

KINGFISHER AIRLINES (KFA): CASTLE IN THE AIR?

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Owned by India's biggest liquor baron, Dr Vijay Mallya, Kingfisher Airlines (KFA) is one of the finest luxury airlines of India. Based in Bangalore, KFA started operations in May 2005 as a wholly owned subsidiary of the United Breweries Holdings Limited (UB group). KFA entered the Indian aviation market at a time when the low cost service model had galvanized the market and had made air-travel accessible to the Indian middle class. Jet Airways was good and on time, but was for busy executives; Air Deccan was for the *aam aadmi* (common man), a sort of shuttle service, while the others either didn't matter or were too small.

THE BACKGROUND

KFA was a pioneer in the concept of bringing luxury, glamour and lifestyle to the skies. The brand image of the parent Kingfisher brand gave further credibility to its marketing campaigns, featuring India's then top models. Kingfisher airlines sold the concept of lifestyle through its glamorous airhostesses, Red-the color of vibrancy, and added hospitality which made every passenger feel like a guest on board-a-craft. It used multiple promotional campaigns, from having India's top model Yana Gupta on flight, to schemes on discounted tickets, initially, to invite people to experience the 'good flying' concept.

After the initial launch of UB Air in 1990, Vijay Mallya decided to take advantage of the attractive growth opportunities for Civil Aviation in India, leverage the equity of the Super brand "Kingfisher" and utilize the strength of the UB Group in consumer product marketing. Kingfisher Airlines Limited launched scheduled Airline services on May 9, 2005 with 4

flights a day with one brand new Airbus A-320 aircraft. In just 10 months from launch, Kingfisher Airlines received 3 International Awards. The first was the "Best New Airline of the year award in the Asia Pacific and Middle East region" given by the Centre for Asia Pacific Aviation. The second was the "Skytrax award for service excellence" conferred by Skytrax-the leading independent research and quality evaluation agency for the World Air Transport Industry, located at London. It was also declared as the "Best New Domestic Airline for Excellent Services and Cuisine" award from Pacific Area Travel Writers Association (PATWA)-one of the biggest travel writers' organizations in the world.

THE PROBLEM

When India's second largest domestic airline, Kingfisher Airlines reported a Rs. 2,328 Crore (1 Crore = 10 Million) net post-tax loss for fiscal year 2012, it was simply an affirmation of the dire straits that a once proud airline has fallen into. Since it got listed in 2006, KFA has accumulated losses at about Rs 8,200 crores and the money to pay for fuel companies, salaries, airport fees, taxis running out, prompting KFA to approach the government for the possible bailout. Kingfisher, which has never posted profit since inception, is under immense pressure from lenders to work out a turnaround plan. A glimpse of the current status:

- Its share prices tumbled to an all-time low of Rs 7.05 on 13th August 2012 and making it a penny stock.
- The carrier owes lenders, led by the State Bank of India (SBI), a whopping Rs 8,000 crores. The majority chunk of Rs 1,500 crore has been borrowed from SBI.



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- High jet fuel costs and grounded planes led to cash-strapped Kingfisher Airlines Ltd's net loss widening two-and-a-half times to Rs. 650.78 crore for the quarter ended 30th June 2012 against a Rs. 263.53 crore net loss in the corresponding quarter a year ago.
- Curtailed network operations led to an 84.19% decrease in total sales at Rs. 301.38 crore for the reporting quarter against Rs. 1,907.01 crore for the corresponding quarter a year ago.
- The promoters' holding has also fallen by 35.86 percent while they have pledged over 90 percent of their shares.
- The published results for six listed companies in the group reveals a total debt of Rs. 14,231 crore for Kingfisher Airlines, United Spirits (USL), UB Holding, Mangalore Chemicals, UB Engineering and United Breweries (UB)

The sad assertion is that Kingfisher's current financial situation, as it stands, is clearly unsustainable in the long run. The question one is asking at this point of time is whether the King of Good Times can keep flying the KFA forever. The answers to this question lie in the analysis of the probable reasons of failure.

FIVE REASONS FOR THE DEBACLE OF KINGFISHER AIRLINES

When Beer barron Vijay Mallya launched his own airlines in 2005 on the name of his top selling beer brand Kingfisher, nobody would have predicted the crises which Kingfisher is currently facing. Below narrated are 5 major reasons for the downfall of Kingfisher Airlines.

1. PROBLEM ASSOCIATED WITH THE AVIATION SECTOR –

Aviation business is one of the world's most risky businesses as the cost involved in it both capital and operational is very huge. None of the airline companies in the world has been able to make consistent profits year after year. This is because of the operating problems associated with the Aviation sector. Starting from Airplanes purchasing cost, **Airline Turbine Fuel (ATF)** cost, maintenance cost,

interest cost, salaries & wages and many other costs companies has to bear. If this is not enough operational problems like weather and technical delays further worsen the condition for aviation companies. These problems makes the aviation business most vulnerable. The operational aspects of running an airline are also anti-market, and rife with government interference. Air turbine fuel (ATF) is a major cost. India's oil sector is in strict government control, with oil public sector undertakings (PSUs) rule the roost in the supply of fuel. The landing fees for airlines have been high at airports still under the partial control of the union-dominated Airports Authority of India (AAI).

The Indian aviation space has been full of doom and gloom in the recent past. State-run Air India has a total debt of Rs. 48,000 crore, Jet Airways Rs. 19,602 crore, JetLite Rs. 2,197 crore, Kingfisher Airlines Rs. 12,668 crore, and SpiceJet Rs. 1,591 crore, according to airline executives and sector analysts. Total debt is the money an airline owes to external stakeholders including banks, caterers and oil companies that has to be serviced either in the short term or the long term.

Increasing liabilities will force some stakeholders to cut their exposure to the airlines, thus inhibiting growth, like oil companies refusing to fuel aircraft unless paid in cash. A cash-strapped airline then cuts flights, inconveniencing other stakeholders and growth gets inhibited. Ultimately, the airline is forced to shut operations or sell out. We have seen this happen to Paramount Airways(Ltd), Deccan (Aviation Ltd) and Sahara (Airlines), in the past. The same could be true for KFA.

2. FAULTY BUSINESS MODEL OF KINGFISHER AIRLINES –

Kingfisher Airlines started their proceedings as a premium player in the Indian Aviation sector, but soon they were stuck in the price war with competing airline companies which led them to offer their premium services at much reduced prices to the passengers. This hurt Kingfisher on both the revenue and the cost side. A luxury airline like Kingfisher was never required for Indian market where less than 1% of the population uses airlines as their mode of

transportation but if Kingfisher wanted to make its premium model a success it should have never jumped into the price war. It should have continued with the strategy of charging premium prices for their premium services which could have given them good margins but Kingfisher messed it up all.

Ironically, even after the acquisition of Air Deccan, which was built on the low-cost model, Kingfisher chose to give up the cost efficiencies that the acquisition brought in, instead embracing the inefficiencies of the full-service airline model. For instance, it gave up the web ticketing system that did away with agent costs and extended all bookings through global distribution system, which pushes up distribution and sales costs. Other Low-cost carrier(LCC) strategies—keeping over-head costs low by flying a single-class configuration of aircraft, quick aircraft turnaround, selling tickets online, selling food on board—were never integrated into the main operations of Kingfisher Airlines because they didn't fit the character of a full-service carrier.

Kingfisher failed to scale up its international operations as planned, even after it made the expensive acquisition with the agenda of flying abroad. That's because the launch coincided with the global financial meltdown, impacting air travel severely.

While Kingfisher Red, low fare service of KFA has focused on services like telebooking, free food etc, it has ignored the lower order needs of the customer like economy and punctuality. Because of this business model, its large debt burden only grew larger, worsening its financial health. Analysts point out that Kingfisher adopted the strategy of funding expansion through debt—something the parent UB Group did successfully in its liquor business. However, unlike as in the liquor business—which is cash positive—the airline business could not support the debt with adequate cash flow through operations. Even though revenues stayed ahead of costs, the margin was not adequate to service the burden of ever-increasing interest costs.

3. IMPROPER HANDLING OF FINANCIALS BY THE COMPANY'S MANAGEMENT

Since its inception in 2005 Kingfisher never earned a single penny and is continually increasing its losses year after year. But, the management of the company took no big step to reduce the cost. The ever increasing debt is also a major worry for the company. Company's management has failed miserably in handling the financials of the airline. Kingfisher's net worth has been completely eroded, despite the fact that its auditors had raised several questions about its accounting practices in its annual reports in the past. A comparative analysis of the financial figures for the last five years shows the erosion of network.

Sources Of Funds	Mar '12	Mar '11	Mar '10	Mar '09	Mar '08
Total Share Capital	1,130.75	1,050.88	362.91	362.91	135.8
Equity Share Capital	577.65	497.78	265.91	265.91	135.8
Reserves	-6,213.15	-4,005.02	-4,268.84	-2,496.36	52.99
Networth	-5,082.40	-2,951.19	-3,898.45	-2,125.34	198.88
Secured Loans	5,368.76	5,184.53	4,842.43	2,622.52	592.38
Unsecured Loans	2,661.24	1,872.55	3,080.17	3,043.04	342
Total Debt	8,030.00	7,057.08	7,922.60	5,665.56	934.38
Book Value (Rs)	-97.56	-70.46	-150.54	-83.88	13.9

Source: Dion Global Solutions Limited

The airline is today saddled with total debts of over Rs. 8,000 Crore. The King of Good Times was forced to take loans from banks which now have a total exposure of about Rs. 7,000 Crore to Kingfisher Airlines, of which over Rs 1,300 Crore had been converted into equity during the last fiscal as part of a debt restructuring exercise. Of the banks' total exposure, over Rs. 4,000 crore are in the form of term loans. The consortium, led by banking behemoth State Bank of India, also includes a number of other public and private banks. These loans for Kingfisher have also come at an enormous cost for the UB group. More than nine out of 10 shares of its crown jewel, United Spirits have been pledged as collateral to the banks.

Awash in liabilities, Kingfisher Airlines is today asking the banks for another debt recast and perhaps some easier terms to pay interest costs. What remains to be seen is whether the banks will agree this time because they are under extreme pressure not to do so.

In its bid to reduce costs, the airline has started cancelling flights and has closed down its low-cost carrier Kingfisher Red which, according to one analyst, might prove to be another costly mistake. "Indian passengers are extremely price conscious and this measure may just lead the airline into a deeper mess," he said.

The 'king of good times' may just have to abdicate his throne sometime soon if he wants to stay in business. It isn't always that you can pull off every business venture in your life time. Scotch on the rocks works. Kingfisher on the rocks doesn't.

4.ACQUISITION OF AIR DECCAN BY KINGFISHER

In order to enter the 'Low cost airline' business and to get the permission to fly international Kingfisher acquired Air Deccan which is one of the major reasons for the financial crisis in which Kingfisher is current in. Air Deccan was itself struggling and incurring huge losses when Kingfisher acquired it. Adding two negatives only increased the problems for the company.

Impatient to fulfil his international ambitions, (an airline needs to complete five years of domestic service before it can venture overseas) Mallya forked

out Rs 550 crore for a 26% in distressed budget carrier Air Deccan, giving him instant control of over 29% of the domestic passenger market, so he could meet arch rival Naresh Goyal's Jet Airways head-on. From a 100% full-service model, Mallya switched to a two-brand strategy—Kingfisher and Kingfisher Red. The merger of two thinly-capitalised entities was exacerbated by global meltdown and shooting oil prices. By March 31, 2009, the merged entity's borrowings had escalated from Rs 900 crore to Rs 5,600 crore. GR Gopinath, who sold Air Deccan to Mallya, believes the twin brand strategy in the domestic market confused passengers.

5. VIJAY MALLYA'S OVER ENTHUSIASM SLAUGHTERED KINGFISHER AIRLINES

The man behind Kingfisher, Dr. Vijay Mallya himself killed Kingfisher Airline. Dr. Mallya's enthusiasm for his airline to make it the best in the world led him to over spend on the airline. Mr Mallya, not ready to accept his airline's failure, continuously poured money from the profits of his other ventures and took loans which worsened the conditions for the Kingfisher. The biggest reason for Kingfisher Airline's decline is clearly Mallya's hubris and wrong management calls at every step of the airline's seven year existence. The beer-baron never brought in professionals to run the carrier- even the CEOs he hired like Nigel Harwood (who came from Airbus) or Sanjay Aggarwal (from SpiceJet), were never allowed to take their own decisions. KFA has been micro-managed by Mallya. It has also never made a single rupee of profit. He got the model wrong, the equipment wrong and the strategy wrong- sealing the airline's fate in times that were tough for even the best run carriers.

WHAT NEXT??

If Mallya has been able to still devote time to attend meetings for his racing team and other social events, it's because he is supremely confident of resuscitating Kingfisher. He's dropped broad hints of a strategic investor who's willing to pump in \$250 million into the airline.

Fresh efforts to raise funds, reduce debt and check cash outflows including a Rs 2,000-crore rights issue in 2013; liquidating real estate assets such as

Kingfisher House, the airline's corporate office in Mumbai; and, perhaps most significantly, stepping back from the no-frills segment by pulling the plug on the Kingfisher Red brand are being considered.

Dubai carrier Emirates is believed to have signalled an early interest to acquire a stake in the troubled Kingfisher Airlines with riders that the latter hammers out long-term loan restructuring and revamp the business plan with a realistic chance of survival. The company's flamboyant founder Vijay Mallya is in talks to sell a stake in his liquor business, United Spirits to Diageo Plc to find enough funds to keep Kingfisher in business.

HERE'S WHY KINGFISHER CANNOT REALLY BE RESCUED

With loans of Rs 8,000 crores and accumulated losses of a like amount, any investor will have to take on a burden of nearly Rs 14,000 crores. This is more than double the market value of the entire listed airline stocks in India. For less than a third of that money, an investor would be able to buy the far-more-profitable Jet Airways group. With that kind of money, it would be easier to start a new airline instead of being stuck with Kingfisher and its negative image. So FDI in aviation won't help Mallya – unless some investor has a death-wish.

TIME WILL ONLY TELL WHETHER THE KING OF GOOD TIMES WILL REALLY FLY HIS CASTLE IN THE AIR ONCE AGAIN

The views expressed by the author are only personal and a mere compilation of secondary information available at various sources. It is only for academic purpose and not to criticize any person or organization. The events occurring after September 2012 do not form a part of this case.



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