpiceJet and Warwick Brady, COO of Air Deccan joined industry expert Jim Parker from Raymond James to discuss the peculiar challenges LCCs face in India.

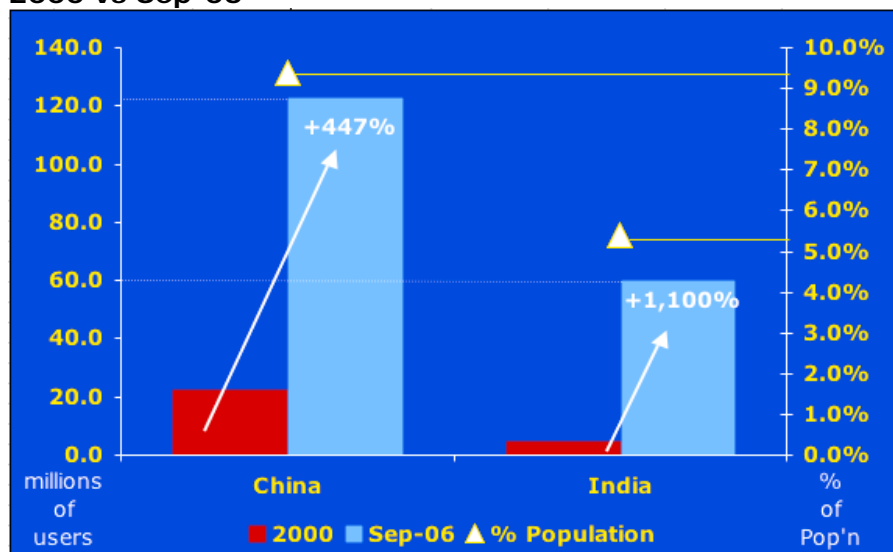
The relatively low level of internet usage in India had previously been cited as a reason that LCCs would not take off in India. And the pre-eminence of cash transactions, with few credit card users, was to be a constraint for direct payment. But, predictably, India has found its own unique ways to circumvent these obstacles.



Jeh Wadia, Managing Director GoAir and Ajay Singh, Director SpiceJet

"Distribution has to be available very close to the customer. Any passenger will be able to transact a GoAir ticket within 20 metres of their home or workplace," promised Mr Wadia, reflecting the limitations of traditional distribution methods in India, due to low (but fast-growing) levels of credit card and internet penetration. India's internet usage since 2000 has increased 12-fold, to 60 million users.

India vs China Internet Users (mill) and Penetration (%): 2000 vs Sep-06



Source: Centre for Asia Pacific Aviation & Internet World Statistics

GoAir has introduced a range of innovative and exclusive distribution channels, including cyber cafes, public phone booths and petrol stations, to reach a potential travel market of 250 million people. This strategy contrasts with SpiceJet, which, given the low levels of credit card and internet penetration in the India, sells an impressive 70% of its fares online.

***“Indians are extremely innovative people. If they know there is a cheaper fare on the net, they will find a way of to get it. They will use the internet at work and borrow their friends credit cards”
Ajay Singh, SpiceJet***

Ajay Singh, Director of SpiceJet, which has grown rapidly to take a 6% market share since launching in May-05, explained, “Indians are extremely innovative people. If they know there is a cheaper fare on the net, they will find a way of to get it. They will use the internet at work and borrow their friends credit cards”.

Air Deccan’s COO, Warwick Brady, stated that despite direct-sell constraints, “Indians will climb through hot coals to get low fares”. Mr Brady, previously with Europe’s largest LCC, Ryanair, described as “explosive” the potential of Indian air travel as low fares stimulate demand across the country.

Deep Karla, founder and CEO of MakeMyTrip.com, an internet travel portal, described the Indian market as “sluggish” and all about “price, price, price” with online buyers restricted to the big cities. MakeMyTrip.com has approximately 3% of the domestic travel market and will soon face some serious competition from Yatra, a new 18-language portal seeking to provide nationwide coverage and backed by US private equity fund, Norwest Venture Partners (NVP).

Yatra and NVP see great potential in harnessing the purchasing power of the 400 million domestic travellers, including air, rail and bus travel, car rental, hotel rooms and cruises. Yatra has partnered with Reliance Capital and TV18 to provide a formidable tool for Indian consumers to search out the best mode of transport and the best fare, further increasing the focus on competition and “price, price, price”.

Meanwhile, as internet usage grows rapidly and new avenues are developed, distribution diminishes as an obstacle to growth. In a country with the highest mobile phone growth rate in the world (there were nearly 6 million new phone users in the month of Aug-06 alone), no distribution obstacle will be insoluble.

Short-haul opportunities - Secondary cities prosper

As the domestic fare war intensifies, opportunities for short haul international operations are opening up – and are often lucrative, in contrast to the crowded domestic environment.

The increase in services outside the traditional gateways of Delhi and Mumbai has been a key feature of the last couple of years. Cities such as Amritsar, Ahmedabad and Hyderabad are experiencing unprecedented international traffic growth, while others such as Pune and Nagpur have seen their first international services.

Foreign LCCs have also been seen in Indian skies, such as Air Arabia from the UAE, Jazeera Airways from Kuwait and Jetstar Asia from Singapore, with Tiger Airways, Nok Air and AirAsia set to join shortly. This has been a source of some discontent amongst India's new airlines.

Current policy requires that Indian carriers operate domestically for at least five years and achieve a fleet size of 20 aircraft prior to receiving permission to launch international routes. Only Air India Express operates as an Indian international LCC.

Recent domestic entrants with international ambitions argue that it is unfair that foreign carriers such as Air Arabia and Jetstar Asia, which do not meet such thresholds, are able to operate into the country. The government may shortly look to review this policy, to at least reduce the qualifying period.

New Foreign LCC in India



Potential LCCs to India



Full service carriers expanding

Although media attention was focused on the new entrants, the incumbent carriers continued to make steady progress despite stiffer competition. Air India and Indian Airlines had their fleet orders for 68 (including 18 for Air India Express) and 43 aircraft respectively, finally approved, and in the interim continue to expand their route networks using leased aircraft.

The Indian Government announced a merger of Air India and Indian Airlines, and although the completion timetable of March 2007 looks ambitious, the process is on track. Air India is currently one of only a few carriers around the world that does not have the feed of an extensive domestic operation, hence the potential synergies of a merger with Indian Airlines. Meanwhile, Jet Airways, the country's largest private airline also announced new aircraft orders and began to expand its international network to Southeast Asia and Europe, followed closely by Air Sahara.

New opportunities for expansion

As 2007 approaches, attention is also likely to fall on new ventures in freight and general aviation (eg. last year saw the launch of India's first fractional ownership business jet operation), as well as opportunities further along the aviation supply chain in areas such as training, MRO and technology solutions to support the rapid growth of the airline and airport sectors.

Not one, but three steps at a time, is the modus operandi of contemporary Indian aviation. Highly proactive political support is guiding the development of the sector at break-neck pace. Development at this speed will encounter its difficulties – such as the lack (until recently) of an M&A policy for the sector. The government has also been unable to complete its new Civil Aviation Policy – it simply can't shine the headlights down the runway fast enough – such is the speed with which change is occurring.

Outlook: Short term gain (for some), long term gain (for all?)

The short-term outlook for airline profitability remains very challenging. This is of particular concern to the established carriers, while the new entrants engage in deep discounting to capture a position in the market. If and when the dust finally settles, India's aviation industry will have undergone a phenomenal transformation from the slow growth that characterised the 1990s and start of this decade.

Boeing: "The losses in the Indian aviation industry is a cause for concern. It needs to be checked otherwise that will be a potential disaster for the industry... [Airlines] have to increase fuel surcharges and look at ways of selling seats at differential prices, so that low yields from cheaper ones could be offset by those from the higher priced seats," Dinesh Keskar, Senior VP. Source: PTI, 31-Aug-06.

Case Study 1: Jet Airways cost analysis

Market leader, Jet Airways, recently reported a net loss of USD9.8 million in the three months ended 30-Jun-06, compared to a USD21.9 million profit in the previous corresponding period, despite a 24.8% increase in revenue. The carrier experienced a USD48.5 million negative swing at the pre-tax level, from a USD35 million profit in the Jun-05 quarter to a USD12.9 million loss in the latest period.

Pressures on yields: The key concerns for Jet are pressure on domestic yields from intense competition and a massive shift in the passenger mix. In the Jun-06 quarter, the carrier had a full fare-to-discounted fare ratio of 65:35, but this switched to 35:65 in the latest quarter, much worse than the budgeted 47:53 ratio. Clearly Jet is having to discount to compete as savvy travelers hunt out bargains.

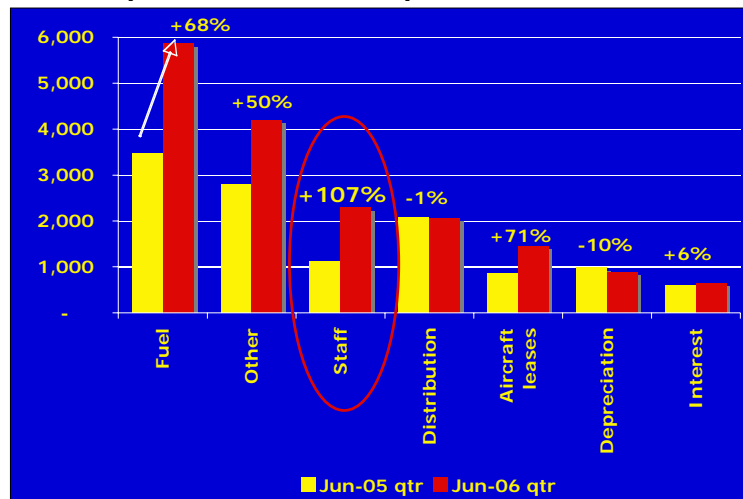
The skills shortage: A major problem for Jet in the domestic market is personnel costs, which more than doubled (despite only a 12.5% increase in staff numbers) to account for 13.2% of total costs in the Jun-06 quarter, compared to 9.3% in the previous corresponding period. According to Jet, higher-salaried staff (pilots, cabin crew and engineers) received annual wage increase of 12-15%, while pilots racked up USD5 million more overtime payments than the same period last year.

All carriers are under pressure to retain staff, so that salaries for skilled staff are rising quickly. Overall, the short-term term outlook for airline profitability remains very challenging.

This is of particular concern to the established carriers, while the new entrants engage in deep discounting to capture a position in the market".

Cost comparison between carriers is particularly difficult, given the different treatment of costs and the paucity of available data. For example, neither Air Deccan nor SpiceJet gives a breakdown of costs in their Profit & Loss Statements to the Bombay Stock Exchange (BSE).

**Jet Airways operating costs:
Jun-05 quarter vs Jun-06 quarter**



Source: Centre for Asia Pacific Aviation & airline reports

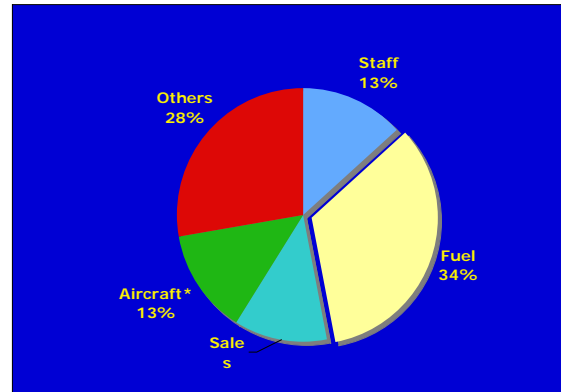
Fuel hurts: Jet Airways' fuel bill accounted for one third of total costs in the Jun-06 quarter, up from 29% in the previous corresponding period. Staff costs accounted for 13%, followed by Aircraft costs (including leases, depreciation/amortisation) and Marketing & Sales costs at 12%, which is significantly higher than the LCCs profiled later. Airport charges and MRO costs were not listed separately, but included in "other" expenses.

By comparison, AirAsia's Malaysian operation reported unit costs per ASK of USD 2.33 cents in the latest financial year, ended 30-Jun-06.

Fuel and oil is the biggest expense item for AirAsia. Fuel accounted for 43% of AirAsia's total costs in the latest period. Staff costs accounted for USD 0.35 cents (or 15%) of AirAsia's total costs and are attributed to its location in a low labour cost region (in Asia) and superior staff productivity.

MRO costs accounted for 14% of the total for AirAsia in the period and the third biggest expense item. Aircraft costs came in fourth at 11% of the total. They are low due to AirAsia's (partly fortunate) strategy of locking in aircraft orders at the bottom of the cycle. Other costs accounted for 9% of AirAsia's total, due to lower external overheads, while Airport costs (ie user station and aviation charges) were USD 0.16 cents per ASK, or 7% of the total, due to lower charges at its Kuala Lumpur hub and Asian destinations than world averages. Sales and marketing costs were negligible, at USD 0.03 cents per ASK, or 1% of the total, attributed to the carrier's effective use of cheap distribution channels, including online sales.

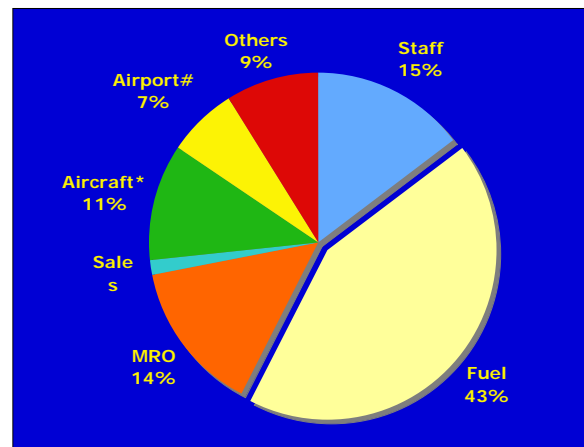
**Jet Airways costs:
3 months ended 30-Jun-06**



Source: Centre for Asia Pacific Aviation & airline reports

*Aircraft = Cost of aircraft, depreciation and amortisation

**AirAsia's Costs:
12 months ended 30-Jun-06**



Source: Centre for Asia Pacific Aviation & AirAsia

Airport = User station and aviation charges

*Aircraft = Cost of aircraft, depreciation and amortisation

Case Study 2: Air Deccan's regional surge

Air Deccan – India's fastest growing carrier – was born out of the idea of reaching the millions on untapped customers in regional towns and small villages. It is just three years since its first ATR flight took off from Bangalore and Air Deccan has significantly increased its regional fleet (comprising ATR-72s and ATR-42s), because they are "well adapted" for feeder routes in India.

Air Deccan: "I wanted to start an LCC as I was and I am convinced that India will become a powerful developed economy and in any developed economy middle-class people fly. Air connectivity to small towns is also a must for equitable development in India. I saw these people not as hungry mouths waiting to be fed but as hungry consumers. Aviation industry had to become a part of this aspirational lower middle-class consumption culture", GR Gopinath, Managing Director. Source: Economic Times, 14-Sep-06.

On 08-Sep-06, Air Deccan took delivery of the 700th ATR ever produced – a 72-seat ATR-500 - the carrier's sixth, as part of an order for 30 of the type placed in Jan-05.

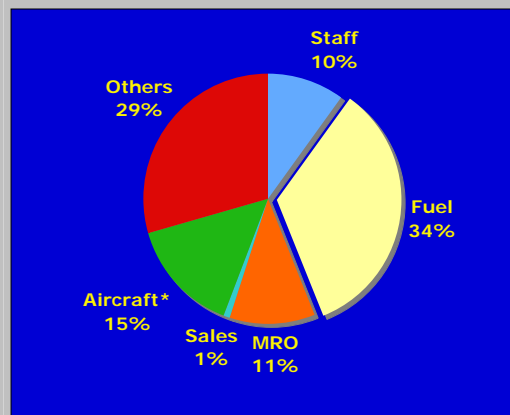
According to Founder and Managing Director, Capt GR Gopinath, the aircraft can access most of the airports unable to be operated by jets. Air Deccan operates regional aircraft from the big cities including Bangalore, Chennai, Mumbai and New Delhi to from tier II and remote towns, including Hubli, Belgaum, Tirupati, Derhadun, Jaipur, Goa, Vijayawada, Mangalore and Amritsar. 35 of the carrier's 55 routes are to small airports that would not handle narrowbody jets. The airline generates 40% of its revenue from this segment and traffic has been growing at approximately 50% year-on-year, off a small base.

Average capacity utilisation on the regional routes is higher, due to fewer congestion-related delays.

Air Deccan costs

Air Deccan's cost base is likely to have shifted significantly since the eight months ended 30-Nov-05 - the period covered by the Air Deccan IPO Prospectus document. In it, Air Deccan revealed 34% of its costs were fuel-related, while staff accounted for 10%. The carrier has a fairly significant "other" category, including airport charges, which were not listed separately. Unlike Jet Airways, Air Deccan disclosed its MRO costs – which were 11% of the total.

8 months ended 30-Nov-06



Source: Centre for Asia Pacific Aviation & airline reports
*Aircraft = Cost of aircraft, depreciation and amortisation

Air Deccan claims an average daily regional aircraft utilisation of close to 13 hours per day and average load factors in excess of 70%. Operating costs on these sectors are, on average, lower than major metropolitan routes, due to the range of incentives offered by local governments to attract regional services, including waivers to landing and airport charges and tax breaks on items including fuel.

Air Deccan has also introduced A320 equipment to go head-to-head on the major metropolitan routes with carriers including Jet Airways and Indian Airlines, as well as entrants, Kingfisher, SpiceJet and GoAir. But the regional services will continue to be a key source of differentiation for Air Deccan, which holds a 21% share (Jun-06) of the increasingly cut-throat Indian domestic market.

India's underdeveloped regional airports may be a source of frustration for some, but a key opportunity for Air Deccan and others are planning to follow its lead. There are nearly 400 airports and air strips in the country, striving for connectivity. Along with regional operator, Jagson Airways, one of the recent start-ups, Paramount Airways, offers business-class only services with EMBRAER 145s, while Kingfisher has ordered ATRs to launch services to regional routes.

To aid its significant capital expenditure plans to develop its regional fleet, Air Deccan is seeking further investment by the government in airport and ATM infrastructure.

Specifically, Gopinath has also called for private investors to team up with develop dedicated LCC terminals in conjunction with state governments at regional airports across India. In the US, two LCCs, JetBlue and now Frontier, are launching into the regional jet zone, to defend and grow their markets. In Asia and Europe, there are also scattered examples of LCCs actively pursuing regional expansion, to achieve various goals.

Air Deccan: "Our only competitors are the smaller regional airlines like Jagson and of course, largely the Indian Railways. Free landing, lower airport fees and aviation turbine fuel taxes give us the cost advantage to service regional airports", GR Gopinath, Managing Director. Source: DNA, 14-Sep-06.

But the costs involved in establishing and maintaining two aircraft fleet types (mainline and regional) can be prohibitive for some LCCs. For others, the competitive and/or strategic cost of not getting into regional operations is too great.

This hybrid form of the LCC model is relatively new, but is gaining acceptance by various operators around the world, spurred on by the availability of new aircraft types and the constant need to adapt to changing market conditions. This can be viewed either as a corruption of the LCC model, with no hope of survival once the tested model is distorted, or as a very natural readjustment to seek yield and greater route diversity. Both may be correct in their context.

The real challenge for each operator is to get the judgement right in its own special conditions. The regional LCC model, unlike its origins, is not a one-size-fits-all.

Airline Profiles

Air India

Air India: "We believe we should be part of an alliance. It can bring us a lot of advantages in terms of better load and will enhance our network. By 2007 Air India will be in an alliance", V Thulasidas, Chairman and Managing Director. Source: Financial Express, 16-May-06.



Launch: 15-Oct-1932
Base: Delhi / Mumbai
Fleet: 5x B747-400, 1x B747-400 Combi, 2x B747-300 Combi, 19x A310-300, 4x B777-200
Order: 8x B777-200LR, 15x B777-300ER, 27x B787-8
Operations: 29 International destinations and 13 domestic destinations.
Website bookings available? **No**
Website: <http://www.airindia.com/>



Indian Airlines

Indian Airlines: "Benefits from the merger [with Air India] would be manifold and both the Indian airline industry and passengers would have numerous advantages once the procedures are completed. Besides avoiding the duplication of services seen at present in some sectors, it would also help considerably increase the seating capacities, he said. "Also, the move would help the airline cut fuel costs...From Nov-06, we will start taking possession of at least one new aircraft every month in the next three years", Thiruvallur Vinod Kumar, Country Manager. Source: Gulf Times, 29-Jun-06

Launch: 01-Aug-1953
Base: Delhi
Fleet: 3x A300, 47x A320, 3x A319, 11x B737, 2x DO-228, 4x ATR-42.
Orders: 19x A319, 4x A320, 21x A321.
Operations: 76 destinations, including 58 domestic, 18 international.
Website bookings available? **Yes**
Website:
<http://indian-airlines.nic.in/home.asp>



Jet Airways

Jet Airways: *"We have no plans to acquire any other airlines. We will stand at our level and go alone", Wolfgang Prock-Schauer CEO. Source: PTI, 28-Jul-06.*

Launch: May-1993

Base: Mumbai

Fleet: 3x B737-800, 3x A340-300E,
4x B737-800, 1x A330-200, 1x B737-
700, 16x B737-800, 8x ATR 72-500,
2x B737-900, 12x B737-700, 6x
B737-400

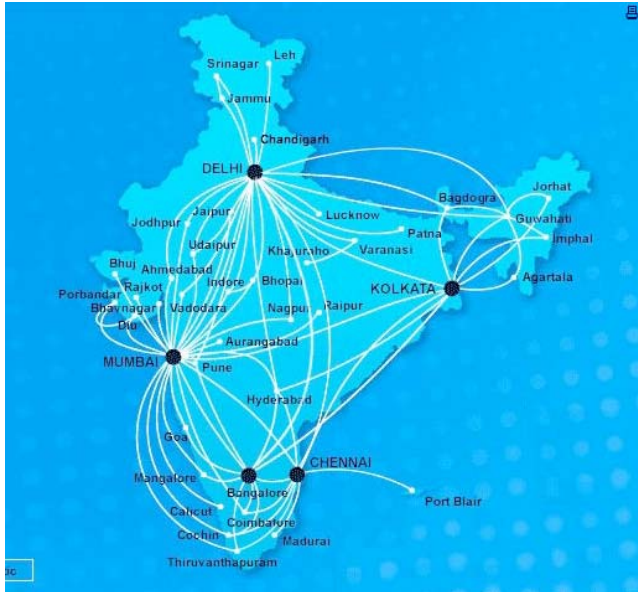
Orders: 43xA320 family aircraft

Operations: 320 flights daily to 44
domestic destinations and five
international destinations.

Website bookings available? **Yes**

Website:

<http://indian-airlines.nic.in/home.asp>



Air Sahara

Air Sahara: *"[In India], we cannot indefinitely have a situation where we have a dozen players each with single-digit market share. We are likely to see, at the initial stages, codeshares and sharing of resources, such as infrastructure. There will be some route rationalisation," Alok Sharma, President. Source: Singapore Business Times, 01-Sep-06.*

Launch: Dec-1993

Base: Delhi

Fleet: 1x B767, 6xB737-800, 8xB737-
700, 4xB737-400, 2xB737-300, 7x
CRJ-200.

Operations: 22 domestic destinations
and four international destinations.

Website bookings available? **Yes**

Website: <http://www.airsahara.net/>



Air Deccan

Air Deccan: "I find no competition from any airline, as my main competition is Indian Railways. Competition is good for travellers," GR Gopinath, Managing Director. Source: AFP, 06-Aug-06.

Launch: 01-Aug-2003
Base: Bangalore
Fleet: 22x ATR-42 and 14x A320.
Operations: 56 domestic destinations with 270 services daily.
Website: <http://www.airdeccan.net/>
Website Bookings: **Yes**



Kingfisher Airlines

Kingfisher Airlines: "We request the government to take a re-look at their Civil Aviation Policy, particularly when there are foreign airlines coming unrestricted to India, including start-ups from the Middle East. I am expecting the delivery of my widebody jets by the end of 2007, and since I can't keep them idle, I have to keep back-up plans ready," Vijay Mallya, Chairman and Managing Director. Source: DNA, 06-Sep-06.

Launch: 09-May-2005
Base: Bangalore
Fleet: 3x A319-100, 9x A320, 4x ATR 72-500
Order: 1x A319-100, 33x A320, 5x A321, 5x A330, 5x A350, 5x A380
Operations: 18 domestic destinations
Website: <http://www.flykingfisher.com>
Website Bookings: **Yes**



Paramount Airways

Paramount Airways: "The airline plans to have a fleet of ten aircraft by the end of 2006 and double this by the end of next year", M Thiagarajan, Managing Director. Source: Hindu Business Line, 20-Mar-06.

Launch: Sep-2005
Base: Coimbatore
Fleet: 2x EMB170, 1x EMB 175
Order: 2x EMB175 by Sep-06
Operations: Six domestic destinations
Website: <http://www.paramountairways.com/>
Online Bookings: **Yes**



GoAir

GoAir: "By 2010, I believe the [Indian] aviation industry will have consolidated significantly. It is a phase of rapid growth in the industry due to huge build-up of capacity in the LCC space, with capacity growing at approximately 45% annually. This has induced a phase of intense price competition [and] coupled with costs pressures, is exerting bottom-line pressure. I believe LCCs in the classic mold, like GoAir, are likely to weather the conditions better due to higher asset utilisation, alternate revenue streams and focus on cost cutting...India's civil aviation industry can only grow exponentially in the years to come and the belief in some quarters about over-capacity is plain and simple hogwash", Jeh Wadia, Managing Director. Source: Financial Express, 12-Sep-06.

Launch: 04-Nov-05
Base: Mumbai
Fleet: four A320
Operations: 13 domestic destinations with 37 services daily
Website: <http://www.goair.in/>
Website Bookings: **Yes**



SpiceJet

SpiceJet: "Fuel is something that we are really worried about. Since Nov-05, all our other costs have come down month-after-month through efficient fees and other things. The only thing, which has worried us, is ATF...Our guidance is to achieve breakeven [in 2006/07]. Had that hit [on fuel costs] not taken place, we would have been talking of a more or less breakeven situation right in this year, the very first year of operation. But we will try for a breakeven or a small profit next year", Siddhant Sharma, Chairman. Source: CNBC, 02-Aug-06.

Launch: Delhi
Base: May-2005
Fleet: 4x B737
Order: 19x B737
Operations: 13 domestic destinations
Website: <http://www.spicejet.com/>
Website Bookings: **Yes**



IndiGo

Indigo: *"Too many airplanes, no way! Personal incomes in India are rising, there's plenty of demand when fares are low, the market is far from mature. Once people realise they can go to see family and go to weddings and it's affordable, you will see this enormous potential take off...[When my former boss, Gangwal, offered me the chance to run IndiGo] I knew I would hate myself forever if I didn't take the rare opportunity to become CEO in India of a start-up airline...It was so darn intriguing", Bruce Ashby, CEO. Source: AFP, 06-Aug-06.*

Launch: 04-Aug-2006
Base: Delhi
Fleet: 2x A320 (at 25-Sep-06)
On Order: 98xA320
Operations: 11 Domestic destinations.
Website: <http://www.goindigo.in/>
Website Bookings: **Yes**



PART 3: Airport Sector Review

Indian Airport Drive: Full steam ahead in India

The surge of traffic growth since 2003 caught India's airport system unawares. India is now undergoing a massive airport development spree to build the capacity necessary for its rapidly growing airline sector. By 2010, India expects national airport system investment of some USD7.4 billion. But where is the money coming from? And will it be enough?

The completion of deals in the past 12 months to modernise and upgrade Delhi and Mumbai airports and develop greenfield airports at Bangalore and Hyderabad were breakthroughs for India's airport system, after years of inertia. With the process of upgrading the major hubs under way, plans to redevelop airports across the country are proceeding at pace, providing significant opportunities for willing investors.

Growth is running hot in India at the moment, with year-to-date domestic traffic rising at a scorching 50% by mid-2006. The spectacular increase in demand since 2004 has been at the leisure/VFR end of the market, representing one of the biggest growth opportunities in global aviation.

Indian airport infrastructure development overview: 2006 to 2010

Category	Airport	Cost (USD millions)	Investor(s)
Restructuring & Modernisation	Delhi/Mumbai Stage 1	2,200	PPP (JV involving private consortium and AAI)
	Chennai/Kolkata	1,100	PPP (JV involving private consortium and AAI)
Greenfield airports	Bangalore/Hyderabad	900	PPP (JV involving private consortium and AAI)
	Goa, Pune, Navi Mumbai, Nagpur (cargo hub) and Greater Noida	1,100	PPP (JV involving private consortium and AAI)
Upgrades	35 Non-Metro airports (see traffic table below)	1,300	PPP (JV involving private consortium and AAI) – Landside ONLY
Modernisation/Improvement	55 selected airports	700	AAI
Northeast airports development	Selected airports	100	AAI
TOTAL		7,400	

Source: Centre for Asia Pacific Aviation

IATA: "India's aviation infrastructure is straining at the seams. The building blocks are getting there. Infrastructure, however, is the key to India realising its aviation potential", Brian Pearce, Chief Economist. Source: Bloomberg, 20-Mar-06.

35 non-metro airports to be upgraded

The modernisation of 35 non-metro airports in India has therefore become an urgent priority and will occur simultaneously over the next three to four years, rather than

in phases, according to an updated plan released recently by the Civil Aviation Ministry. Overall, the plan will cost USD1.3 billion – or around USD38 million per airport. This is some 3.7 times more than the total invested in non-metro airports in the previous five years, demonstrating the prior period's under-investment.

The Ministry aims to complete the development of the 35 non-metro airports by 2008-09 and plans to invite tenders for airport projects shortly. Private sector participation will be invited in commercial landside developments only. All aeronautical activities will remain completely under the AAI.

Chennai and Kolkata airports – Next in line for privatisation?

The signing of the 30-year Operations, Maintenance and Development Agreements with the GMR and GVK consortia in Apr-06 was a major step in the Delhi and Mumbai airport modernisation programme. It means attention will now shift to Kolkata and Chennai.

The Prime Minister's Infrastructure Committee issued an "in-principle" approval for the process in Aug-05. The proposal was also reported in the Central Government's 2005-06 Economic Survey.

While no details of the privatisation method have been finalised, the government is reportedly considering a method similar to the JV process used for Delhi and Mumbai airports. It is likely the AAI will retain a minority shareholding, while the majority would be held by private parties.

PPPs on the rise

The PPP model is gaining acceptance as the best method to upgrade India's under-developed airport infrastructure, even if questions about the transparency of the tender process had temporarily stalled the process. What is unclear though, is the level of investor interest in India's smaller airports. It is possible these airports will need to be bundled with larger, more profitable ones to ensure investment can be attracted.

Indian Airport Traffic

	2004/05	2005/06	% Change
Major hubs			
Mumbai	15,665,777	18,410,234	17.5%
Delhi	12,782,979	16,235,422	27.0%
Chennai	5,633,926	6,779,977	20.3%
Kolkata	3,494,564	4,406,763	26.1%
Greenfield sites			
Bangalore	4,113,383	5,654,703	37.5%
Hyderabad	2,845,029	3,995,103	40.4%
Agatti	n/a	n/a	n/a
Agra	n/a	n/a	n/a
Dehradun	n/a	n/a	n/a
Dimapur	n/a	n/a	n/a
Khajuraho	n/a	n/a	n/a
35 Non-Metros			
Ahmedabad	1,289,747	1,893,590	46.8%
Goa	1,265,410	1,672,666	32.2%
Trivandrum	1,160,151	1,322,527	14.0%
Pune	600,949	919,635	53.0%
Guwahati	598,932	726,966	21.4%
Combatore	391,175	573,891	46.7%
Lucknow	453,345	547,468	20.8%
Amristar	347,911	487,141	40.0%
Jaipur	380,251	446,841	17.5%
Nagpur	277,830	376,446	35.5%
Vadodara	361,894	360,489	-0.4%
Jammu	262,316	306,385	16.8%
Mangalore	268,424	304,824	13.6%
Indore	269,625	272,484	1.1%
Varanasi	253,011	248,953	-1.6%
Vishakhapatnam	200,036	240,004	20.0%
Agartala	230,328	236,970	2.9%
Bhubhaneshwar	205,230	220,118	7.3%
Patna	176,234	218,824	24.2%
Udaipur	217,018	210,506	-3.0%
Port Blair	193,785	204,379	5.5%
Trichi	167,991	188,620	12.3%
Madurai	158,424	178,824	12.9%
Bhopal	127,510	147,268	15.5%
Rajkot	158,172	139,982	-11.5%
Aurangabad	133,199	137,388	3.1%
Raipur	95,257	135,320	42.1%
Impha	129,103	134,701	4.3%
Chandigarh	105,846	130,723	23.5%
Ranchi	79,698	93,508	17.3%

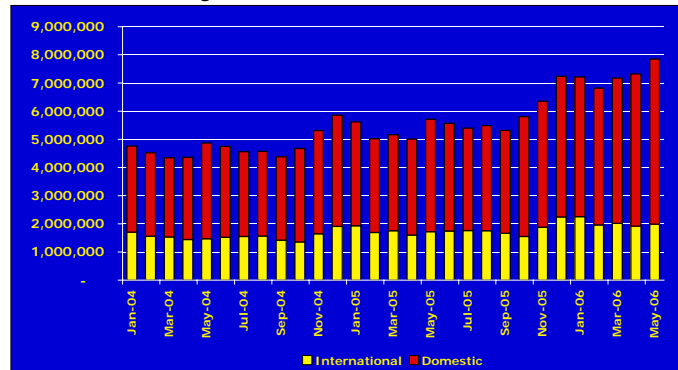
Source: Centre for Asia Pacific Aviation

* Years ending 31-Mar

Airport Traffic Watch

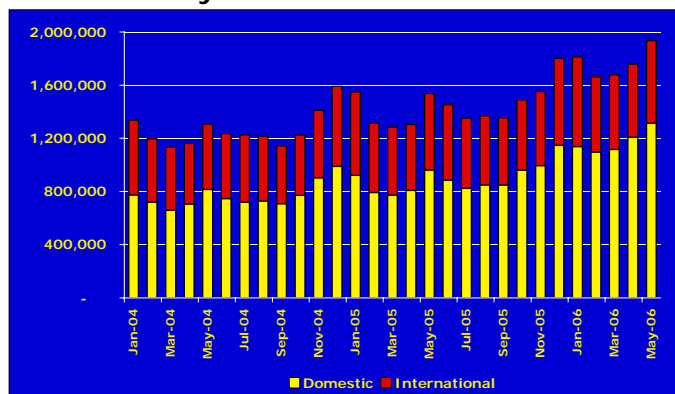
Overview: Passenger numbers at Indian airports have been surging. In the first five months of 2006, international passenger numbers have risen **32%** over the same period in 2004, while domestic volumes have risen **73%** - creating congestion at many of the country's leading airports. Mumbai and Delhi account for the bulk of **passenger** traffic. And, despite those airports continuing to grow at over 20% year-on-year, the emerging story is of the rapid growth at newly liberated points like Goa, Amritsar, Ahmedabad, Kochi and Hyderabad.

All Indian Airports Monthly Passenger Traffic: Jan-04 to May-06



Source: Centre for Asia Pacific Aviation & Airports Authority of India

Mumbai Monthly Passenger Traffic: Jan-04 to May-06



Source: Centre for Asia Pacific Aviation & Airports Authority of India

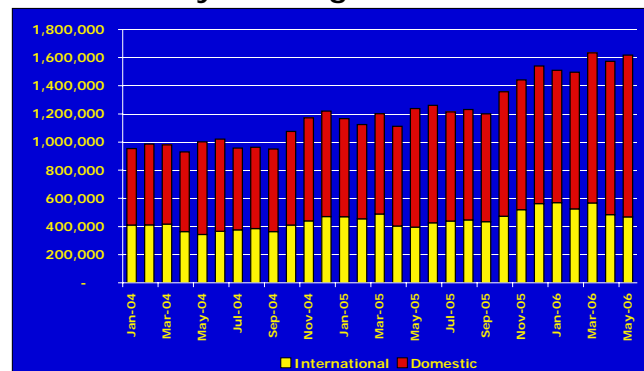
Mumbai and Delhi account for over half of India's air **cargo** traffic. And the top five airports process almost nine out of every ten tonnes. Much of this can be attributed to international operations. But Bangalore is growing rapidly; as it attracts more international services, this rapid growth should continue, subject only to adequate infrastructure being available.

Mumbai: Mumbai – India's busiest airport – has experienced a **21%** and **60%** increase in international and domestic passenger numbers in the first five months of 2006 over the same period in 2004.

Mumbai Airport is close to breaking the 2 million passenger barrier/month.

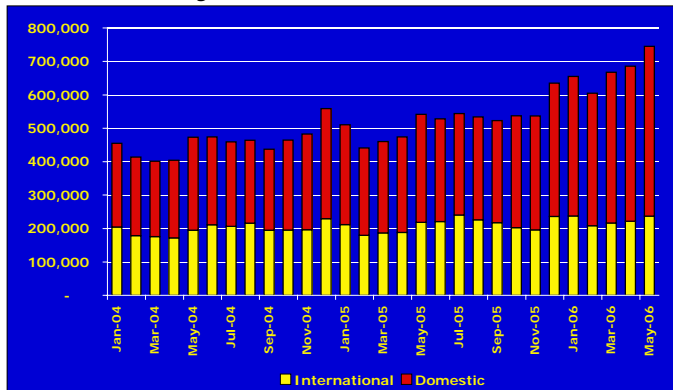
Delhi: The capital, Delhi, has witnessed very strong growth above the national average, with international and domestic passenger numbers rising **34%** and **80%** respectively in the first five months of 2006, compared to the same period in 2004.

Delhi Monthly Passenger Traffic: Jan-04 to May-06



Source: Centre for Asia Pacific Aviation & Airports Authority of India

**Chennai Monthly Passenger Traffic:
Jan-04 to May-06**



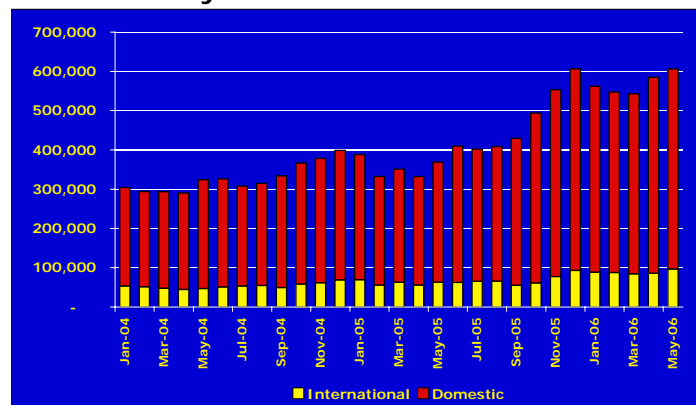
Source: Centre for Asia Pacific Aviation & Airports Authority of India

Chennai: Chennai has reported below-national average growth in international passengers in the first five months of 2006 of **21%**, relative to the same period in 2004.

Domestic passenger numbers at Chennai have outperformed the national average, rising **83%** in the period.

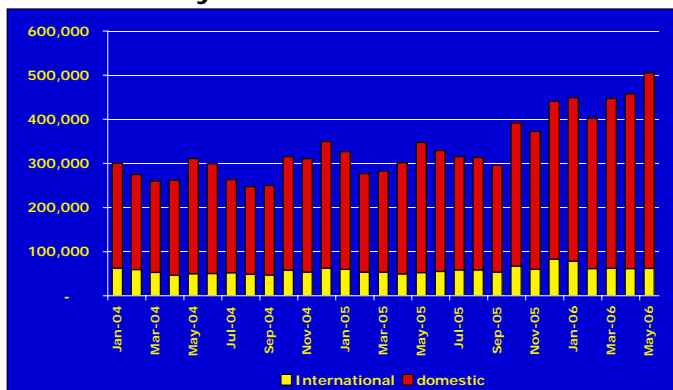
Bangalore: Bangalore has literally come from the clouds to claim the spot as the fourth busiest Indian airport, with an **82%** increase in international passengers (albeit off a small base) and a **90%** increase in domestic passengers in the first five months of 2006, compared to the same period in 2004.

**Bangalore Monthly Passenger Traffic:
Jan-04 to May-06**



Source: Centre for Asia Pacific Aviation & Airports Authority of India

**Kolkata Monthly Passenger Traffic:
Jan-04 to May-06**



Source: Centre for Asia Pacific Aviation & Airports Authority of India

Kolkata: Kolkata has grown slightly below the national average, with 20% and 70% gains in international and domestic passenger numbers, respectively, in the first five months of 2006, compared to the same period in 2004.

PART 4: Conclusions

Turn back the clock to restore stability?

There will be calls to re-regulate the airline system because some of the new airlines (existing and proposed) may not be sustainable in the current rapid growth/low yield environment. But it is important to resist the temptation to try to fine-tune a system which some might see as unstable or even anarchistic.

India's adolescent deregulated industry has evolved into a young adult and, even if it is seen to make mistakes, the only way it will evolve to the next level is to allow it to benefit from its own mistakes.

Why a long term view is needed

It is tempting to draw conclusions from what has happened elsewhere in the world, where LCCs have burst on the scene in the past decade. But, although the Indian market has many similarities – it is consumer driven, has attracted investor interest and has many under-served routes – it is very different in its overall stage of evolution.

For India's aviation market still remains massively – massively – short of achieving its full potential. Even China's remarkable domestic growth rates over the past decade should be exceeded in coming years.

Why? – because:

- So many city pairs remain effectively untapped;
- Poor infrastructure still prevents the achievement of demand-led growth (due both to the poor status of its airports and to the unpredictable nature of surface connections to and from airports, which greatly dilute the attractiveness of short haul air travel);
- India's wealth is spread across a much wider frame than China's which is concentrated on the east coast, making a criss-crossing, point-to-point network much more viable.

And, remarkably, it is relatively safe to project market potential, despite its currently small base. The longstanding record of train travel and its profiles give sufficient promise of that.

Consequently, it is far more important to prepare ahead for the next phase of development, rather than to look backwards to return to stability and low growth.

This involves, for example:

- Ensuring a transparent mechanism which is designed to prevent undue distortions of the system. That is, the application of competition laws that outlaw collusion and prevent anti-competitive combinations of airlines. It is essential to have ground rules which will encourage continuing new entry

(and innovation) – not to establish dominant forces which prevent it of make it more difficult;

- Rapidly delivering improved infrastructure – in the form of greatly increased capital investment in airports, as well as in airport-city access roads and train lines. In this respect, airport policy should be subsidiary to the best interests of airline expansion, both domestic and international;
- Continuous innovation by airlines to overcome obstacles created by distribution barriers and human resources shortages.

Is “consolidation” an answer?

The consolidation or merger “solution” is often promoted today when airline competition becomes too stiff, or when a market is described as having too many competitors.

In reality there are few examples where this has actually proven to be a “solution”, especially where the competitors are effectively fighting head-to-head on the same routes. And, even where combinations are tried, the process is certain to be complex; corporate cultures are different, fleets are rarely compatible and financial integration is an expensive process.

The least likely to succeed are those where the two parties are:

1. competing head-to-head; and
2. both losing money.

Two losers don’t add up to a winner – but....

Two loss-making ventures are unlikely to become profitable – unless they together have such market power that they can substantially reduce the level of competition in their respective sphere of operation.

In the Indian domestic market, where as we have noted, there is still enormous potential for growth, there may however be cause for success of two or three such combinations:

1. **Jet Airways – a subsidiary needed?:** A substantial, publicly listed domestic and (newly) international operator. As a full service airline, Jet is disadvantaged in the medium term by its inability to deliver a lower cost (and low frills) product. This will exclude it from expanding aggressively in point-to-point markets in India. As time passes and the market matures in a way that significant cost differentials can be maintained, a lower cost airline will prevail – and be profitable - against even a high market share network airline.

Although Jet will progressively generate advantages by its ability to connect international traffic (its own and foreign airlines’) onto its domestic services, this is still a small proportion of total traffic. It is also an advantage which will be challenged as the Air India/Indian Airlines combination becomes more competitive and other new Indian airlines commence international service.

So Jet Airways needs a low cost subsidiary which will complement – and not cannibalise too extensively – its domestic operation. Whether the timing is right now may be questionable, but Jet's best option would probably be to buy into another – existing – low cost airline. Internationally too, it probably has an exceptional opportunity to exploit any available short-haul low cost markets, where other Indian domestic carriers are still restricted from going.

2. **Air India/Indian Airlines – together at last?:** The second combination which will quite probably be successful is clearly under way already. This long-overdue merger process is not driven by the domestic low cost airline market, although the overall liberalised atmosphere has accelerated, or even made possible, this move to rationalise.

In this case however the scenario involves two virtually complementary airlines – and, while losing market share, they are not unprofitable. Their only overlap is on some short haul international regional routes.

But even in this case, no-one expects the process to be easy, especially with institutionalised inefficiencies and duplication of facilities and skills, founded on the inertia of several decades. But there is a genuine opportunity here to establish an effective domestic/international airline which should again be able to be a major force in India's aviation within five years.

3. **Kingfisher – champagne AND beer?** Initially a LCC model, Kingfisher has evolved into a full service operator, with a world-class premium product. From a standing start last year, it currently has a 6% domestic market share and serious pretensions to become an international force, once current restrictions on international route access are removed.

If it is to tap into the very high levels of domestic low cost growth, as its competitors will be doing, Kingfisher could well see advantages in acquiring a fully functioning low cost company if the opportunity presents itself over the next year or so. More than any other Indian company, it is well aware of the demand for both a champagne class and of providing for beer drinkers.

Overall, India is in exciting era of unprecedented aviation growth, What it needs now is to maintain a long term view of its aviation needs, a vision which allows some market chaos if necessary among the private sector – while reinforcing greatly the drive towards improving the infrastructure that will allow that private sector and the public interest to generate gains.