IAG: BA surging ahead, dragging Iberia with it

INTERNATIONAL Airlines Group’s annual capital markets day in the middle of November presented mostly positive comments and, unlike other recent announcements from the other European airlines, contained no overt or veiled profit warnings. The group increased its headline target for operating profits in 2015 by over 10% to €1.8bn although the underlying target of achieving a 12% return on capital remains unchanged.

This upgrade in the group’s targets come mainly from a strong performance by the British Airways operating unit in the current year and the impact of the acquisition of Vueling. The group implicitly expects that the improvement in margins seen this year at BA will continue through the next two years: the group increased its estimate for BA’s operating profit in 2015 from £1.1bn to £1.3bn (with an expected profit this year of £700m). It has also added a contribution to arise from growth at and Vueling. In contrast, while saying that the Iberia restructuring plan is on track, it has in effect forecast a lower operating performance from the Spanish flag-carrier by 2015 than it had proposed in last year’s capital markets presentation.
The group’s financial targets have not really changed. It is aiming to have a business model that can sustain organic growth levels (excluding Vueling) of 2-3% a year, and which provide returns to shareholders (with luck and a following wind) in excess of cost of capital. It appears to be expecting operating profits of €740m in the current year, so to reach its target will need to improve earnings by €1.1bn in the next two years.

There are four main planks to the strategic financial plan over the next two years:

- “Transform Spain” to bring Iberia back into profit and a sustainable growth path;
- “Transform London” to improve performance at BA through sustainable increased unit revenue performance;
- Extract further synergies from the combined group; and
- Allow for growth potential at BA and Vueling.

Each of the first two planks are expected to generate improvements in operating profits of around €400m (each postulated with €100-€150m upside potential). The group once again has increased its estimate of future synergies arising from the merger of BA and IB and suggests that now it may achieve additional revenue benefits and cost reductions of around €190m over the next two years. On top of this it is allocating around €200m from growth at both BA and Vueling. If that upside potential at BA and IB were realised the target for 2015 could easily reach a €2bn operating profit.

Synergies – new target €600m net EBIT impact

When the BA/IB merger was first announced the companies estimated combined synergies of €400m by 2015. Last year at this time the group estimated the figure at €560m and now has upgraded it to €650m with a net operating impact of €600m. Roughly half of the synergy contribution comes from reduced costs and the other half from improved revenues. Of course the management’s statement of synergies can never be confirmed independently from published accounts, but the group does state that in 2013:

- Net additional revenues reached €66m and cost reductions touched €56m giving an annual benefit of €122m;
IAG Fleet Plans

<table>
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</table>

Source: IAG. † Change from 2012 plans.

- The group began outsourcing transactional functions;
- Sales outlets have now been integrated in 19 locations, with Portugal, Morocco, Israel and the Nordic countries integrated in 2013;
- Seven major European airport ground handling contracts have been renegotiated;
- 19 new code share routes (with Buenos Aires, Rio and Sao Paolo prominent performers) have been implemented, giving 58 total code share routes;
- A new long- and short-haul Group fleet order secured additional discounts from the manufacturers, in effect providing savings of €20m-€30m a year.

Fleet Plans

Last year the group announced its intention of reducing its total fleet from 380 units to 358 by the end of 2015, mostly through cutting back short haul operations at Iberia as part of its planned restructuring. The acquisition of Vueling added over 50 A320s to the group fleet and has radically changed the short haul growth prospect.

BA is gradually renewing its long haul fleet. It now has three A380s and four 787s in service with another six and eight respectively to be delivered in the next two years. These are replacing the ageing 747s and 767s, creating a modest increase in average long haul gauge. At the same time it is disposing of its 737 Classics (particularly at Gatwick) as more A320s are delivered.

Iberia continues to take on new A330s on lease (as an interim measure until the A350 comes on stream) gradually replacing the fuel-hungry A340s. Vueling has plans to expand its current fleet of 59 A320s to 100 in the next two years.

Overall, the group appears to be planning an average annual growth of 6.6% in capacity (in ASK terms) over the next two years (4.9% pa excluding Vueling). The 100 aircraft on order for delivery between 2016 and 2022 are primarily to secure fleet replacement; the additional 170 options over that period could generate long term growth of 5% a year in an upside case.

The group has adjusted the timing of its capital expenditure programme over the next few years, but has retained its plan of an average spend of €2bn a year. This neatly fits in with the group’s financial targets for 2015 of a 12% return on capital (just above its estimated 10% weighted average cost of capital); roughly two thirds of the spending is needed for replacement of existing equipment and one third to help generate long term growth of 3% a year. As a result of the acquisition of Vueling, it has slightly in-
increased its gearing targets: debt (including leases) of between 50-60% of total capital, with ratios of net debt and gross debt to EBITDA of three and four times respectively. It is also targeting investment grade for the individual airlines; this may be easier for BA to achieve than the other two.

Q3 Results

In the three months to end September 2013 group revenues were up 7% on the back of a 9% increase in passenger capacity and traffic. A 1% increase in passenger unit revenues was offset by a 14% drop in cargo and other revenues. In constant currency terms passenger unit revenues increased on a like-for-like basis by 7.4%, specifically reflecting the bounce back from a poor quarter for BA in the prior year period (the result of the London 2012 Summer Olympics, a negative €100m effect on revenues).

For the group, operating profits came in at €657m, hugely up from €17m in the previous year, and even 50% higher than the level achieved in the same period in 2011. For the full year IAG expects to be able to produce operating profits of €740m (still less than half of the level it needs to achieve to generate returns above the cost of capital). Mildly disturbingly, the group stated that it expected growth in 2014 to be driven by “volume” rather than revenue as BA launches new long haul routes and as a result of the continued expansion at Vueling.

BA – Transforming London

Heathrow looks as if it is returning to be the power house of prof- 

its for BA. Management stated that it is well ahead of its original plans for 2013 and has raised its targets for 2015 by £200m to aim for operating profits of £1.3bn (nearly twice this year’s expected result of £700m).

One of the main drivers behind this was the “transformational change” arising from the acquisition of bmi and its slug of slots at Heathrow. At a stroke this allowed BA to capture over 50% of the slot base, recover some short haul point-to-point and feed services which it had had to forego in previous years in favour of long haul, and allow it room to introduce new (and sometimes reintroduce old) long haul services. The company had originally estimated that the bmi integration would have had a mildly negative impact on the current year’s profitability with a first half loss of around £50m and a second half break even. It now estimates that it has actually had neutral effect in the first half of the year and in the second half will generate a contribution of more than £30m. In total, short haul revenues are some £120m better than anticipated.

The increase in the target for 2015 comes partly from the better than expected performance in 2013. The airline is expecting:

- Non fuel unit costs to fall by 1% in 2014 in constant exchange rates and be flat in 2015 generating an additional £70m net impact (although this depends on the final decision about the regulatory charging structure at Heathrow);
- Fleet replacement programme to generate £140m net savings (mostly fuel) as the new generation aircraft are delivered;
- Network and product: the company expects that it will be able to
retain and continue to gain additional unit revenue benefits with expectations of a 1-2% increase a year in terms of revenue per ASK – this could produce additional profit of £100-150m on short haul operations and £150-200m on long haul, £130m higher in total than the company had originally targeted;

- In 2015 it will consolidate all the T1 operations into T3 (following the bmi purchase, the airline is operating at three terminals at Heathrow), which will allow it to “unlock” the right aircraft on the right route and to improve customer service.

The company states that it has an overall aim of generating returns in excess of its 10% pre-tax cost of capital at each of the three London airports – Heathrow, Gatwick and London City – and for both long haul and short haul. It does not normally provide airport-level information in detail, so for outside observers success will be difficult to corroborate.

However, perhaps disturbingly, it appears that there will be a somewhat higher overall growth in BA’s capacity of 6% in 2014 compared with the average 2-3% medium term target and near flat growth this year. (This is somewhat similar to the growth plans at Lufthansa for next year – see Aviation Strategy October 2013). However, the company explained it almost rationally and the core network growth is seen at 2.8% – almost entirely long haul (see chart above).

On short haul operations BA did say that it expects to break even in the current year compared with a loss of £120m in 2012 and implied that it is aiming to generate profits in this sector of £150m within two years. It may be able to do this. Overall capacity growth in this sector is set to be up by only 0.5% in 2014. It is focusing on point to point services while maintaining the transfer rate at LHR and improving connection potentials at LGW (without emphasising that airport as a hub). It will be removing the last of the 737 Classics from the fleet in 2014 leaving a short haul fleet almost entirely consisting of A320s at LHR and LGW, and Embraers at LCY. At LCY, BA is now the largest operator, and is benefiting from the weak competition provided by financially challenged Air France affiliate CityJet.

**Joint Ventures**

As usual it is difficult getting precise figures on the performance of the joint ventures. On the Atlantic “Joint Business” with American, Iberia and Finnair, BA stated that in the three years since launch it had seen:

- Overall capacity up by 12.5% (or an average 4% pa);
- Revenue increase of 31.5% and unit revenue improvement of 17%;
- An improvement in premium market share of over three percentage points, and in premium load factor of nearly seven points;
- A one point increase in non-premium market share.

The company also highlighted that two of the new routes it will be operating next year (to San Diego and Austin, Texas) were only made possible because of the immunised joint venture with American.

There was little comment on its “Siberian JV” with JAL and Finnair except that it was generating revenue benefits especially in code shares through Narita and Haneda (although probably not hugely significant given the weakness of the yen). Management hinted that with LATAM plumping to join oneworld (TAM and LAN Columbia join the GBA in March 2014) there might be an opportunity to develop a JV on the South Atlantic. It still trying to find a partner in China.

Joint ventures are not necessarily immutable. After Qantas shifted allegiance to Emirates and dissolved the long established JV with BA on the Kangaroo route, BA stated that it had been able significantly to improve returns on the route: it cut capacity by 11% and saw unit revenues jump by 29%.

**Iberia – Transforming Spain**

The new Iberia CEO, Luis Gallego, gave a fairly convincing presentation on how he will transform the di-
The Iberia long haul product was recognised to be a bit “tired” with sub-standard business class and economy offering on long haul leading to a low overall customer satisfaction in comparison with major peers. At the beginning of 2013 the company started rolling out a new generation full-flat business class seat on long haul and significantly upgraded economy product including the new standard individual IFE on its new A330s. It has already seen a strong increase in customer satisfaction on the new aircraft and this new in-flight product will be fitted on the eight new A330s to and will be retrofitted on the 17 existing A340s.

The company is introducing some profound changes in revenue management. Iberia had some surprising procedures; last year were we told about a habit of emphasising loss-making short-haul to short-haul connections. This year we discover that they had had such a rigid approach to high season bookings that overall there was only a 5% differential between high and low season yields, while they also had far too many FFP redemption seats available on too many of the routes which normally have over 90% load factors. Changing the approach has resulted in positive unit revenue performance of 2.5% in Q2 2013 and 6% in the summer season.

One of the biggest changes is the introduction of a new brand identity and paint scheme – last changed in 1977. Naturally the brand launch comes with the usual marketing gobbledygook: “...represents our core values Afinidad, Empuje, Talento” and is designed to emphasise the

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**Aviation Strategy**

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nosaur of the Spanish flag carrier and achieve reasonable levels of profitability, even if it might not quite get there by 2015. At the capital markets day last year, Iberia had stated that its priority objectives were to stop operating cash burn by mid 2013, build a competitive cost base for the long term and to fund the transformation entirely from within its own resources.

Between 2008 and 2012 Iberia had seen its cash pile of €2.9bn shrink to €808m with losses over the period of €800m, fleet spending of €700m and early retirement package payments of €600m. With a return to a little better than break-even in the summer it might have been able to halt the cash outflow, but there is obviously a long way to go to turn the business around.

In 2013 the company drastically restructured its network operations. It cut some 17 short haul and four long haul routes from its network (along with 20 short haul and three long haul aircraft from its fleet). Route optimisation targeted unprofitable short haul routes with limited feed potential and the long haul routes that were unprofitable and had no strategic fit, resulting in an overall 15% reduction in capacity.

That was the easy bit. One of the big difficulties is dealing with the uncompetitive cost structure, employment levels and bloated legacy edifice. It is not necessarily that its unit costs are too high in comparison with peers – ex-fuel unit costs are in fact some 10% below peers on long haul and 15% below legacy peers on short haul – but being based at the bottom of an inbound tourist well it is competing on routes where the unit revenues are **significantly** lower. It is this gap between RASK and CASK that causes the damage.

Attempts to restructure the staffing levels and short haul operations have been fraught with legal restrictions. Iberia Express was launched two years ago designed to be a lower cost and more efficient short haul operator than the main line. This led to union action and a government-imposed arbitration procedure which generated a judicial resolution (“laudo”) that significantly limited Iberia Express’ activities. Iberia appealed against the judgement as well as a new laudo with similar restrictions. After the announcement of the new restructuring plan in 2012 and a lack of agreement with unions, Iberia unilaterally initiated collective dismissal procedures, which again led to strikes but this time a voluntary mediation agreement signed by the company and a majority of employees.

The mediation agreement did not quite go as far as Iberia wanted but allowed for over 3,000 redundancies (or 15% of the workforce); a 14% cut in salaries for pilots and cabin crew and a 7% reduction for ground staff; an additional 4% wage cut until productivity measures are agreed; salary and tenure freeze until 2015. So far the company has shed 2,300 out of 20,600 jobs (excluding some 130 natural wastage). It is currently in negotiations with the unions for long term agreements to obtain significant productivity improvements for the existing flight and cabin crew, introduce new salary scales and remove the imposed restrictions on Iberia Express.

**Commercial turnaround**

Just cutting costs will not be good enough and the company outlined some of the elements it has in place to try to transform the Iberia product, customer experience and revenue generation.

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Spanish nature of the brand. Iberia in part is using this as a catalyst (as BA itself has done in the past) to invigorate and change the corporate culture. It will be imposing a radical transformation in its management team: slimming down with a significant reduction in numbers and a new management style, simplification of the organisation structure with fewer reporting levels and a drive to recruit additional skills from outside the existing company.

**Vueling – emphasis on cost discipline**

Alex Cruz, CEO of Vueling, gave a presentation on the group’s newly acquired LCC. He emphasised the vision:

- **Cost discipline:** targeting unit costs ex fuel below €4c/ASK in the short run, with a continuing annual cost savings programme
- **Profitable growth:** with a current fleet of 70 A320s it has plans to expand to over 100 aircraft in 2015. It is increasingly focusing on non-Spanish markets and aims to expand market presence at key European airports. It helps to be market leader in Barcelona with a 36% share.
- **Product and innovation:** a hybrid LCC with “business-class” seating in the front four rows of the aircraft, preferring main airports (and avoiding direct competition with Ryanair) and providing multiple sales channels. With a strong O&D network in Barcelona, it also prides itself on operating a “profitable and sustainable model of transfer passengers” – with over 11% of the total passengers connecting between Vueling flights in 2013 (16% of the Barcelona traffic) – while not shying away from (profitable) interline and code share agreements.
- **Efficient operation:** Quick turnaround, high utilisation, single aircraft type, high punctuality. It states it achieves 90% customer recommendation levels.

Vueling is growing very strongly. It has doubled the size of its operation in the last five years and now operates 70 aircraft and carries 17m passengers (12m through Barcelona) on 222 routes connecting 107 destinations in Europe. It prides itself on having achieved an operating profit in each of the past five years (although profits fell from €2m per aircraft in 2009 to €0.5m per aircraft in 2012). This year it is expanding capacity and traffic by 25% year on year and has 62 A320s on order with 58 options. Despite its size and its hybrid business model it has an underlying ex fuel unit cost not too dissimilar from either easyJet or norwegian.

It is of course above Ryanair, which just announced new bases at Brussels Zaventem and Rome Fiumicino directly competing with Vueling.

One of the major benefits to Vueling from being within the IAG stable should be in cost of aircraft ownership. All its fleet is leased and, although no doubt arranged on the best terms it could achieve, the company should be able to use the holding Group’s balance sheet and negotiation power to reduce the net input cost.

**Outlook**

All the three major network groups in Europe are essentially pursuing the same strategy – to return to a reasonable level of profitability in 2015 that more than covers the cost of capital. Each needs to recover profitability on short haul operations which have seen severely negative results in the past few years. Each is pursuing similar methods, in particular trying to keep capacity growth low. There are some concerns that this “discipline” may slip a little for different reasons in 2014. IAG has one major benefit in comparison with either LHAG or Air France-KLM: BA’s base at London Heathrow with its vastly superior O&D point to point traffic base. The IAG team gave a convincingly encouraging view that the group will achieve its 2015 targets.
Etihad Airways: Carving out a distinct identity

THOUGH Etihad Airways only started operations in November 2003, just 10 years later the flag carrier of the Abu Dhabi is one of the “Big Three” airlines in the Gulf states – and it is differentiating from its rivals through a series of minority equity investments in airlines around the globe made over the last two years.

For the first three years of its existence Etihad’s growth was steady, if unspectacular, but the pace picked up from September 2006 when James Hogan was appointed chief executive and president. His strategy included what he calls a “forensic approach to cost control” alongside new aircraft orders for long-term growth and the creation of essentially a virtual global alliance through codeshares and minority equity stakes.

The results have been promising. Etihad recorded its first-ever full year profit in 2011, and in 2012 the airline posted revenue of $4.8bn, 17% up on 2011, with EBIT of $170m (a 24% increase on 2011) and a net profit of $42m (compared with a $14m net profit in 2011). Etihad carried 10.2m passengers in 2012, 23% up year-on-year.

In the first nine months of 2013 Etihad recorded revenue of $3.8bn, 9.3% up on January-September 2012, based on a 13% rise in passengers carried to 8.6m. (No profit figures are released in its quarterly reports). Cargo accounted for more than 17% of total revenue for Etihad in Q1-Q3 2013, with cargo tonnage handled rising by 30% year-on-year in the period. Etihad Cargo now handles around 90% of all air cargo coming to and from Abu Dhabi, and the Etihad freighter fleet comprises three A330-200Fs, three 777-200Fs and three 747Fs.

Etihad currently employs 16,258, with 12,614 of those in the passenger airline, of which 1,531 are pilots and 3,776 are flight attendants. The other 3,914 are employed in Etihad Airport Services, comprising Ground, Cargo and Catering positions.

Unsurprisingly aviation is a “critical cluster industry” in the Abu Dhabi Plan 2030 – the Emirate’s long-term plan for growth and economic diversification. Etihad is already a key contributor to the Abu Dhabi economy – its analysis shows that it contributed $10.7bn to Abu Dhabi’s GDP directly and indirectly in 2012, representing 10.5% of the non-oil GDP of the Emirate. Interestingly only around 20% of the 7,000 Etihad employees based in the Emirate are actually UAE nationals, which shows just how “international” the airline is. This year Etihad opened a new headquarters for the whole of Europe in Berlin, which followed the opening of its fourth global contact centre in 2012, in Manchester, which serves customers in 19 markets 24/7 with a staff of around 200. And as part of its efforts to target the AIT market, this year Etihad Holidays launched its first operation outside of the Middle East – in the UK, offering holidays in Abu Dhabi city, Saadiyat Island and Yas Island.

Today Etihad operates to 96 destinations directly (see chart left), in
62 countries across all continents in the world. In the first three-quarters of 2013 new routes were launched to Washington DC, Amsterdam, Sao Paolo, Belgrade, Sana’a (Yemen) and Ho Chi Minh City, with a route to Los Angeles set to launch in June 2014.

**Fleet growth**

Underpinning the organic growth in the network has been a huge aircraft order announced in July 2008 at Farnborough, when orders and options were made for more than 200 aircraft worth $43bn at list prices (100 firm orders, 55 options and 50 “purchase rights”).

At the end of the third quarter 2013 Etihad’s fleet stood at 83 aircraft – 50 of which are Airbus models and 33 Boeing aircraft (see table above) – and with an average age of 5.5 years. At the same date more than 80 aircraft were on firm order, including 41 787s, 15 A320 family aircraft, 12 A350s and 10 A380s. The A380s and 787s are scheduled for delivery from the end of 2014, and all those 80 aircraft are to be delivered by 2020, by when the fleet will have risen to at least 159 aircraft.

In October this year Etihad also signed a deal to buy five 777-200LRs from Air India for a price reported to be between $300m to $350m. The aircraft (of which less than 60 were manufactured) have an average age of six years and will be delivered to Etihad from the start of 2014, and after a refit to Etihad’s standard three-class cabin configuration the first aircraft will enter service in April 2014.

They will be used on Etihad’s new route between Abu Dhabi and Los Angeles, announced this October and which launches in June 2014. Etihad currently flies to New York, Chicago, Washington DC and Toronto in North America (with load factors of more than 80% it is believed), and it is keen to add further services to the continent, with Hogan predicting another route to the US will start before the end of 2014. Etihad’s ambitions for the US are being helped by the US government’s agreement to launch “pre-clearance customs facility” in Abu Dhabi from this December. Elsewhere new routes to India, Europe and south-east Asia are expected to be launched through 2014, with a raft of new services inevitable once the new 787s and A380s start arriving.

For the period post 2020 Etihad (at the Dubai air show in November) announced two additional orders: one for 30 787-10s, 17 777-9Xs, eight 777-8Xs and a single 777F, plus purchase rights for another 26 Boeing aircraft; and one for 50 A350 XWBs, 36 A320neos and one A330-200F. These orders for 143 new aircraft bring Etihad’s total order book to a staggering 224.

Etihad’s global operations are centred on its hub at Abu Dhabi (the capital of the UAE), which though it has to compete with Emirates’ hub at Dubai and Qatar’s at Doha is still a large facility by world standards. Abu Dhabi International Airport opened a second runway in 2008, followed by a new Terminal 3 in 2009, which is exclusively used by Etihad. These developments increased the airport’s capacity from five to 12m passengers a year, but further expansion is planned.

A “Midfield Terminal Complex” (so-called because it’s located between the two existing runways) will have around 1.4m square metres and is due to be completed in the third quarter of 2017 at a cost of $3bn, and which will increase the airport’s capacity to more than 30m passengers a year initially and up to 40m passengers in future years after further expansion.

Nevertheless, Etihad is clearly smaller (and younger) than its key Gulf rivals – Emirates carried 39.4m passengers in the 12 months to March 2013 and Qatar carried 18m in the same period, compared with Etihad’s 10.2m passengers in 2012.
Clear blue water

Yet Etihad is undaunted by its two larger Gulf rivals, and under Hogan Etihad is attempting to put some clear blue water between it and Emirates and Qatar strategically. There are already some key differences. Unlike Emirates’ entirely widebody fleet, almost a third of Etihad’s non-cargo aircraft are narrowbodies, which creates feed into long-haul routes out of Abu Dhabi – though the proportion of narrowbodies is not as high as at Qatar Airways (where 37% of its passenger aircraft are narrowbodies).

However, there are other differences between Etihad and Qatar – most notably being that unlike Qatar, which has just joined oneworld, Etihad is pursuing global reach through a wide and expanding series of minority airline investments.

Since late 2011 Etihad has steadily built a portfolio of investments in others airlines, which include:

➔ A 29.2% stake in airberlin, bought in December 2011 for an initial investment of $105m. At a further cost of $200m in equity and debt financing Etihad also has a 70% share in a new joint venture that controls airberlin’s FFP scheme, called topbonus, with airberlin owning the other 30%.

➔ A 40% stake in Air Seychelles, acquired in January 2012 for $20m and shareholders’ loan of $25m, and accompanied by a five-year management contract.

➔ A 3% stake in Aer Lingus, bought in May 2012, which Etihad says is “with the intention of forging a commercial partnership with the Irish national carrier”.

➔ In August 2013 Etihad started a five-year management contract of Air Serbia (the former JAT Airways), as part of a deal with the Serbian government to acquire 49% of the airline in January 2014.

➔ In October this year Etihad increased its stake in Virgin Australia from 10.5% to 19.9%, which is the maximum allowed by Australia’s Foreign Investment Review Board that convened in June 2013. Etihad and Virgin Australia signed a 10-year strategic partnership in August which includes codesharing, joint sales and marketing FFP links. Currently Etihad (25) and Virgin Australia (3) operate 28 flights a week between Abu Dhabi and Australia.

➔ In November this year Etihad announced the acquisition of a 33% stake in Swiss regional airline Darwin Airline based in Lugano, which it said would be the first carrier to be re-branded as Etihad Regional, to be used to “join the dots” for it and its partners in Europe and to connect tertiary cities.

Combined, these six investments give Etihad stakes in airlines with 430 aircraft operating to 412 destinations and carrying more than 45m passengers a year.

Etihad also has 185 interline and 46 codeshare deals with airlines round the world (in the third quarter of 2013 codeshares were agreed with South African Airways, Air Canada, Belavia and Korean Air), which Etihad says provide access to more passengers and cargo destinations than any other airline in the Middle East.

Indian opportunity

Etihad has also agreed a deal to buy 24% of India’s Jet Airways for around $380m, though this is subject to regulatory approval from the Competition Commission of India. This tie-up initially appears more risky than anything Etihad has done before – Jet has made a loss for the last six years and reported a record net loss of $145m in the third quarter of 2013. Additionally the Indian aviation industry is going through a troubled period at the moment, with all four of its listed airlines reporting losses or (in the case of Kingfisher Airlines) suspending operations. Etihad is also reportedly investing another $150m in Jet’s FFP, $70m for a sale and leaseback deal for three pairs of Heathrow slots, and as much as $150m of loans to shore up the Jet balance sheet. And in order to turn Jet Airways around and make a significant contribution to Etihad’s bottom line the UAE carrier will have to devote considerable management time to its Indian investment – Indian sources say that Etihad has promised that four of its most senior executives will take positions at Jet, including Willy Boulter, VP commercial strategy and planning, and Rangesh Embir, VP finance.

However, it’s no coincidence that Qatar Airways is also reportedly in negotiations to buy a minority stake in SpiceJet, the Indian LCC, because an opportunity for Gulf airlines to become involved in the Indian market has appeared thanks to the Indian government’s decision to allow foreign airlines to acquire up to 49% stakes in its carriers combined with a new air services agreement between India and the UAE that was finally approved in September – a deal that increases seats between the two regions nearly four-fold to 50,000 a week over a period of time.

It’s an opportunity that Etihad and others are keen to exploit given the huge economic links between the regions. According to the Indian ministry for commerce and industry, bilateral trade between India and the
UAE alone is estimated to be worth more than $75bn in 2013 – a staggering figure, and undoubtedly the factor behind a raft of new UAE investments in India, including property, port facilities, hospitals and – now – airlines.

Hogan says that Etihad’s equity partnership strategy is primarily driven by that effect it has on the bottom line: “Our equity partners provide significant contributions to our business and not just in terms of the revenues they deliver. The agreements provide us with greater economies of scale, increased purchasing power and the ability to leverage synergies. We have enjoyed cooperation on fleet orders, deliveries and management, as well as joint purchasing in areas ranging from fuel to insurance to in-flight catering and equipment. It’s about working smarter to deliver lower unit costs.”

The strategy appears to be working. In the third quarter of 2013 Etihad says that revenue from code-share and equity alliance partners totalled $247m – 36% higher than July to September 2012 – and representing a substantial 23% of all passenger revenue at Etihad in the quarter.

Hogan adds that “it’s easier, faster, and far more cost effective for Etihad to grow through one-on-one partnerships with established, respected, carriers than to rely on its own resources and to start from scratch in every market”, and Etihad is clearly on the look-out for other equity investments, though Hogan insists the “equity model will continue to be about growth, not control”.

What is the real strategy?

The sceptical view is that the development of minority equity stake investments looks increasingly like the Swissair “Hunter” strategy of the late 1990s. Speaking at the GAD conference in Nice at the beginning of November, Hogan denied this, emphasising that the aim is to build a strategy to drive traffic over the hub in Abu Dhabi to give a network that is competitive with and differentiated from his neighbouring Gulf competitors.

In addition, Etihad is not taking management control, even were it allowed, but adding management team expertise and board level representation hoping to strengthen the existing management’s ability to generate returns. Ultimately perhaps the decisions on investments reflect Etihad’s own shareholder’s interests, including a diversified long-term use of its oil revenues.
American-US Airways merger: Can it deliver promised benefits?

After a four-month delay caused by the DoJ’s antitrust lawsuit, American and US Airways expect to close their merger on December 9th, enabling AMR to emerge from Chapter 11 and creating the world’s largest carrier. The new company, to be known as American Airlines Group, will trade on the Nasdaq under the symbol “AAL”.

The final legal hurdles were cleared on November 27th, when the bankruptcy court handling AMR’s Chapter 11 case approved the November 12th agreement between AMR, US Airways and the DoJ to settle the DoJ’s August lawsuit that had sought to block the merger. The court also ruled that the merger may be consummated despite a pending private antitrust lawsuit from a group of consumers.

The DoJ settlement came about after considerable pressure from many quarters (labour, business leaders, etc), the Texas Attorney General dropping out of the DoJ lawsuit on October 1 and with the trial date approaching (November 25). By all counts, it was a reasonable settlement, and all parties seemingly walked away happy.

The DoJ secured what can only be described as unprecedented slot divestitures. American and US Airways agreed to divest 52 daily slot pairs at Washington Reagan National (DCA) and 17 slot pairs at New York LaGuardia (LGA), as well as two gates and related facilities at each of Boston Logan, Chicago O’Hare, Dallas Love Field, Los Angeles and Miami (slots only exist at four US Northeast airports). The divestitures will be made available to LCCs after the merger closes through a DoJ-approved bidding and sale process. The slot divestitures will mean a 15.2% reduction in the two airlines’ combined daily round trips at DCA (from 290 to 246, excluding eight slot pairs currently leased to JetBlue) and a 7% reduction at LGA (from 175 to 163, excluding five slot pairs already leased to Southwest).

By comparison, United and Continental got away with having to give up only 18 slot pairs at Newark, where the DoJ had similar concerns about competition. United was left holding 75% of the slots at Newark, whereas after the divestitures the new American will account for 57% of the slots at DCA – only marginally more than the 55% share currently held by US Airways.

Therefore the DoJ felt that it achieved its key objective of securing LCCs significantly improved access to capacity-constrained airports – something that has to be good for competition and consumers in the long run.

When the DoJ filed its lawsuit in August, many were puzzled by that decision because it seemed like the rules were being changed in the middle of the game. But the reason is becoming clear. According to antitrust lawyers, before the lawsuit AMR and US Airways were prepared to give up nothing. So, the DoJ has succeeded in “extracting changes from an industry that had come to expect that its mergers would never be challenged” (as a Reuters article put it).

But American and US Airways now feel that, in the great scheme of things, the divestitures are a relatively small price to pay. Their business plan was based on 6,700 daily departures in 50-plus countries and did not rise or fall on a divestiture of 112 daily departures or a 15% reduction in service at one airport. Besides, the new American is retaining its dominant position at DCA.

The airlines have agreed separately with the DOT to continue to
use all of their current DCA commuter slots for service to small and medium-sized communities. Analysts do not consider that an onerous commitment because most of those operations are believed to be profitable.

The other so-called concessions made by American and US Airways were mostly political gestures (to the states that had joined the DoJ lawsuit) that have little impact on the bottom line. The airlines have agreed to maintain their primary hubs “consistent with historical operations” for three years (something they wanted to do anyway) and maintain daily service in a number of markets for five years.

All in all, the settlement is expected to have no material impact on pro forma earnings or the merger synergies. The new American is still expected to generate the originally estimated $1bn-plus in annual net synergies beginning in 2015.

Industry implications

There is a strong and broad consensus that the DoJ settlement and the AMR-US Airways merger generally will be beneficial for the US airline industry, the US economy and many local communities.

However, long-term consumer benefits in the US domestic market are uncertain, and obviously not every LCC will benefit – the reasons why the consumer lobby and carriers such as Virgin America are not celebrating.

The main benefit of the AMR-US Airways merger is that it will lead to the US having three powerful global carriers of roughly equal size. American’s pilot union APA put it very aptly: “The merger will remedy American’s longstanding network shortfalls and put American on equal footing with Delta and United.”

While Delta and United will face a stronger competitor, that will be more than outweighed by the benefits of having fewer domestic players and hence more rational industry capacity and pricing.

Largely because of the earlier mergers and Chapter 11 restructurings, the past five years have seen very healthy trends in the US airline industry: tight capacity, rational pricing, higher yields, vastly improved profitability and ROIC goals being increasingly achieved. Even though the AMR-US Airways merger is not expected to lead to a significant reduction in domestic capacity (because of the complementary networks), it should help maintain capacity discipline. The financial community sees AMR-US Airways as the final major component in achieving what Fitch has described as a “more sustainable industry structure”.

US LCCs will benefit from both a more rational domestic capacity environment and the growth opportunities resulting from the divestitures and the new American’s likely exit from some smaller markets as the network rationalisation gets under way.

The biggest beneficiaries of the divestitures are likely to be the two largest LCCs, JetBlue and Southwest. JetBlue, which has been building service at both DCA and LGA, issued a press release saying that it applauded the DoJ settlement and was “eager” to increase service especially at those two airports. Southwest has a history of bidding aggressively for slots, and CEO Gary Kelly said recently that the carrier was “absolutely” interested in more slots at DCA and LGA.

Spirit Airlines can also be expected to bid for slots, especially at LGA. Allegiant has said that it would consider any opportunities, but there are no obvious ones here for a carrier with a niche business model that focuses on smaller cities. And sadly, there may not be anything much there for Virgin America, which has in the past found it tough to secure access to busy airports such as JFK, O’Hare and Newark.

Virgin America actually went public with its opposition to the AMR-US Airways merger just one day before the DoJ settlement was announced. The carrier had just won permission to present its case to the November 25 court hearing. It had planned to argue that the merger would solidify already considerable
impediments to new entrants and that any settlement focusing on DCA and LGA slot divestitures would be inadequate. Virgin America is unlikely to be interested in LGA because of the perimeter rules prohibiting flights to Los Angeles and San Francisco. It remains to be seen if it is interested in any of the gates that will become available at Logan, O’Hare, Love Field, LAX and Miami.

**Uncertain consumer benefits**

US consumer organisations have never liked this merger because they (correctly) note that a reduction in the number of airlines tends to lead to higher fares. A May 2013 study by the Boyd Group found that the average true price of a one-way ticket in the US has increased by 30% since 2008.

From the consumer viewpoint, one problem in the US has been that the two largest LCCs, Southwest and JetBlue, have begun to behave too rationally. They have stopped or dramatically slowed growth, stopped aggressive discounting and begun courting higher-yield traffic, with the aim of maintaining healthy profitability and maximising shareholder returns.

Then again, having a healthy and profitable airline industry, including a sizable and diverse LCC sector, is also good for the consumer in the longer run. There are plenty of airlines left in the US to ensure robust competition.

But the slot and gate divestitures, while impressive compared to previous mergers, are unlikely to “dramatically enhance the ability of low-cost carriers to compete systemwide”, as the DoJ’s Antitrust division suggested.

Impact on competition and fares will depend on the market. Analysts have made the point that since LCCs tend to focus on large leisure-oriented markets, the DCA and LGA slot divestitures may end up benefiting travellers on routes such as Orlando but ultimately reduce the level of service to smaller cities and even larger ones such as Raleigh/Durham and Minneapolis.

Delta has cleverly put itself forward as a remedy for such service shifts, arguing that it should be allowed to bid for slots especially at DCA, because it could ensure continuation of nonstop flights to small and mid-sized cities. The argument has some merit, but the DoJ is expected to rule that only LCCs are eligible to bid.

**AMR’s financial turnaround**

After incurring adjusted net losses totalling $11.2bn in 2001-2012, including a $1.1bn loss in 2011 and a $130m loss in 2012, and having been in Chapter 11 since November 2011, AMR has at last staged a financial turnaround this year.

The latest quarterly results suggest that AMR is now in great shape. Its 3Q13 net profit was $289m, contrasted with $238m net loss in 3Q12. The $530m adjusted net profit was a new quarterly record. Operating margin was an excellent 10.4% – not in Delta’s league (15.9%) and lower than US Airways’ (12.1%), but easily beating UAL’s 7%.

The turnaround has been driven by the restructuring efforts. Labour costs fell by 13.3% year-on-year. Mainline ex-fuel CASM was down by 5.4% – the fifth consecutive quarter of unit cost reduction. AMR also enjoyed “solid revenue momentum”. Its transatlantic RASM rose by 11.4%, which the airline attributed to the success of its joint business with BA, Iberia and Finnair.

In the past two quarters AMR raised almost $2bn in new term loans and $1.4bn through a private EETC offering (the latter to refinance debt) – all at very low interest rates. As a result, its cash reserves rose to $7.7bn (31% of last year’s revenues) and its interest expenses will be reduced.

AMR anticipates further profit margin improvements from renegotiated vendor and supplier contracts and through a better matching of aircraft size to demand with the deployment of A319s and two-class RJs, beginning in 3Q.

AMR’s Chapter 11 has seen continued active fleet renewal. The mainline operation is taking A319s, 737-800s and 777-300ERs and retiring 757-200s and MD-80s. This year will see 59 new aircraft added to the year-end 2012 mainline fleet of 608, but because of retirements the fleet will grow by only nine units (to 617).

AMR will now be reporting healthy profits for 2013. BofA Merrill Lynch’s mid-October prediction was operating and ex-item net profits of $1.5bn and $919m and an operating margin of 6%. Significantly, AMR will be making an employee profit-sharing payment for 2013 – its first in 13 years.

But it remains to be seen if and how quickly the new American will be able to close the margin gap with Delta and deliver the promised “significant value” to shareholders.

On the positive side, having secured unusually strong support from labour bodes well for labour integration. JP Morgan analysts also suggested recently that the decision to migrate IT “upwards” to AMR’s more robust systems (contrasting with UAL-Continental’s strategy) could “alleviate some of the technology hurdles”. Labour and IT
integration have been the toughest nuts to crack in recent mergers.

On the negative side, S&P suggested on November 12 that the main risk associated with the AMR-US Airways merger is that the increase in labour costs under new contracts will come in higher than the management currently foresees. US Airways has below-market labour costs and continues to experience labour strife.

There may also be a problem that the combined AMR-US Airways network, although very large, “will not be quite as strong as those created by the United-Continental and Delta-Northwest mergers” (as S&P put it).

In the first three quarters of 2013 Norwegian saw revenue rise by 21% year-on-year to NOK 11.8bn (€1.5bn), based on a 16% rise in passengers carried to 15.5m; ASKs rose by 29%, slightly behind a 30% increase in RPKs, with load factor falling marginally from 79% to 78.5%. In the 1Q-3Q 2013 period EBIT reached NOK 1.2bn/€151m (compared with NOK 455m in 1Q-3Q 2012), and the net profit totalled NOK 516m (€67m), 19% up year-on-year.

Rapid growth of Norwegian

Norwegian Air Shuttle: Long-haul a risk worth taking?

AFTER placing Europe’s largest ever single aircraft order in 2012, Norwegian Air Shuttle has firmly established itself as Europe’s third-largest LCC. But is Norwegian taking a huge risk by launching long-haul routes this year as it chases ambitious long-haul expansion around the globe?

Norwegian Air Shuttle was launched in 1993 by former employees of Fornebu-based Busy Bee, which operated Fokker F50s on domestic Norwegian routes on behalf of Braathens until it went bankrupt in 1992. Norwegian took over a small number of F50s and continued to operate the routes for Braathens, but after SAS bought Braathens in 2001 the contract with Norwegian was terminated, and the airline relaunched itself as a LCC in April 2002.

Based at Oslo Airport, Norwegian steadily developed its fleet away from reliance on F50s, but it wasn’t until the early 2000s that expansion truly kicked in, with a listing on the Oslo stock exchange in 2003, a first profit being recorded in 2005 and Swedish LCC FlyNordic being bought from Finnair in 2007.

The airline has benefitted by the relative strength of Scandinavian economies compared with the rest of Europe over the recent recessionary years. in the first three quarters of 2013 Norwegian saw revenue rise by 21% year-on-year to NOK 11.8bn (€1.5bn), based on a 16% rise in passengers carried to 15.5m; ASKs rose by 29%, slightly behind a 30% increase in RPKs, with load factor falling marginally from 79% to 78.5%. In the 1Q-3Q 2013 period EBIT reached NOK 1.2bn/€151m (compared with NOK 455m in 1Q-3Q 2012), and the net profit totalled NOK 516m (€67m), 19% up year-on-year.

LCC model

Norwegian runs a classic LCC business model: a single class (in short-haul at least); internet bookings accounting for 80% of all bookings in the first three-quarters of 2013; and with ancillary revenue (mostly from baggage and allocated seating fees) contributing 11% of all revenue in the third quarter of 2013 (equivalent to NOK 90 – €11.8 – per scheduled passenger) – though this is still short of a targeted proportion of 15%.

Norwegian currently operates more than 400 scheduled routes to 124 destinations in 38 countries. Revenue from international traffic
accounted for 78% of all revenue in the third quarter, and this rose 21% compared with the same quarter in 2012 – whereas domestic revenue was almost flat year-on-year. That’s largely the result of a clear focus in international expansion at the airline, with new bases, destinations and markets being added over the last 12 months, and partly because Norwegian has already built up a dominant position in the domestic Norwegian market.

Whereas in 2002 SAS was essentially the only option for routes within Norway, by 2011 (the last year for which data is available) Norwegian Air Shuttle carried 45% of domestic passengers to/from Oslo in 2011, ahead of SAS. However, there is an interesting sub-plot to domestic competition in Norway. Norwegian Air Shuttle only agreed to launch domestic Norwegian services from 2002 if the government prohibited frequent flier programmes on those routes, which Norwegian argued would prevent former SAS customers from flying with a new rival. The Norwegian government therefore banned SAS from offering its FFP on domestic flights – but earlier this year SAS launched a challenge to this ruling by offering its EuroBonus frequent-flier program to domestic Norwegian flyers, arguing that robust competition between SAS, Norwegian Air Shuttle and others meant that the prohibition of FFPs was no longer necessary. Norwegian Air Shuttle responded by saying SAS’s move “looks like a blatant violation of the law”, but after an investigation by the Norwegian Competition Authority the ban on domestic FFPs was formally lifted in May.

Norwegian has been steadily strengthening its market share at the three major Nordic airports – in the third quarter of 2013 its market share (in terms of all passengers carried) at Oslo was 39% (compared with a 29% in Q3 2008), at Stockholm 23% (10% in Q3 2008) and at Copenhagen 17% (2% in Q3 2008). Added to this are increasingly significant shares at other airports – outside the Nordic countries Norwegian operates bases at London Gatwick, Malaga, Alicante and Las Palmas and, since October this year, at Tenerife. A fifth Spanish base will open at Madrid Barajas in the summer of 2014, with two 737-800s stationed there to service six new routes, and which will entail the hiring of 100 pilots and cabin crew locally.

At the three established Spanish bases – Alicante, Las Palmas and Alcante – Norwegian had a 6% share in Q3 2013 (compared with 2% in Q3 2008) while at London Gatwick it had a 6% share in the third quarter of 2013 (after only launching a base there in the spring of 2013). At Gatwick passengers carried by Norwegian grew by 243,000 in the third quarter of 2013, accounting for almost 90% of total passenger growth at the airport in the July to September period. Unsurprisingly, Norwegian is a key advocate of the construction of a second runway at Gatwick.

Fleet growth

Norwegian currently operates a fleet of 80 aircraft (with an average age of 4.6 months) – 10 737-300s, 68 737-800s and two 787-8s, with an additional two A340-300s wet leased from Portuguese leasing company HiFly.

The airline gave notice of its extraordinary ambitions in January 2012 when it placed an order for 222 aircraft, comprising 22 737-800s, 100 737 MAX8s and 100 A320neos. Currently there are 264 aircraft on firm order – the 100 A320neos (being delivered from 2016 onwards), the 100 737 MAX8s (arriving from 2017), 61 737-800s and three 787s.

The current fleet plan sees 84 aircraft by the end of this year, rising to 95 at end 2014 and 102 in 2015. By the 2015 year end the fleet will comprise five owned 737-300s; 89 737-800s (of which 51 will be owned, 13 sold and leased-back, and 25 leased); and eight 787s (three owned and five leased).

Of the 737 fleet, the -800s are most usually allocated to longer routes to North Africa, the Canary Islands and North Africa, and on shorter, high-density routes in Europe. The 737 MAX is an interesting choice for Norwegian: it is more fuel efficient than the 737-800 (of which, for example, Ryanair ordered 175 in June), so Norwegian is in effect betting that the price of fuel will remain high so that the airline can fully exploit the better economics of the MAX.

Norwegian is well aware that it may face stiffer competition in the future from its fellow LCCs. Earlier this year Ryanair stated it was specifically targeting northern Europe for network expansion and indeed this winter launched routes between Stockholm, Oslo and Karlstad to the Canary Islands.

Long-haul ambitions

On long-haul, the first two (leased) aircraft from a total of eight incoming 787s (five to be leased from ILFC and three owned) have already arrived at Norwegian (the first aircraft came in June), with one more (the first of the owned aircraft, coming direct from Boeing) due...
Those 787s are eagerly anticipated by Norwegian as a delay in their delivery forced the airline to lease A340s-300s for the first long-haul routes, which began in May this year from Oslo and Stockholm to New York City and Bangkok. Routes from Oslo, Stockholm and Copenhagen to Fort Lauderdale will launch in November 2013, and a whole raft of services from the Nordics will launch through 2014 as the 787s arrive, including to the new destinations of Oakland, Los Angeles and Orlando from the spring of 2014. Long-haul services to North America will also begin from London Gatwick in the summer of next year.

However, it’s clear that the leased A340s are making the initial long-haul routes substantially loss-making for Norwegian, with Bjørn Kjos, the CEO of Norwegian (and a former Norwegian air force pilot) admitting that “before the 787 we could not add up the figures to get a low enough cost and sufficient margin against legacy carriers”.

Indeed, results in the third quarter of this year were affected significantly by the need to wet-lease those replacement aircraft, which cost NOK 101m (£12.7m) in those three months and thus was a major cause of a 31% fall in Norwegian’s net profit to NOK 436m (£54.9m) in the third quarter, despite a 15% rise in revenue. Incidentally the other factor affecting the 3rd quarter results was warm summer weather in northern Europe, which hit holidays to the Mediterranean region.

Put another way, according to Norwegian the leased aircraft have a 50% higher fuel consumption per seat than the 787, and as the 787s arrive they will save Norwegian NOK 80m (£10.1m) per aircraft per year (compared with a leased A340). Ironically Norwegian had to ground both of its first two 787s briefly in September and October to sort out some technical “glitches”, which have afflicted 787s, but management considers this to be a minor setback only.

The incoming 787s are configured with 32 seats in Premium Economy and 259 in Economy and are a major factor in the significant 40% increase in capacity planned for 2014, along with larger 737s and increased sector lengths on short-haul. Average sector length for Norwegian as a whole is currently 1,260km, which is a significant rise on the average 1,048km length it had for the whole of 2012.

For long-haul the strategy is a three phase plan – the first is expansion of Scandinavia to North America services, to be followed by the addition of services from London Gatwick next summer. Those Gatwick flights will be very competitively priced against – for example – BA, says Norwegian, with the prime target being holidaymakers and not business passengers (with the Gatwick– JFK services being a three times a week service only). The third phase will be an expansion of Europe to Asia routes, once traffic rights are secured, with Kjos hinting that China and India are the prime target markets for Norwegian. To support those long-haul ambitions Norwegian is highly likely to order the higher capacity 787-9 in the medium-term, it is believed, and that order may even be placed as early as next year.

Strategic stretch?

The obvious strategic question is just how an LCC that operates in the traditional Scandinavian environment of high costs, taxes and strong unions can expand successfully into a significant long-haul presence.

On the Scandinavian cost structure, initially Norwegian has been careful not to question “structural norms”, but more recently Kjos has been challenging some of these, such as by threatening to hire more foreigners and basing aircraft out of the country unless labour regulations are changed. Much of Norwegian’s back office infrastructure is already based in east European countries; for example its IT department is run out of Ukraine.

As can be seen in the chart above, unit costs have been falling slowly but steadily as the scale of
Norwegian increases, and the target is for a CASK of NOK 0.42 (€0.05) for the whole of 2013. In the third quarter CASK excluding fuel fell 7% year-on-year, and significant efforts are being made to reduce non-fuel costs even further. These include self check-ins/bag drops, automated group bookings and streamlined operating systems across the airline.

The overall CASK target for 2014 is NOK 0.38 (based on current fuel and currency forecasts for the year), and a key driver of that year-on-year fall will be increased sector lengths and larger aircraft. As well as the 787s Norwegian will benefit from changes to its 737 fleet – through the whole of 2013 14 new 737-800s will be delivered, which have 38 more seats than the 737-300 model that is gradually being phased out of the fleet.

Norwegian currently employs around 3,000 people in Norway, Sweden, Denmark, Finland, Estonia, UK, Spain and Thailand, and a new agreement between the airline and the Norwegian Pilot Union (NPU) was agreed in November this year. The deal was significant as this October Norwegian started to set up a new company structure to allow faster growth internationally.

With Norwegian Air Shuttle ASA as a parent company two fully owned subsidiaries will be established, each with their own AOC – one based in Norway and one in the EU. Scandinavian pilots are being transferred to the Norwegian company (and keep their existing salaries and other benefits), while the EU company will control traffic rights as needed, with non-Scandinavian pilots being employed by that subsidiary.

Interestingly Norwegian is registering its 787s in Ireland to get around the Norwegian law that requires all Norwegian aircraft to operate with a solely Norwegian crew, and it has been reported that Norwegian is in negotiations to move its operational headquarters for all long-haul services to Ireland.

Financially, the airline is robust. Cash and cash equivalents rose a hefty 33% over the last 12 months to reach NOK 2.3bn (€0.3bn) as at the end of September 2013, although long-term debt rose by 16% in the year to September 30 2013, to reach NOK 4.5bn (€0.6bn) – the majority of that increase coming from increased aircraft financing.

At the end of the 3rd quarter 2013 the largest single shareholder in the airline was HBK Invest (which is controlled by CEO Bjørn Kjos), with 27%, followed by Folketrygdfondet (which manages the Norwegian government’s pension fund), with 9.5%. After that, no single shareholder had more than 4.1% of the airline. Finnair sold a 4.7% stake in Norwegian (acquired in 2007 as part of the sale of FlyNordic to Norwegian) for around €53m in April this year.

Shareholders saw a rollercoaster rise in the share price from the IPO through to the end of 2011 (see chart above left), but since then the shares had been on a strong upward path until May of this year, after which (and coinciding with the launch of long-haul routes) they have been on a steady decline. The share price through 2014 will be a key indicator of just how successfully the market judges Norwegian’s attempts to become the first European LCC to build up a significant long-haul operation have been.
Jet values and lease rates

The following tables reflect the current values (not “fair market”) and lease rates for narrowbody and widebody jets. Figures are provided by The Aircraft Value Analysis Company (see following page for contact details) and are not based exclusively on recent market transactions but more generally reflect AVAC’s opinion of the worth of the aircraft. In assessing current values, AVAC bases its calculations on many factors such as number of type in service, number on order and backlog, projected life span, build standard, specification etc.

Lease rates are calculated independently of values and are all market based.

### RJ VALUES (US$m)

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Source: AVAC

Notes: As assessed at end-October 2013, mid-range values for all types
### RJ LEASE RATES (US$000s per month)

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### NARROWBODY LEASE RATES (US$000s per month)

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### WIDEBODY LEASE RATES (US$000s per month)

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Source: AVAC

Notes: As at end-October 2013, lease rates assessed separately from values

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**AIRCRAFT AND ASSET VALUATIONS**

*Contact Paul Leighton at AVAC (Aircraft Value Analysis Company)*

*Website: www.aircraftvalues.net*
*Email: pleighton@aircraftvalues.net*
*Tel: +44 (0) 20 7477 6563*
*Fax: +44 (0) 20 7477 6564*
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