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Malaysian Airlines: the final restructuring

Malaysian Airlines (MAS) is attempting to turn itself into a "NewCo" in a last-ditch attempt to keep the Malaysian flag carrier alive. Does a new version of an airline that dates back to 1937 have any chance of succeeding?
Following the twin disasters of MH370 in March and MH17 in July, in which 537 passengers and crew lost their lives, the Malaysian flag carrier faces an immense challenge to stay solvent.

Comparing July 2014 figures (the last month for which figures are available) with July 2013, overall passengers carried has fallen from 1.5m to 1.3m, with load factor dropping from 83.3% to 75.2%. That effect is skewed more towards domestic traffic, with domestic passengers carried falling by almost a quarter over the 12 month period, compared with a 5% drop in international passengers.

In the last reported quarter — the three months to the end of June 2014 — MAS reported a 7.2% fall in operating revenue (compared with the same quarter in 2013) to RM3.3bn ($1bn), with a RM228m ($72m) EBITDA in April-June 2013 turning into a RM33m ($10m) loss at that level this year. The net loss for the 2014 second quarter was RM307m ($97m), and with an expected very poor second half of the year to come once the full effects of MH370 and MH17 are felt, the full 2014 figure will most likely be terrible. So yet another year of losses is guaranteed for an airline that had made neither operating nor net profit since 2010 (see chart, right). Indeed over the 2011-2013 period MAS has racked up more than US$1bn of operating losses and US$1.34bn of net losses.

Rescue plan

Reports out of Malaysia say that the airline is losing more than US$2m a day, and it was therefore inevitable that Khazanah Nasional, the Malaysian state's sovereign investment fund that owns 70% of the airline, would produce some sort of plan to save the airline. In late August it announced a 12-point plan that envisages a "NewCo" being launched by July 2015, which will be a slimmed-down, privatised version of MAS with significant job losses and a much smaller route network.

The key points of the 12-point plan are:

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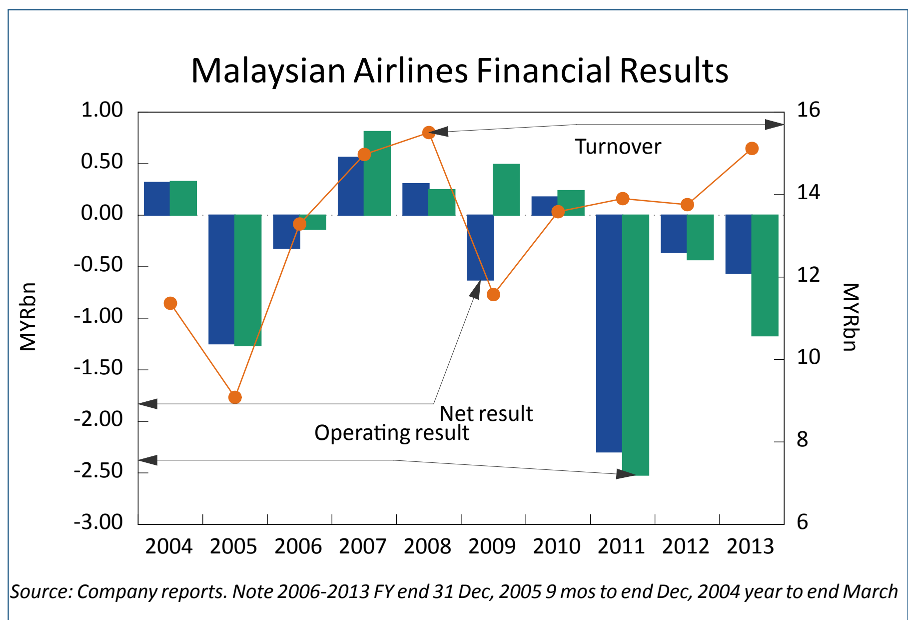

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Publisher:

Keith McMullan
James Halstead

Editorial Team

Keith McMullan
kgm@aviationstrategy.aero

James Halstead
jch@aviationstrategy.aero

Heini Nuutinen
hn@aviationstrategy.aero

Nick Moreno
nm@aviationstrategy.aero

Tel: +44(0)207-490-4453
Fax: +44(0)207-504-8298

Subscriptions:

info@aviationstrategy.aero

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Aviation Strategy Ltd
Registered No: 8511732 (England)
Registered Office:
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London EC1V 7ET
VAT No: GB 162 7100 38
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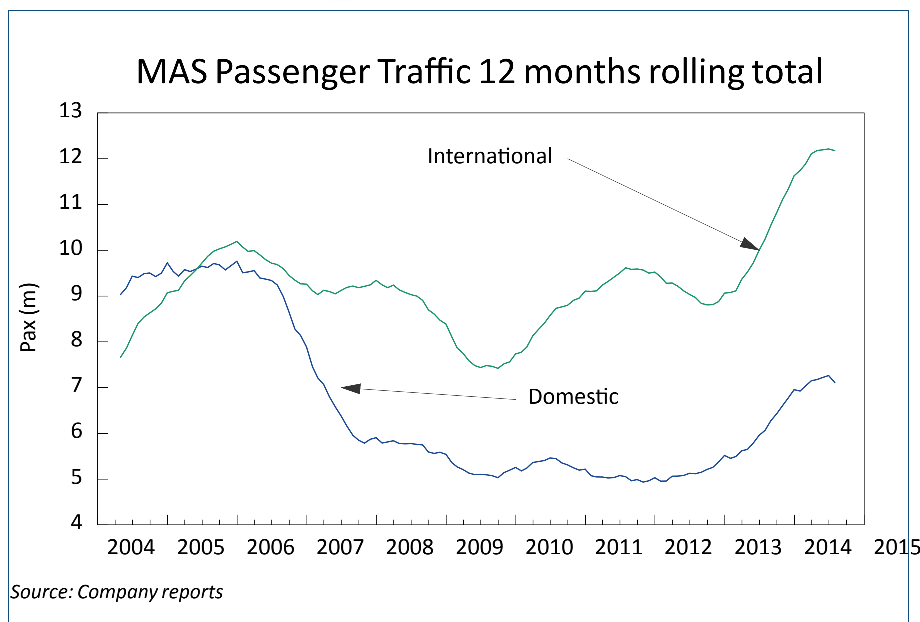

Source: Company reports

✈ Delisting of the existing MAS by the end of 2014 and transfer of operations and assets to NewCo by July 2015. But the NewCo will "critically involve a significantly corrected cost and operational structure and workforce, properly benchmarked to competitive industry practices and norms". The plan is for NewCo to return to profitability by the end of 2017, and then to relist sometime between 2018 and 2020, which will include a complete or partial disposal of Khazanah's stake at that time.

✈ An injection of up to RM6bn ($1.9bn) in the airline over the period to 2016. Net gearing is planned to come down from the current 290% to a targeted range of between 100% and 125%, to be achieved largely through debt-to-equity swaps.

✈ An operational overhaul, to include:

✈ A rationalisation to switch from being a global airline to becoming a largely regionally-focussed carrier, with global connections mainly provided through **one**world (which it joined in February 2013) and other codeshare partners.

✈ Significant cost savings, to be achieved largely though renegotiated supply contracts, new labour agreements and moving the HQ from Subang to Kuala Lumpur International Airport. The workforce is to be cut from 20,000 currently at MAS to 14,000 at NewCo.

✈ A change in leadership. After three years in the job the contract of Ahmad Jauhari Yahya — Managing Director/Group CEO of MAS — was recently extended for another year, to run until September 2015. His task is to guide the airline through the transition, though in the meantime Khazanah Nasional will look for his replacement and an announcement is expected to be made by the end of 2014 — providing a suitable candidate can be found.

One MAS executive says that it is almost certain that NewCo will operate under a new brand given the perceived damage to its reputation from the MH370 incident, with the Malaysian Airlines name consigned to history.

The key question is: will the 12-point plan be implemented as envis-

Malaysian Airlines Route Network

aged and — even if this happens — will it be enough to save the new MAS. As to the former question, MAS undoubtedly has a window of opportunity to restructure itself given the recent disasters, though inevitably the key challenge will be the 30% reduction in the workforce, where a loss of 6,000 jobs is a huge blow to the workforce and unions.

Winning the unions' support will be critical. The most important is the Malaysia Airlines System Employees Union, which was at the forefront of opposition to an attempted share swap with AirAsia in 2011 (see page 5). There is already a long—running battle in Malaysia over an attempt by 1,500 MAS cabin crew to represent themselves through the National Union of Flight Attendants Malaysia, an entity that the airline's management refuses to recognise and which has led to an ongoing legal dispute.

Interestingly, many hundreds of cabin crew have voluntarily left MAS since the start of 2014, and union sources say that morale among MAS staff is at rock bottom. But that will not necessarily means that unions will agree to a 30% cut in staff numbers without a fierce fight — in fact the carrier's dire state may make unions more intransigent, since they may feel they have nothing to lose. What it will probably come down to is just how much redundancy payment the staff that do leave will receive, and clearly voluntary redundancies will be far less traumatic than forced ones.

Network shrinkage

The current route network (see chart, left) will look very different under NewCo. It has already changed significantly in recent years anyway. The long-haul route network has already been cut year-after year for the last decade or so, with — for example — the proportion of widebody seats in the total fleet falling from 72% in 2008 to 57% in 2013. As recently as 2012 MAS had routes to destinations such as Rome, Johannesburg, Cape Town, Buenos Aires, Los Angeles and Rome, but it cut its long-haul network almost in half that year.

The only long-haul routes outside the Asia/Pacific area that currently remain are to London Heathrow, Paris CDG, Amsterdam, Frankfurt, Istanbul, Jeddah and Dubai — but many of those are likely to go over the next year as part of the transition to NewCo.

This will impact the fleet significantly, which currently stands at 125 aircraft (see table on page 4) and which includes a single 747-400, 13 777-200s, 14 A330-300s and six A380s. TheA380s are used primarily on routes from Kuala Lumpur to London and Paris, and as "in-fill" on Kuala Lumpur-Hong Kong in order to increase aircraft utilisation. But the future reliance on **one**world for most (if not all) of NewCo's long-haul routes may see Kuala Lumpur to CDG and LHR served by alliance partners. If just one of those destinations went then NewCo would be left with an uneconomic fleet of A380s; but are there any potential buyers for a couple of second-hand A380s — let alone six of them?

Overall, the long-haul network is under attack from the Super-Connectors and Air Asia X (which

has 100-odd A330neos and A350s on order), while British Airways has just announced the resumption of flights to Kuala Lumpur after 14 years (implying the withdrawal of MAS services but some form of revenue sharing within the **one**world alliance).

Network rationalisation won't stop at long-haul. Routes within Asia/Pacific region are also likely to be trimmed, or potentially even culled significantly. Following public reaction to MH370 many (if not all) routes to China are believed to be unprofitable; currently MAS operates to Beijing, Guangzhou, Kunming, Shanghai and Xiamen, but it's probable that only one or maybe two of these will still be in the network 12 months from now.

Can NewCo survive?

Even assuming that the 12 point plan is adopted without too many problems, will the NewCo be sufficiently lean to survive in a fiercely competitive Asian/Pacific aviation market?

It's not just in the 2010s that MAS has been unprofitable — it has struggled both operationally and financially for year after year, decade after decade, and the blame for that must go on the revolving door of poor management and an even poorer owner in the Malaysian state, which has failed to establish the airline as a stable company with consistent profitability.

Significantly MAS has attempted to restructure itself five times in the last 15 years, and all these attempts have been abject failures — a fact that even Khazanah admits. The Malaysian government injected RM17.4bn ($5.5bn) in those restructurings — money that has been largely wasted, with Khazanah stating that "previous piecemeal changes involved MAS cancelling unprofitable routes and selling non-core assets ultimately failed to resolve the core challenge: an inflated cost structure with the revenue to offset it˝.

The gap between MAS and its rivals is remarkable, whether looking at the revenue or cost side. Revenue per employee is half of Cathay Pacific's and 63% below Singapore Airlines' (SIA). Against its low-cost carrier competitors, MAS's cost base is around 40% higher.

The performance of the share price over the last seven years (see chart on page 5) has been nothing short of disastrous, and even the posting of operating profits in 2007, 2008 and 2010 has done little (if anything) to stop the continual loss of investor confidence in MAS. Whatever management and government has done has failed to work, and that's because of one external factor — the continuing rise of ruthless competition from the Gulf Super-Connectors on routes from Europe, Middle East and Africa through the Gulf and onto the Asia/Pacific region, and from the LCCs within the Asia/Pacific region itself.

Indeed the "Big Three" Gulf carriers have essentially killed MAS's long-haul network entirely on their own. Between them Qatar Airways (ironically a fellow **one**world member), Emirates and Etihad have long offered more weekly seats to/from Malaysia as MAS offers in its entire long-haul network — and MAS simply has had no response to this.

Worryingly for the NewCo, the same end result may happen in short- and medium-haul — the areas that NewCo is now retreating into — with MAS seemingly powerless to combat the challenge within the Asia/Pacific region from the LCCs.

No answer to AirAsia

The threat from AirAsia (see *Aviation Strategy,* August 2013) — an LCC with 170 aircraft and with 322 A320s on order — is of course well-known, but MAS was sluggish to react as its rival grew through the 2000s, and MAS's current strategy of engaging in fare wars with AirAsia (in which each has accused the other of "dumping fares") has proved very costly; the old

Malaysian Airlines Group Fleet

	2008	2009	2010	2011	2012	2013	2014	*Orders*
737-400	37	37	37	34	28	19		
737-800		3	12	22	35	49	56	
A380					4	6	6	
A330	14	14	12	17	20	17	15	
777-200	17	17	17	17	17	15	13	
747-400	13	10	10	9	7	4	1	
ATR72	6	14	19	22	22	25	28	*2*
DHC-6	5	4	4	4	4	6		
F-50	9	7						
Cargo								
747-200F	7	4	4					
747-400F		2	2	2	2	2	2	
A300-600F	1							
A330-200F				2	4	4	4	
Total	**109**	**112**	**117**	**129**	**143**	**147**	**125**	***2***

MAS and almost certainly the NewCo too will never be able to match its rival's cost base.

MAS has never attempted properly to set up an LCC of its own (as most of its full-service contemporaries have done or at least tried to do). MAS has two regional subsidiaries — MASwings, founded in 2007 and with a fleet of 18 ATR 72s and DHC-6s, and Firefly, also launched in 2007 and which operates 15 ATR 72s and a single 737-400 — but even though MAS tried an LCC model on domestic Firefly trunk routes, that was quickly discontinued.

MAS's reluctance to launch an LCC of its own has probably been a mistake. The premium market that MAS had traditionally been targeting has been shrinking fast, and will do so even faster now that MAS is effectively abandoning any pretence of a long-haul network.

The challenge from AirAsia is immense. Today the AirAsia group offers direct routes from Kuala Lumpur to 88 destinations via AirAsia, its affiliate airlines and AirAsiaX — that's a larger route network than MAS, which offers just over 50 destinations from Kuala Lumpur, even prior to the NewCo retrenchment. As MAS keeps on cutting destinations from Kuala Lumpur, so AirAsia keeps on adding them, and the reason for that is the underlying difference in the cost base at AirAsia and MAS.

AirAsia's CASK figures at least 40% lower than MAS's , and even if the NewCo 12 point plan is successfully implemented that gap will only come down to 20%, or 15% at the very best. That's still not good enough, and in any case AirAsia will continue to drive down costs too.

The need to start from scratch and build an LCC from a blank sheet is still imperative but it's something that MAS had always refused to countenance, and of course it's too late now given that it has to restructure from the existing infrastructure and cost base at MAS (or "OldCo").

One way (and perhaps the only way) out of MAS's strategic dead-end would be to form an alliance with AirAsia, and indeed MAS did briefly agree a significant share swap with AirAsia back in 2011 in which Khazanah Nasional would receive a 10% stake in AirAsia, with AirAsia's major shareholder — Tune Air — receiving 20.5% in MAS. But those plans collapsed the following year following opposition from unions and within certain parts of the Malaysian government.

Tony Fernandes, CEO of AirAsia, would probably feel that was a lucky escape, and he now expresses hope that "Malaysia Airlines is now going to be operated rationally. The airline was operated with a lot of subsidies, but that's coming to an end and that's good news for us." Indeed fares have already started to rise in Malaysia, but this may be only a temporary phenomenon.

MAS also has to battle against Indonesia's Lion Air (see *Aviation Strategy,* April 2014), which has more than 500 aircraft on firm order and also owns 49% of Kuala-Lumpur based LCC Malindo Air (which operates 15 aircraft and intends to increase its fleet to 100 strong).

A future?

Given that the Malaysian state has already pumped in many billions of rm into MAS with effectively zero return, now Khazanah Nasional is promising that (as part of its 12 point plan) after the final RM6bn ($1.9bn) injection of state support then no further help will be given. Some analysts are sceptical of that claim, but if true then the 12 point plan is the final chance for MAS.

The odds are that NewCo will not become the airline that the plan envisages. Jerry Lee, aviation analyst at RHB Research in Kuala Lumpur, says that: "On paper, it looks great — cut capacity, slash the workforce, improve productivity — but whether it can be implemented effectively, that's still a question mark."

Some analysts are worried about a perceived lack of detail in the 12

point plan, and a former senior executive at MAS is concerned about both corruption and "financial leakage" at the airline, and whether those issues will be addressed properly during the hectic switch to a NewCo. There's no doubt that the timetable for action is very tight, given that the Association of Southeast Asian Nations' "Open Skies" policy should launch by the end of 2015, under which unrestrained third, fourth and fifth freedoms will become the norm in the 10 member countries. Any hitch to implementation of the NewCo and its 12 point plan may well be fatal, and it's probable that NewCo is being set up far more quickly than is sensible. But the OldCo has little choice — NewCo is its only option for survival.

What may ultimately sink NewCo is the quality of MAS's management, which in places is dire. For example, in September the airline's marketing department had to hastily rename a promotional competition on its website that had initially been called the "Ultimate Bucket List˝, in which it gave Australian and New Zealand travellers the chance of winning tickets if they said what they would want to tick off on their bucket lists (i.e. before they died). Naturally the change only occurred after an outcry from the public and press — MAS had seen nothing wrong in what in what it was doing so soon after two major aviation disasters.

The worry is that a raft of poor, uncommercial senior and middle managers will make the transfer over to NewCo, while those leaving the company will be largely at the customer-facing end. The latter will save costs for the company, but if the former stay the consequences may be more significant.

Of course it's possible that the NewCo will meet all its objectives, shrink and take out just enough of its costs base to be a going concern, at which point another airline might be tempted to ride to the rescue as a white knight (or more likely buy the airline at a bargain price).

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For further information please contact:
James Halstead or **Keith McMullan**,
Aviation Strategy Ltd
e-mail: info@aviationstrategy.aero

Flag-carrier rescues: Some issues

THE fundamental problem that governments have when setting out to rescue their flag-carriers is that they have only a vague, political idea of what role the airline should be playing. Typical non-commercial aims under full or part government ownership are to:

✈ Assure links between the capital and regional points within the country

✈ Maintain region politico-economic balance against flag-carriers of nearby countries

✈ Promote a global presence to reinforce economic growth

✈ Retain what is still a national symbol.

In a rescue situation there is only one aim: to make the airline commercial, accepting the reality of deregulated airline competition. The menu of reforms varies from airline to airline but usually contains these elements.

✈ New Management. Successful airline managers are generally creative types who are driven to grow their companies and deliver profits. However, the turnaround role involves destruction, brutal negotiation and somehow managing political expectations, requiring a different type of executive.

✈ Network Rationalisation. The concept is simple: quantify the losses on a route-by-route basis (more complicated for a hub network than a point-to-point operation but perfectly feasible), identify the loss-making routes at various levels of contribution or profitability and cull them starting with the most hopeless and stopping with the marginally hopeful. The big problem arises when there are so many unprofitable routes that cutting them redistributes fixed costs to the profitable routes sending them into loss.

✈ Fleet Restructuring. The feasibility of disposing of surplus capacity depends the degree of debt associated with the fleet (usually very high if the airline has reached this point) and willingness of banks and lessors to renegotiate (it helps if local financial institutions, the government and the airline are closely bound up together – the JAL situation). There is the danger that if too much capacity is cut, the operational efficiency of sub-fleets is compromised – MAS's A380 problem. Selling aircraft also requires there to be second-hand demand — also MAS's A380 problem.

✈ Sale of Subsidiaries. This may seem to be a relatively painless way of raising cash. But it frequently turns out that the maintenance or catering subsidiary's apparent profitability actually depends on contracts with the flag-carrier.

✈ Reduction in Workforce. Involuntary rather than voluntary lay-offs are preferable in order to retain the most productive employees, but this may not be politically palatable. One solution for the turnaround team is to make this the government's problem. The Greek government guaranteed all of Olympic's employees not only generous redundancy terms but also jobs in other parts of the public sector (or course Greece ended up in de facto bankruptcy).

Assuming the turn-around works, what airline model replaces the flag-carrier model? It depends on the geography and the economy. Air France became a global network carrier because it was based at Paris (but has clearly not shaken off its flag-carrier legacy). Usually, the result is a hybrid type model – Swiss out of Swissair's subsidiary, Crossair; SN Brussels out of Sabena's subsidiary, DAT – viable, smallish airlines that can later be taken over by a global network carrier, Lufthansa in this case.

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Air France-KLM: Getting ready to perform

September saw Air France-KLM hold its first investor day in two years. With its medium term restructuring plan "Transform 2015" scheduled to mature next year, the event was heralded to include a longer term strategy named "Perform 2020" by which the group would present its view of how it would progress in the next five years and beyond.

There are many similarities between the Air France-KLM strategy presented with that recently highlighted by the Lufthansa Group (see *Aviation Strategy*, July/August 2014). As with its German rival, it plans to continue to limit mainline capacity growth, concentrate on a continuous reduction in unit costs, emphasise long haul joint ventures, target growth in its MRO business, and start a major expansion of its own low cost operator. It will also continue to limit capital expenditure (despite its long haul fleet renewal) in order to further reduce debt.

According to the Air France-KLM management, this new five year plan will be a "strengthened enterprise model" built on the traditional stakeholder triangle:

- *Customers*: the carrier of choice in all the markets in which it operates,
- *Employees*: a committed workforce participating in the success of the group,
- *Shareholders*: a de-risked profile delivering consistent growth and value.

The "Perform 2020" five year plan has an overall target of improving total group profitability to generate returns on capital employed of around 10% by 2017 (it was less than 3% in 2013 without accounting for the losses at Alitalia). To do that it will need to increase EBITDAR (earnings before interest, tax, depreciation and rentals) by around 9% a year for the next four years. This would bring it close to touching the peak 16% EBITDAR margin it last achieved in 2007.

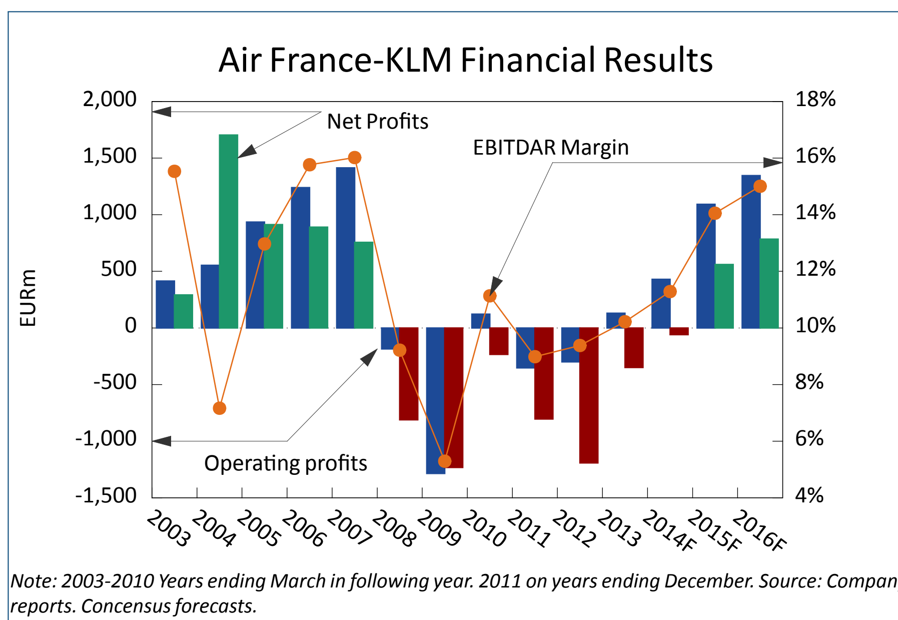
It expects to achieve this target from higher profits in the passenger hub business, a return to operating profit breakeven in the point to point business, improved performance from an expanded Transavia, a return to breakeven for the cargo division, and higher profits in the maintenance and catering segments.

Cargo

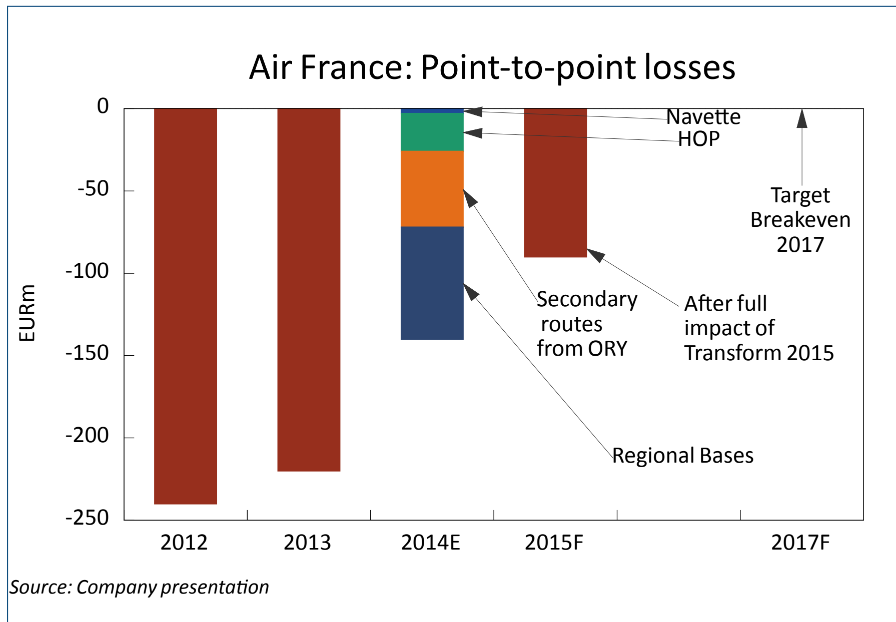
Air France-KLM had already take the decision in its Transform 2015 restructuring plan to reduce its exposure to full cargo aircraft. KLM finally acquired full control of Martinair in 2008 and in the financial year 2008/09 the Air France-KLM group was operating 25 full freighter aircraft. By 2013 it had removed eleven aircraft form the fleet and full freighter capacity had fallen by 50%.

It has now taken the decision to accelerate the phase out of the last remaining five MD11-Fs in Amsterdam (on top of the five aircraft announced for disposal in October 2013). As a result the group cargo operations will have three 747-ERF based in Amsterdam and two 777F based in CDG; by 2017 the group's full freight cargo capacity is expected to fall by another 50%, and full-freighter cargo capacity is planned to account for only 15% of total freight capacity (although, of course, KLM continues to operate its combi-aircraft with their high and variable belly capacity).

The management stated that the



Note: 2003-2010 Years ending March in following year. 2011 on years ending December. Source: Company reports. Concensus forecasts.



Source: Company presentation

fleet of freighter aircraft, despite the restructuring programme had still lost €110m in 2013 (out of total cargo operating losses of €202m). The target under the new plan is merely to get to break even by 2017.

Rationalising the decision to retain full freighter aircraft, KLM CEO Camiel Eurlings argued that the ability to be able to offer freight forwarders the specialised lift that full-freight aircraft can provide (especially for oversized consignments, those needing front nose loading, or products prohibited on passenger aircraft) automatically provided it with an uplift in unit revenues of 20% and has a knock effect on increasing yield in belly-hold operations. In the meantime the group has also introduced a new cargo commercial policy including a significant push on higher margin specialised products (such as pharmaceuticals, animals — and no doubt flowers). At the same time the group will reposition the smaller full freight aircraft on niche markets, chartering, routes with low passenger services and limited belly-hold capacity and oversize products.

Passenger business

One of the mantras from the management is "capacity discipline". The group plans to continue to increase capacity by no more than 1-1.5% a year overall for the next three years (of which long haul would provide growth of around 2%, short haul hub feed remain static, and a decline in non-hub short haul point-to-point capacity). In doing so it will concentrate on developing long haul joint ventures to help it counter the impact of the super-connectors. Apart from the long established immunised JV on the Atlantic with Delta, and the stake in Kenya Airways, it is in the process of trying to develop deep relationships with China Eastern and China Southern, has taken a 3% stake in Gol in Brazil, and says it is trying (forlornly perhaps?) to negotiate some form of revenue share agreement with Etihad.

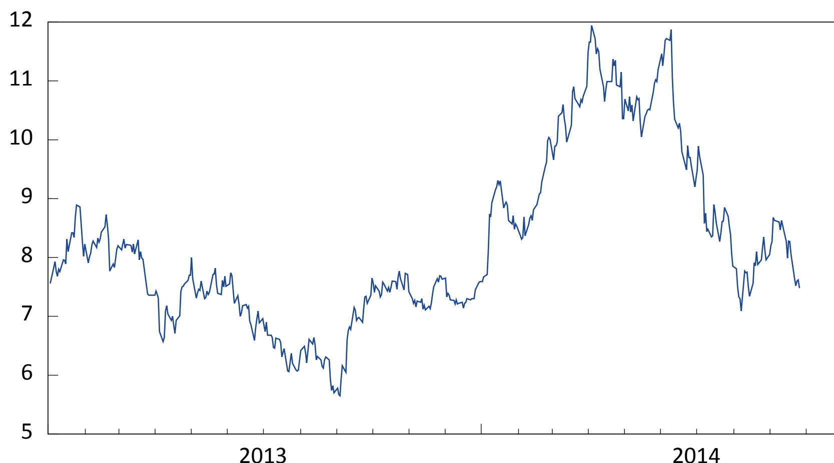
On short haul hub operations it is in the process of increasing seat density (and at KLM reducing turnaround times) on flights into the hubs, and states that it will reduce capacity on weakest routes and "enhance the portfolio of medium haul destinations and frequencies". Rather disturbingly perhaps it is also looking to increase the short haul to short haul connection potential at the hubs (short haul hubbing does not work at all well in Europe). Almost in the same breath, the management suggested that there has been a change in customer perception of connection times and that this is no longer a criterion in flight selection; as a result it would be looking to "investigate opportunities to adjust hub organisation".

For once the group showed details of the relative profitability of the passenger business (see table below). In 2012 the group's hub operations made a small operating loss which rebounded to a €400m operating profit in 2013. The management suggested that this could double in

Air France-KLM Passenger business profitability 2013

	Revenues €bn	Operating results €m	Margin
Long Haul	12.8	800	6.3%
Short haul	4.7	-400	-8.5%
Hub operations	*17.5*	*400*	*2.3%*
Point-to-point	1.7	-220	-12.9%
Transavia	0.9	-23	-2.6%
Total	**20.1**	**157**	**0.8%**

Source: Company presentation



2014 to around €800m and presented a chart portraying continual regular growth over the next three years.

Short haul point-to-point

The real problem is on short haul operations that do not form part of the hub systems — a factor particularly pertinent to Air France. As for all the legacy carriers in Europe, short haul services are under significant competitive pressures from LCCs. Air France has an advantage in that France is a highly centralised nation (all routes lead to Paris), has the second largest catchment area in Europe for air travellers at is base in Paris, and — to a certain extent — that it has had significant domestic competition from the TGV for many years. It also has dominant slot positions at the two main Paris airports.

However, it seems to adhere to the belief that it needs to operate short and medium haul services that do not touch its hubs, in part to maintain increased market presence to gain perceived benefits through the frequent flyer programme.

For the first time the company pointed to the relative profitability of the segments of its point-to-point short haul business (see chart xxxx). In 2012 non-hub flying generated losses of €240m (presumably excluding the losses of recently disposed CityJet). The results for 2013 improved slightly despite the disastrous plan to expand quasi-low cost operations from regional bases. In 2014 the group suggests that total losses in this sector will have reduced to €140m.

Within this result however, the core Orly shuttle business from Paris to the main regional cities in France only produced a small loss, the regional HOP! Operations (encompassing the former Britair, Régional and Airlinair) lost about €25m, secondary European route operations from Orly lost around €45m and the point-to-point services from regional airports to other destinations in Europe lost around €65m. The measures included in the Transform 2015 plan will remove around €50m of these losses (mostly the winding down of the ill fated plan to expand regional base European operations) but this still leaves losses of €90m to recover — and under the new plan the company would like to bring it to break-even by 2017.

Air France regards the point-to-point network as a significant asset:

- €1.7bn revenues, 15m pax and 34 stations
- 38 A320s and 61 regional aircraft
- 77% market share Paris-Orly to regions
- 50% market share inter-regional
- Dense domestic network and large customer base increase efficiency of loyalty programme

The group has already gone through a significant level of restructuring of the system as part of the Transform 2015 plan. Total point-to-point capacity has fallen by 25% in the past two years (admittedly partly resulting from the disposal of CityJet), regional bases have been "resized" and the regional services have been brought together under a single network and brand of HOP! It has been able to achieve a reasonable increase in aircraft utilisation, an 8% reduction in station unit costs, and reduced staffing levels by 14% through voluntary redundancies since 2012. At the same time on the regional services it has introduced new commercial initiatives — including a new leisure pricing offer, a revamped business tariff, and a discount pass which have so far this year generated a near 6% increase in unit revenues and a four point improvement in load factors.

From early 2015, the company will rationalise the Air France point-to-point operations and HOP! Into a single business unit, which in conjunction with further tweaking of the network is seen to help it towards a target of break-even by 2017.

Transavia

Air France seems to have embraced the idea that the way to deal with the growth of competitive LCCs is to de-

velop its own in-house pan-European low fares carrier (although very few legacy carriers have been able to do so successfully). As a result it announced plans to expand the operations of Transavia significantly towards a base fleet of 100 aircraft by 2017 up from the current 44 units (30 in the Dutch-based Transavia and 14 in Transavia France).

Currently Transavia operates 200 routes with 870 flights a week to 85 destinations using an all 737 fleet. In 2013 it carried 9m passengers, generated just short of €1bn in revenues (30% in France) and an operating loss of €23m. It operates from bases in Amsterdam, Rotterdam, Eindhoven, Orly, Lyons and Nantes. It boasts a unit cost not too far from the levels of easyJet or Vueling — but, as it still operates a significant level of non-scheduled flights (charter represents just under 50% of the Dutch operations), it has a substantially longer average stage length. It boasts a strong brand position in the Netherlands, growing awareness in France but limited presence outside its home markets.

The idea is to move towards a pan-European scale. Over the next three years the management stated that it would continue its pace of growth at Orly — up by 15% a year in the last two years. (And Air France, with just around 50% of the slots at the constrained airport, has the ability to provide it with a substantial valuable base for growth.) Air France CEO Frédéric Gagey was keen to emphasise that although the group was giving slots to Transavia at Orly at the same time as closing loss-making AF routes from the airport, this did not mean a transfer of point-to-point services to the low cost carrier, but the opening of new destinations under the new brand.

It would also aim to open between five and ten bases outside its home markets (presumably at the end of routes currently served), targeting the number two or three market position with three to ten aircraft at each base. By 2017 it is targeting to be one of the top five largest LCCs in Europe, the low cost leader in the Netherlands, the largest international airline at Orly, over 20m passengers a year. Up to 2017 the significant expansion will have a negative impact on profitability but the management expects to break-even in 2017 and be able to deliver a medium term operating margin above 5%.

Of the hundred aircraft in the fleet by 2017 it was envisaged that one third each would be operated by the Dutch operation (implying no further growth there), Transavia France, and a new Transavia Europe (operating under an AOC from another country).

When Transavia France was established, the group had been limited by union accord to operate no more than 14 aircraft in the new unit. The group CEO Alexandre de Juniac accepted that they would have to renegotiate with the pilots' unions to lift that limitation; and that if they did not agree, Air France-KLM would concentrate on expanding Transavia Europe. In addition he was adamant that the LCC could not afford to be bound by current Air France working terms and conditions.

Somewhat surprisingly, Air France does not seem to have pre-negotiated its plans with the pilots. The two main unions, SNPL and SPAF, complained that they had not been consulted. They started strike action with demands that current Air France working conditions, scope clauses and seniority lists apply to all Air France owned airlines. Also, bizarrely, the unions demanded that Transavia France should operate A320s. The two weeks' strike is likely to have cost the group some €250m.

Air France-KLM has remained adamant that Transavia France will not be viable under those terms. However, it has apparently prorogued the agreement to limit the Transavia France fleet to 14 aircraft; and, in an attempt to resolve the industrial action, backed down from establishing Transavia Europe. At the same time it has emphasised that Transavia will operate fleet with a single aircraft type — the 737 — while it would have separate employment terms and that (somehow) it will maintain a single seniority list. The SNPL strike has ended without resolution of the disagreements.

Air France-KLM appears to have decided (as has the Lufthansa Group) that IAG's acquisition of Vueling in 2011 was "a good idea" to create a growth platform to compete against the growth of Europe's LCCs. Unfortunately, the Air France-KLM corporate structure does not provide an easy way out from involving the powerful French unions. At the same time, management may have ignored the detail that its home grown (ex-Charter) LCC Transavia is a little *different* from Vueling — an airline that is a effectively a low cost flag carrier for Catalonia.

Fastjet: Right strategic message, terrible financials

FASTJET when it launched in 2012 appeared to have the right strategy at the right time — adapting the LCC model to open up the African market (see *Aviation Strategy*, September 2013). But things have not gone to plan, and financial results have been terrible.

Part of the losses are attributable to the mistake made by Fastjet before start-up when it bought into Lonrho's Fly540 airline operations as a short-cut to obtaining multiple AOCs and implementing a pan-African LCC strategy. It rapidly became clear that the Due Diligence process had failed to identify numerous difficulties with Fly540 and that Fastjet had invested in a major hidden liability which drained cash.

While Fastjet successfully established a Tanzanian airline, the other Fly540 airlines were all suspended and are being disposed of. The Kenyan business was appraised as not being convertible into an LCC. In Ghana the restructuring of Fly540 was blighted by "infrastructure issues at Ghanaian airports" and "adverse economic conditions". In Angola there were, among other things, "logistical hurdles of importing aircraft spares", which made the country a poor investment opportunity.

Fastjet Group's accounts for 2013, published in July, lack detailed P&L analysis, but there is a segmental break-down — see table above.

The three suspended Fly540 airlines (in Angola and Ghana plus the catch-all "Central" division) accounted for $59m or 73% of the Group's net losses, mostly as the result of the original investment being written down or off. However, at the EBITDA level they accounted for just $19.8m or 48% of Fastjet's total operating loss of $41.2m on revenues of $53.4m.

Fastjet: P&L by region (US$ m)

	Tanzania	Angola	Ghana	"Central"	TOTAL
Revenue	26.1	18.8	8.5		53.4
EBITDA	-21.4	-6.8	-2.1	-10.9	-41.2
Interest		-1.3	-1.5	-0.5	-3.3
Depreciation	-0.6	-2.4	-2.2	-1.2	-6.4
Impairments		-12.2	-5.9	-13.4	-31.5
Tax				1.5	1.5
Sub-total	-0.6	-15.9	-9.6	-13.6	-39.7
Net Result	-22.0	-22.7	-11.7	-24.5	-80.9

An operating loss is expected in the first years of any airline start-up, but the scale of losses at Fastjet Tanzania, the core LCC operation, is disturbing. At EBITDA level Fastjet lost $21.4m on $26.1m of revenues, an operating loss margin of 82%. Air Arabia, the first Middle East LCC, was making a profit in its second year of operation in 2005.

Understandably, Fastjet management prefers to focus on the discontinued operations when commenting on the losses. CEO Ed Winter: "When we started we thought [the various Fly540 operating licences] would have a benefit that would outweigh management time and cost but the more we worked on transforming those businesses we realised they weren't viable."

The explanation has been persuasive; Fastjet, which is quoted on AIM (London's Alternative Investment Market) has attracted new investors, raising £15m in new equity in April and May. But this amount of new capital will be nowhere near enough to fund continuing losses. Interim results for the first half of 2014, released at the end of September, showed an EBIT loss of $30.5m, of which $13.9m was from the Tanzanian operation, most of the rest from Fly540 Ghana and Angola operations.

Some LCC metrics may shed light on Fastjet's financial performance.

✈ Aircraft utilisation, which is a function of the network and schedule from the Dar es Saleem base, was only averaging 5.7 hours a day in

Fastjet Fleet Plan (A319s)

	2013	2014	2015	2016	2017	2018
Tanzania	3	3	5	6	6	6
Kenya			3	6	8	8
Zambia			2	3	3	3
S. Africa			3	5	7	7
TOTAL	**3**	**3**	**13**	**20**	**24**	**24**

the first quarter of this year though this has now improved to 9.9 hours a day by August. The target is 11.7 hours by the end of the year, which is what would be expected for a fleet of modern A319s. Fastjet's dilemma is that by adding new flights it may damage its yield and/or its load factor. It also has to maintain its very good punctuality record — 90% (arrival within 15 minutes).

✈ Fastjet set out to stimulate new traffic, including a high proportion of first time flyers, with some very low initial fares – under $50 on average in early 2013. However, average revenue per passenger (including ancillaries) improved to $82 in the first half of 2014, which is in line with LCC norms for this type of network.

✈ Load factor averaged just 72% in 2013, though in August Fastjet reported 79%. The airline needs to get its load factor up to at least easyJet levels, mid 80s, which would mean that it would be carrying about 280,000 passengers per aircraft per year.

✈ Unit costs are out of line with those of successful LCCs. In 2013 costs averaged US¢16.7 per ASK (of which only US¢3.6 was fuel), well over twice the required level. Fastjet suggests that the airline will grow out of this problem, as there is a high proportion of fixed costs which will be unchanged by additions in capacity. The target is to reduce unit costs by 27% by the end of this year.

✈ Unlike other start-ups Fastjet, because of the Fly540 legacy, has an over-manning issue. There are 433 staff on the payroll, at an average remuneration of $34,000. Around 120 employees would be an efficient level for its current A319 operations. There are 130 flight crew which implies about 8 crews per A319; an efficient level would be 5 crews assuming 11.7 hours/day aircraft utilisation (rather than the current level).

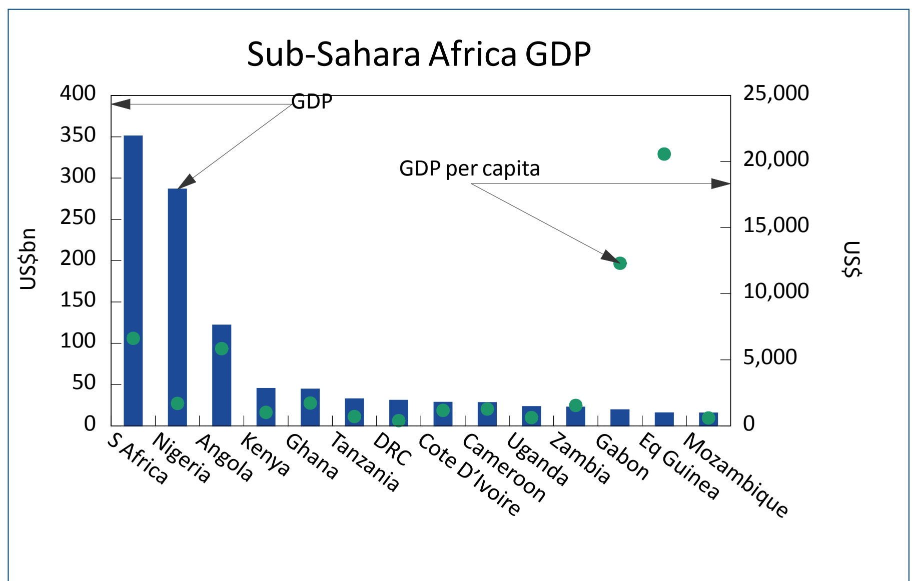
Rapid growth is therefore essential for Fastjet. The plan is to go to 24 A319s by 2018, though a 34-unit fleet by that date has recently been mentioned by Ed Winter. Negotiations have apparently been held with Airbus. The immediate challenge, however, is to source two A319s to replace aircraft due to returned to a lessor.

Expansion will require another major round of funding. Fastjet has mentioned both new African backers and an airline investor. Etihad inevitably has been mooted though, with Fastjet in talks with Emirates about a code-share at Dar es Salaam, there is an outside possibility of a deal with flyDubai. EasyJet doesn't seem interested despite, or perhaps because of, the Stelios Haji-Ioannou link (he owns about 10% of Fastjet, having invested $1.6m in the latest funding round and swapped his €605,000/year consultancy contract for shares).

Meanwhile, Fastjet has to accelerate the establishment of new operating bases. It aims to obtain its AOC for Zambia by the end of 2014, but Kenya, which was to have been the first base outside Tanzania, has been proving problematic (one issue is that Fastjet would be obliged to fly domestically for a year before adding international services). Potential bases in Uganda and Zimbabwe are also being explored.

So far Fastjet has not attempted to enter Africa's huge potential domestic markets – Nigeria and South Africa (see chart below) – simply because they are perceived as being too difficult. However, Fastjet's first international route, launched last November, was to Johannesburg, and a base there is slated for 2016.

Stelios Haji-Ioannou has again been rude about Fastjet management but probably with more justification that at easyJet. The airline is not only legally based in the UK but also its top managers work out of London Gatwick, which seems a little remote from the key African markets. And despite the huge losses and a share price languishing at 1p, the CEO earned $794,000 last year and the CFO, recently departed, $412,000.



Mexico's LCCs gear up for growth and fundraising

As Mexico's economic recovery gathers pace and airline industry conditions improve, the country's leading LCCs can look forward to new opportunities to fund the $13bn-plus of new aircraft orders they have placed since 2010. While Volaris went public successfully in September 2013, VivaAerobus and Interjet may now be able to revive their IPO plans this autumn or in early 2015.

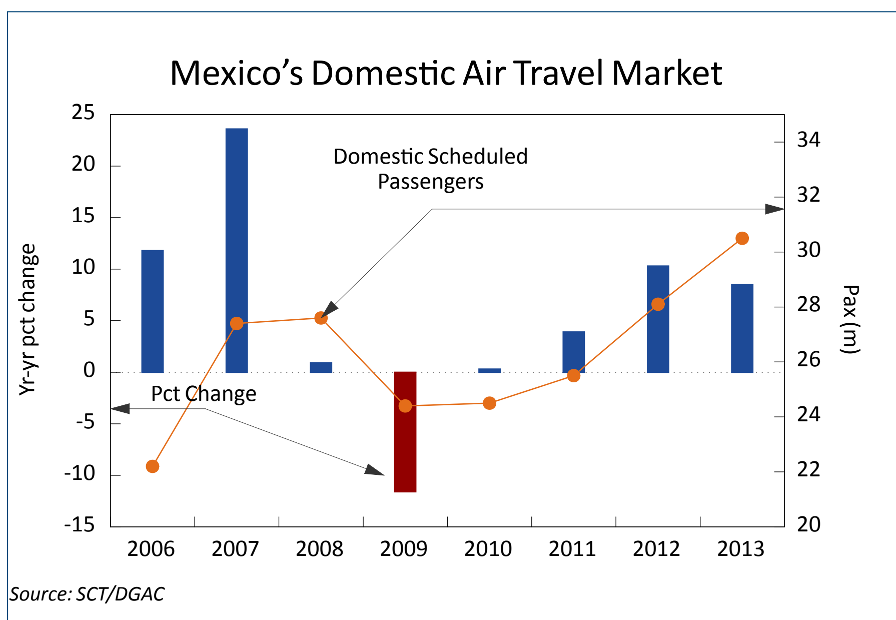
The past 12-18 months have been challenging in the Mexican aviation market because of Mexico's economic slowdown and the resulting airline price wars. Aeromexico, the country's global airline, has also been plagued by labour strife.

Mexico's GDP expanded by only 1.4% in 2013 – the worst performance since the 2009 recession, when the economy contracted by 6%, and following from 4%, 3.9% and 5.3% growth in 2012, 2011 and 2010, respectively. This year's GDP growth is currently projected to be in the 2.5% to 2.7% range.

The economic slowdown affected domestic air travel demand, leading to extensive fare discounting by the LCCs to maintain load factors and market shares. Mexico's DGAC warned in July that the price wars raging in the domestic market could lead to financial instability.

Volaris – the main instigator of the fare wars and the only one of the LCCs that publicly discloses its financial results — has lost 780m pesos ($58m; 8.4% of revenues) on an operating basis in the nine months to end June 2014. Before that Volaris was profitable, achieving quarterly operating margins in the 1% to 10% range.

Volaris has seen sharp declines in its revenue measures over the past year. The worst performance was in the first quarter of 2014, when average fares, yield and RASM all plummeted by 21%. It was a heavy price to pay for keeping the load factor stable (at 81%) in a weak market.



Source: SCT/DGAC

Because of the stimulation provided by the super-low fares, Mexico's domestic market has continued to grow at a healthy pace. Passenger numbers rose by 8.5% in 2013 (to 30.5m) and by 8.1% in January-July 2014. By comparison, 2012 saw 10.3% growth, but before that there was stagnation in 2010-2011 and an 11.6% contraction in 2009.

Mexico's domestic air travel market is unusual in that the growth has been very bumpy and the market has expanded only minimally overall since 2007, despite the emergence of three vibrant LCCs (Interjet in December 2005, Volaris in March 2006 and VivaAerobus in November 2006). The reasons are Mexicana's demise, the many smaller-airline failures and the sharp 2009 recession.

Mexicana, formerly the country's second-largest carrier, filed for bankruptcy and ceased operations in August 2010. The shutdown of the carrier and its low-cost and regional units Click and Link removed a large chunk of the overcapacity that had developed as a result of five years of intense start-up LCC activity. The seven other smaller-airline failures since 2007 (Azteca, Aladia, Aerocalifornia, Avolar, Alma, Aviacsa and Nova Air) also contributed to the capacity decline.

In addition to helping create a more rational competitive environment, Mexicana's demise gave the new-entrant LCCs unique growth opportunities, both domestically and

Mexican Airlines' Market Shares

	Domestic Passengers % of total			International Passengers % of total		
	July 2014	**2012**	**2009**	**Jul-14**	**2012**	**2009**
Aeromexico Group	32.4	37.7	32.3	64.5	67.0	31.1
Volaris	25.7	20.5	12.8	23.9	21.9	2.9
Interjet	22.3	23.9	12.7	10.3	9.0	0.0
VivaAerobus	13.2	12.5	5.8	0.8	2.2	0.4
Mexicana			27.2			65.4
Others	6.4	5.3	9.2	0.4		0.2
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Top 3 LCCs	61.2	56.9	31.4	35.0	33.1	3.3

Source: SCT/DGAC

internationally. The three top LCCs quickly captured an unprecedented 60% share of Mexico's domestic passengers and more than a third of Mexican carriers' international passengers. The latest DGAC statistics show that those shares were 61.2% and 35% in July.

While Aeromexico and its regional unit Aeromexico Connect also initially captured significant chunks of Mexicana's domestic market share, since 2012 Grupo Aeromexico has ceded all of those gains to the LCCs. Its domestic passenger share has returned to the 32%-level it was back in 2009.

Volaris has been the clear winner in the latest market share battles. Since 2012 its domestic market share has increased by 5.2 points to 25.7%, while Interjet's has fallen by 1.6 points to 22.3% and VivaAerobus' has inched up by just 0.7 points to 13.2%. Volaris has overtaken Interjet as the largest carrier in the domestic market.

Could it be that the funds raised in the IPO made Volaris more aggressive with growth and fare discounting? That having much stronger reserves than its peers made it willing to take more risks?

Volaris' cash reserves peaked at 2,974m pesos (23% of the last 12 months' revenues) post-IPO at the end of September 2013, up from 822m pesos at year-end 2012. But by June 30 the reserves had dwindled to 2,088m or about 16% of revenues – a modest level by international airline standards.

But Interjet and VivaAerobus are now also becoming more aggressive. VivaAerobus is planning a major US push this autumn, while Interjet will be adding Houston as its fifth US gateway in October. Both airlines undoubtedly hope to fund part of their substantial new aircraft order commitments through the capital markets.

Therefore IPOs are on the horizon for both of those carriers. It is just a question of when. Will they try to cash in on the current economic momentum and the excitement generated by the Mexico City Airport plans and go for autumn IPOs (if market conditions allow)? Or will they wait until early 2015 when Mexico's economy may have recovered fully?

Improved economic outlook

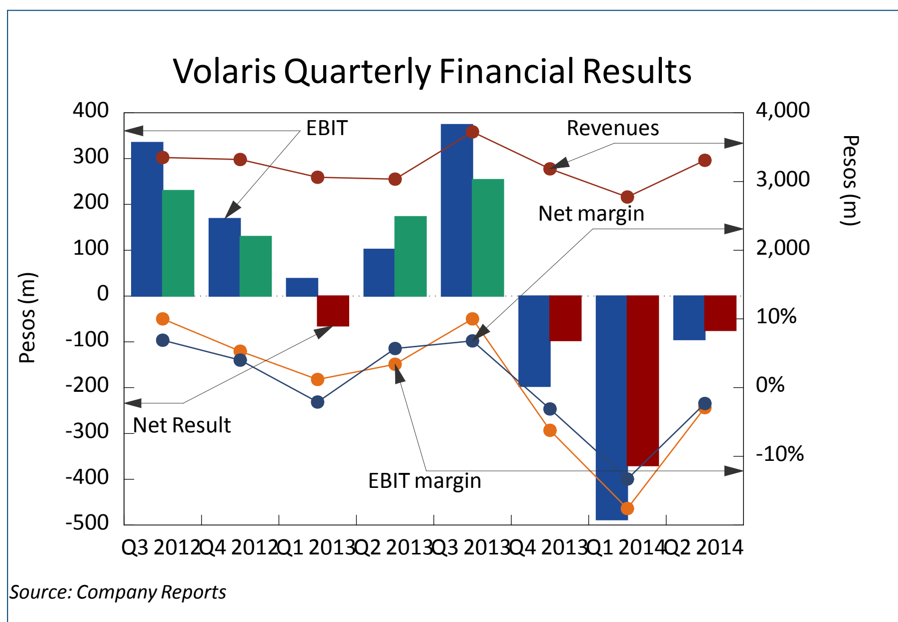
Mexico is in the process of staging an economic recovery. GDP growth is believed to be accelerating in the second half of 2014 as domestic demand strengthens and demand from the US (Mexico's largest export market) rebounds. Despite the recovery, inflation is expected to slow towards the Mexican Central Bank's target of 3% in 2015. Current projections envisage GDP growth as high as 4.2% in 2015.

The longer-term economic outlook is promising. The recent abolition of the state-owned oil company's production monopoly is expected to help lift Mexico's GDP growth above 5% starting in 2017. The government's newly-expanded $590bn (public/private) National Infrastructure Investment Plan for 2014-2018 is expected to add 1.8-2 percentage points to Mexico's growth rates by 2018. There will be the economic boost provided by the construction of a new airport for Mexico City.

Mexico is the second largest economy in Latin America (after Brazil). The expectation that it will almost certainly outperform Brazil in the next couple of years should help boost global investor interest in Mexican equity offerings.

Mexico's socio-economic trends all point to significant long-term growth in air travel. The population is estimated to grow by 1.4% annually. The number of middle-income households in increasing steadily. There is much more potential to attract traffic from long-distance buses.

Volaris noted in its IPO filings last year that the substantial investments made in airport infrastructure in Mexico in the last decade will help sustain the growth in air travel. Mexico privatised most of its key airports years ago. However, Mexico City has serious airport congestion and capacity issues. Cancun has developing capacity issues. And major airports such as Toluca and Monterrey will near satu-



Source: Company Reports

ration later this decade.

Mexico City's Benito Juarez International Airport has been operating at capacity for years. It handled 31.5m passengers in 2013 and is Latin America's busiest airport in terms of aircraft movements, but it handles relatively little freight because of lack of capacity. An earlier effort to build a replacement airport had to be abandoned in 2002 due to violent protests. Interim measures to ease the crunch at Juarez have included slot restrictions in peak hours, a slot reorganisation and directing spillover traffic to Toluca Airport.

President Enrique Pena Nieto's plan, announced in early September, to build a new $9.2bn, six-runway airport for Mexico City is a clear positive for Mexico's airlines. The airport, which will be built next to Juarez on government-owned land using both public and private funding, will be able to handle almost 120m passengers a year, quadrupling Juarez's capacity. It will ensure that Mexico's airlines will have all the capacity they need in the foreseeable future to grow their operations out of the nation's capital and most important business and leisure traffic hub.

The private Mexican airport operators have their own investment plans for the secondary airports. For example, GAP is planning to invest $459m in airport improvements by 2019, with Guadalajara receiving 40% of the total.

Of course, Mexico City's future mega-airport will also be able to accommodate significant growth by foreign carriers. That and the likely future open skies ASA with the US and the granting of fifth freedom rights to foreign airlines (possibly via Toluca) — all of which are on the table in current ASA negotiations — will mean intensified competition for Mexico's LCCs on their US and Latin America routes.

But the LCCs could benefit from increased opportunities for interline or commercial alliances. Airlines from all corners of the globe are known to be looking to operate 787s or A380s to Mexico City, which could develop into a key hub for Latin America.

Mexico may have little to lose by granting fifth freedom rights and liberalising fully its ASA with the US. In July Mexican carriers accounted for only 25.6% of the total international passengers to and from Mexico, with foreign operators (mostly US airlines) having the lion's share of 74.4%. Mexico might as well go for what its carriers want, which is profitable growth opportunities. Mexico's LCCs support full liberalisation of the ASA.

In the following pages *Aviation Strategy* takes a look at each of the three leading Mexican LCCs in turn.

Volaris: Growth and losses since IPO

Volaris raised around $350m in total in its IPO in September 2013, which gave it listings in Mexico and New York (NYSE). The airline received $200m-plus in proceeds; the rest was divided between its backers, which included Indigo Partners.

But the stock's performance has been disappointing, reflecting general market jitters and concerns about the economy and the airline industry, rather than anything specific about Volaris. On the NYSE, after closing at $14.01 after the first day of trading in September 2013, the stock soon began a steady decline, halving to the $7-level by April-May. By mid-June the price had recovered to the $9-level, where it has hovered since.

Volaris used the IPO proceeds to pay down debt, make aircraft pre-delivery payments and boost its cash reserves. Since the IPO the company has had a positive net cash position. It has continued to rely on operating leases; most recently, in early September, it completed sale-leasebacks for seven A320s.

The current 48-strong fleet (as of June 30) is a mix of A320s (29) and A319s (19), with an average age of 4.1 years. Volaris continues to take delivery of larger A320s while gradually returning A319s, with the aim of achiev-

ing an all-A320 fleet by 2020.

Volaris placed a $4.4bn order for 44 A320neos/A321neos from Airbus in January 2012. This year it has signed a contract with a lessor for an additional 10 A320neos and six A321neos in 2016-2018. As a result of those deliveries and the A319 returns, Volaris expects to operate 86 aircraft in 2020.

Volaris is a classic ultra-low cost carrier (ULCC) and claims to have the lowest CASM among Latin America's publicly traded airlines. Its high efficiency levels are driven by point-to-point operations, a single fleet type, single-class operation, high-density seating, productive workforce and other factors. The pricing strategy is Ryanair/Spirit-style, with extremely low base fares and optional products and services available for additional fees. The base fares are priced to stimulate the market and compete with long-distance bus fares. The airline regularly offers "bus switching initiatives".

Volaris targets VFR, leisure and cost-conscious business travellers in Mexico and selected Mexico-US markets. Because of its ultra-low costs, the carrier is extremely bullish about its growth prospects and has continued to expand aggressively. After last year's 17.9% growth, ASMs in January-August 2014 were up by 12.4%. The network now includes 120-plus routes connecting 35 cities in Mexico and 15 in the US.

The key post-IPO network developments include, first, building Monterrey as the carrier's fifth base (after Cancun, Guadalajara, Mexico City and Tijuana). Volaris increased its destinations from Monterrey from three to 11 earlier this year.

Second, Volaris' international growth has been especially strong: passenger numbers were up 26% year-over-year in July, compared to the sector's 9.7% increase. The airline has added major US gateways such as Phoenix, San Antonio, Chicago and Denver to its network. This autumn is seeing new services linking Guadalajara with Portland and Orlando, Tijuana with Oakland, Monterrey with JFK and Cancun with Las Vegas.

Volaris has tried to counter the weaker demand and revenue environment by enforcing tighter cost discipline. It has succeeded in reducing total CASM and keeping ex-fuel CASM flat since 2012. One interesting measure has been to further increase the seating density on the A320s from 174 to 179. The fleet transition from the A319s to the larger A320s is also helping keep unit costs in check.

Volaris has also taken action to develop ancillary revenues. Late last year it amended its baggage policy and introduced on-board sales of food, beverages and products. As a result, its non-ticket revenue per passenger grew by 46% to $21 in the second quarter.

Interjet: Mexico's upmarket LCC

Interjet has sought to differentiate itself as a more upmarket, JetBlue-style LCC, one that provides "quality service at an affordable price". It offers a generous 34-inch seat pitch and imposes no extra charges for luggage or other items.

The Toluca-based carrier was the largest beneficiary of Mexicana's shutdown domestically and now operates an extensive 38-point network in Mexico. But it only went international in July 2011 and currently operates to Guatemala, Havana, Costa Rica, Bogotá and four US cities. Interjet began codesharing with Iberia in July and will be launching its fifth US route, Monterrey-Houston, in late October.

Interjet's current fleet consists of 42 A320s and eight Superjet SSJ100s. It achieved fame by becoming the SSJ100's first operator in the Americas in September 2013. The 93-seat SSJ100s are deployed on medium-density domestic routes and on some US routes.

Interjet has ordered about $4.2bn of new aircraft since 2010. Its outstanding firm orders include 40 A320neos and 12 SSJ100s. The SSJ100 deliveries will be completed by year-end 2015 (assuming that those deliveries will not be affected by the US, EU or Russian sanctions).

Interjet has been taking on debt to fund aircraft, and has also secured ECA financing for at least some of the SSJ100s. In 2011 Interjet had to pull its IPO when market conditions deteriorated. Since then its owners have repeatedly indicated that they would rather wait for truly robust market conditions in order to get a good price.

VivaAerobus: Big US push this autumn

The smallest of the three, VivaAerobus calls itself "Mexico's ultra-low cost carrier" and a "pioneer in Mexico of the bus-to-air model". A joint venture between Mexico's leading bus company IAMSA and Ryanair family investment vehicle Irelandia (each holding 46.1%), the carrier has a Ryanair-style no-frills business model and claims to enjoy the lowest cost per seat on the entire continent.

The Monterrey-based carrier has grown at a slower pace than its Mexican peers and has made many strategy changes. It currently operates about 49 domestic routes, which are typically secondary markets that bypass Mexico City. The leadership has stated that the carrier hopes to grow

its domestic market share from the current 13.2% (July) to 20-25% by 2021.

VivaAerobus has a miniscule 0.8% international market share because it currently serves only one destination outside Mexico (Houston), having earlier pulled out of several US markets that it had added in 2011.

In late 2013 VivaAerobus indicated that it was evaluating 20-25 markets in Central and South America in view or launching service to some of those points in late 2014. But none of that has materialised. Instead, the carrier will be staging a strong return to the US markets this autumn. It is returning to San Antonio and Las Vegas (both from Monterrey) and adding two more routes to Houston (from Guadalajara and Cancun) in November-December. It has also applied to start service to Dallas Fort Worth in December from as many as four cities in Mexico.

In a fleet strategy switch a year ago, VivaAerobus opted to replace its used 737-300s with new A320s. It placed a $5.1bn order for 52 A320s (including 40 A320neos and 12 A320ceos) plus 40 neo options in October 2013, thus joining its Mexican LCC peers as an Airbus customer. The transaction was hailed as the largest order Airbus had ever received from a single airline in Latin America.

This autumn's US expansion is possible because VivaAerobus has already begun receiving the A320s, which have 22% more seats than the 737-300s (180 versus 148). The first two A320s entered commercial service in April and the carrier expects to have received five by year-end.

As of August 18, the number of 737s in the fleet had whittled down from the original 19 to 15, and the carrier had received four A320s. The fleet transition will be completed by 2016, while the firm A320neo deliveries will continue through 2021. One of the key objectives with the fleet transition is to widen the cost-per-seat advantage that VivaAerobus already claims to possess.

The initial A320s appear to have come from lessors. However, when the Airbus order was announced VivaAerobus CEO Juan Carlos Zuazua said that the "optimum mix" for the total order would be 60% purchased/40% leased.

VivaAerobus actually filed for an IPO in Mexico in January 2014, hoping to raise up to 2.8bn pesos ($208m), but those plans had to be shelved in February due to volatile market conditions. Recently there were reports that VivaAerobus was again ready to proceed with an IPO and was just waiting for the right market conditions.

According to the early-2014 IPO filings, VivaAerobus generated a 203m pesos ($15.1m) operating profit on revenues of 2.87bn ($213m) in January-September 2013 – an operating margin of 7.1%. Interestingly, the company sought to benefit from the Ryanair connection, in that the prospectus boasted that the other Irelandia-backed LCCs had generated average returns of 22% following their IPOs.

By Heini Nuutinen
hnuutinen@nyct.net

Aviation Strategy

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