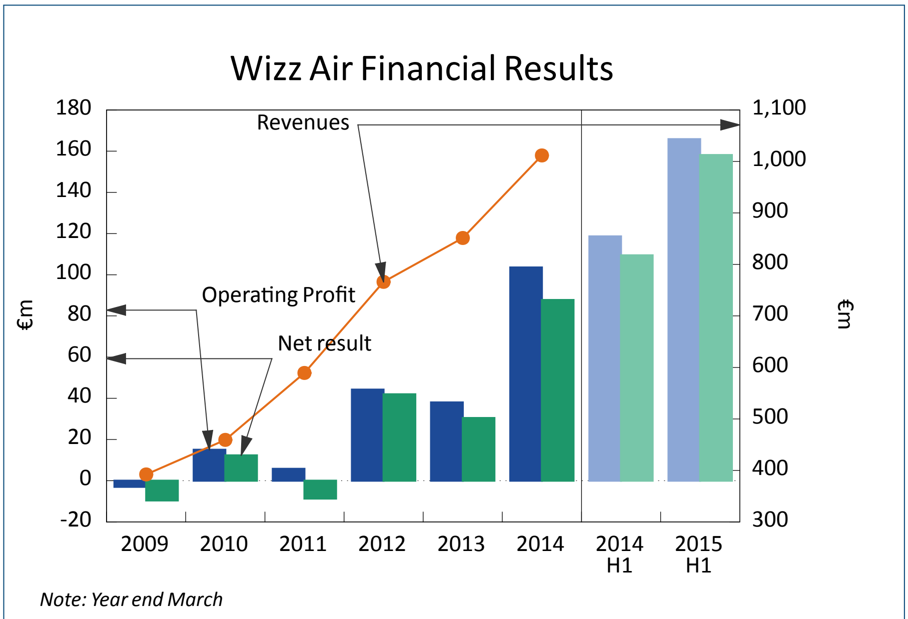
Wizz Air: Patience rewarded for ULCC investors

FINALLY, investors behind Europe's fifth largest LCC and second largest ultra low cost carrier (ULCC) have been able to extract some value from their patient perseverance. Wizz Air Holdings plc surreptitiously floated on the London Stock Exchange in February through an IPO, allowing serial airline investor Indigo to sell down some of its substantial holding and realise returns from its decade long investment.

The company sold 23.4m shares (13.8m from existing shareholders) at £11.50 representing 45% of the enlarged issued equity capital and valuing the group at £600m. After the issue largest shareholder Indigo Partners retains a near 20% stake. However, it also holds €26m in convertible debt and 48m non-voting, non-participating convertible shares which on full conversion would represent an additional 58% of the total equity and provide a fully-diluted market capitalisation of £1.5bn. The issue appears to have been reasonably successful — the shares are currently quoted at £13.90, 20% above the issue price.

Wizz Air started operations in 2004. Established in late 2003 by József Váradi, erstwhile CEO of the former Hungarian flag carrier Malév it has pursued the strategy of developing a route network connecting the "poorer" Central and Eastern European (CEE) nations with the "richer" mainstream EU markets. Starting from a base in Budapest and tagging on the coat-tails of the 2004 and 2007 EU expansion which saw the accession of ten former Eastern European nations to the trading bloc, it has pursued the ultra-low-cost-carrier model, targeting demand from CEE markets deemed too weak for the likes of Ryanair and easyJet (who up to now have had more lucrative targets to pursue). It was given a significant boost from the demise of Malév in 2012.

Operating in a niche area it has been able to build a network of 18 bases in ten CEE countries, mainly to secondary and tertiary airports in Western Europe, and operates to 91 destinations in 33 countries on 300 routes with a fleet of 54 A320s (and 57 further on order). With a prime AOC in Hungary, it also has an operation in the Ukraine with its own AOC through Wizz Air Ukraine (and formerly ran a subsidiary in Bulgaria before that country's accession into the EU). In the past eight years it has grown at a compound annual rate of nearly 20%. For the calendar year 2014 it achieved booked traffic of 15.8m passengers



Note: Year end March

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Publisher:

Keith McMullan
James Halstead

Editorial Team

Keith McMullan
kgm@aviationstrategy.aero

James Halstead
jch@aviationstrategy.aero

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

Subscriptions:

info@aviationstrategy.aero

Aviation Strategy Ltd
Registered No: 8511732 (England)
Registered Office:
137-139 Goswell Rd
London EC1V 7ET
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making it the fifth largest LCC in Europe.

Revenues have grown to just over €1bn for the year to March 2014. Profits were elusive until three years ago. However, in the financial year ended March 2014 it achieved operating profits of €103m and net profits of €88m. Its EBITDAR margin of 24% for the period is admirable while its operating profit of €6.37 per seat is only slightly below competitor Ryanair's for the same period. For the six months to end September 2014 it achieved a 23% year on year growth in revenues to €727m, operating profits of €166m (up by 40%) and net profits of €158m (compared with €109m in the prior year period).

The strategy is firmly based on ULCC principles:

- ✈ point-to-point services radiating from bases to secondary (ie cheap) airports;
- ✈ single fleet type;
- ✈ a truly terrible aircraft paint scheme;
- ✈ high aircraft utilisation (12.7 hours a day in the twelve months to Sept 2014);
- ✈ high load factors (86.3% for the same period);
- ✈ no GDS;
- ✈ full unbundling of fare structures to present the lowest possible fare on the market-place shelf, while encouraging passengers to "trade up" by buying ancillary services.

In the year to end March 2014 the group achieved an average fare of just over €47 per booked passen-

Wizz Air Bases and Destinations

ger but average ancillary sales of €25 representing 33% of total revenue — the highest rate published by any of the European LCCs. One of the more intriguing service fees they offer is an "on-time performance guarantee" for €10. It should be noted that they have unbundled the fares so much that ancillary fees include inescapable booking fees and check-in fees of €18 per pax.

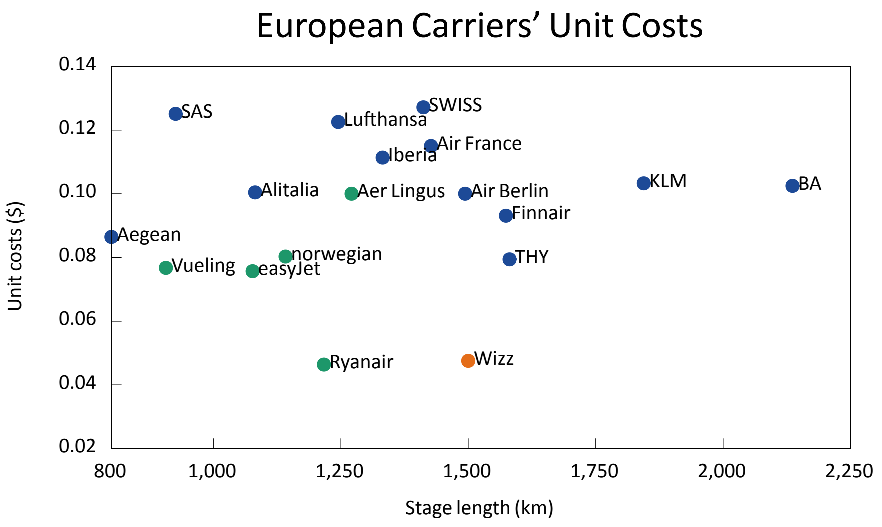
It has a single type fleet — firmly based on the A320 family. The group currently has 54 A320s in operation with a full economy high density 180 seat configuration. It has plans to double the size of the fleet to 106 units by end of 2018: 27 of the new aircraft to be delivered over the period are expected to be the higher density A321. This is likely to provide a continued 15-20% annual growth in capacity for the foreseeable future.

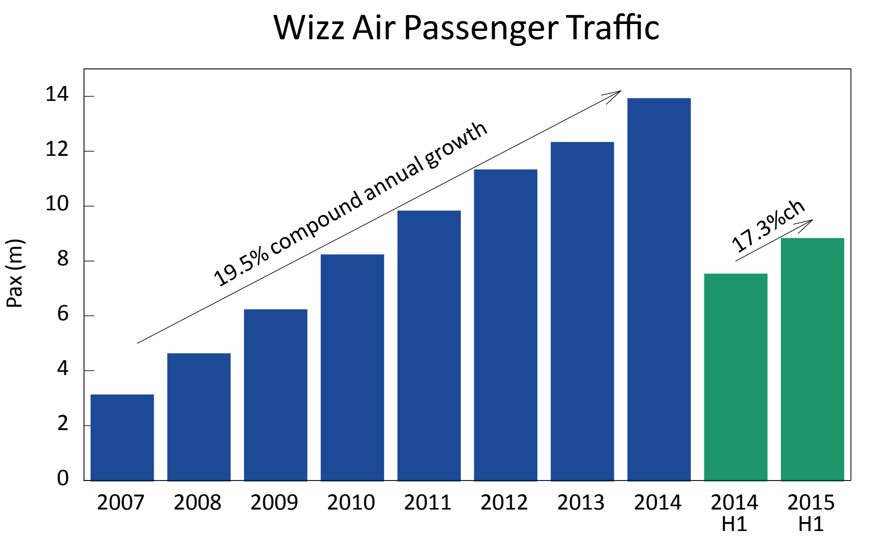
The strategy is also firmly based on the core principle of transporting passengers between CEE countries and Western Europe. The newly acceded CEE countries to the EU have substantially lower per capita income than the more mature Western European nations, but their economies are growing at a significantly faster pace and as the per capita income grows Wizz sees expanding propensity to travel by nationals of these countries.

At the same time the company has recently started to increase the number of routes from CEE eastwards to countries outside the EU in Eastern Europe, the Caucasus and the Middle East as part of its "Go East" initiative with routes launched to Georgia, Israel and Macedonia in 2012, Azerbaijan, Bosnia and Herzegovina, Moldova, Russia, Turkey and the UAE in 2013 and Egypt in 2015.

LCCs are not known for adhering to established norms. Wizz Air seems to have taken this one stage further. The holding company is incorporated in Jersey (in the UK but outside the EU), the corporate head office is based in Geneva (outside the EU but in the EEA — but we understand they got a good tax deal), the main AOC is in Hungary (outside the Euro-zone but in the EU) while the majority of traffic is generated in Poland (29%) and Romania (24%); Hungary accounts for 17% of passengers. It reports its results in Euros and is quoted on the (Sterling oriented) London Stock Exchange. All weird and presumably wonderful .

Wizz remarkably operates with a unit cost not too dissimilar from that of Ryanair — the paragon ULCC in Europe — of €¢3.68/ASK, some 3% higher than that of the Irish carrier (although it does have a slightly higher average stage length) and 25% lower than other LCCs. On a per seat basis, however, for the year ended March 2014, its operating costs of €56 per seat were some 25% higher than Ryanair's — the greatest dif-





Note: Financial year ending March

Wizz Air Fleet Plan

Aircraft	2013	2014	2015	2016	2017	2018
A320	45	54	63	63	63	79
A321			2	11	23	27
Total	45	54	65	74	86	106

Note: Calendar year end

ference being in aircraft ownership costs where Wizz has little real hope of achieving Ryanair's economies of scale — (see table below). However, not surprisingly, its staff costs are some 10% below that of Ryanair's on a per seat basis.

Ryanair is also its main real competitor. The two carriers compete head-to-head on eight routes and indirectly on a further 59 routes accounting for 30% of Wizz Air's seat capacity (but 5% of Ryanair's) although they only share two aircraft bases: Wrocław and Budapest. However, 38% of Wizz's capacity is operated in 160 market pairs where there is no scheduled competition and a further 20% in 60 market pairs with no low-cost competition. For most of the CEE markets in which it operates it has the advantage of having weak (or non-existent) local flag carrier competition.

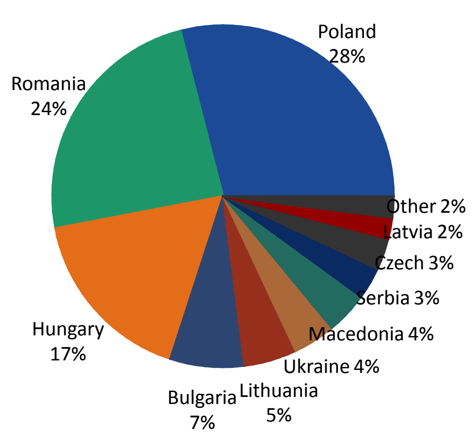
Unlike Ryanair, there is no need nor desire to turn cuddly. In the current stage of the cycle and while Ryanair's attention is focussed on lucrative Western markets, Wizz looks set to be able to provide strong returns. There will however come a point when Indigo Partners look to sell (they, as non-Europeans, are not officially allowed to own more than 49% of a European airline). Although at an investor day a few years ago Michael O'Leary stated that he would not buy Wizz Air even for a €2 coin, there may come a day when he could change his mind.

Europe's ULCCs
Per Seat Revenues and Costs

€/seat	Wizz Air	*Ryanair*
Ticket revenue	40.53	*38.51*
Ancillary revenue	21.73	*12.68*
Total Revenue	**62.26**	***51.19***
Staff costs	4.20	*4.71*
Fuel costs	22.19	*20.46*
Distribution & marketing	0.67	*1.96*
Maintenance	2.98	*1.18*
Rentals	6.92	*1.03*
Handling	15.40	*11.58*
Depreciation	1.56	*3.58*
Operating cost	**55.89**	***44.49***
Operating Profit	**6.37**	***6.69***

Note: year end March 2014

Wizz Air Passenger Traffic
to/from Home Markets H1 2015



Aegean: Very efficient, very profitable and Greek

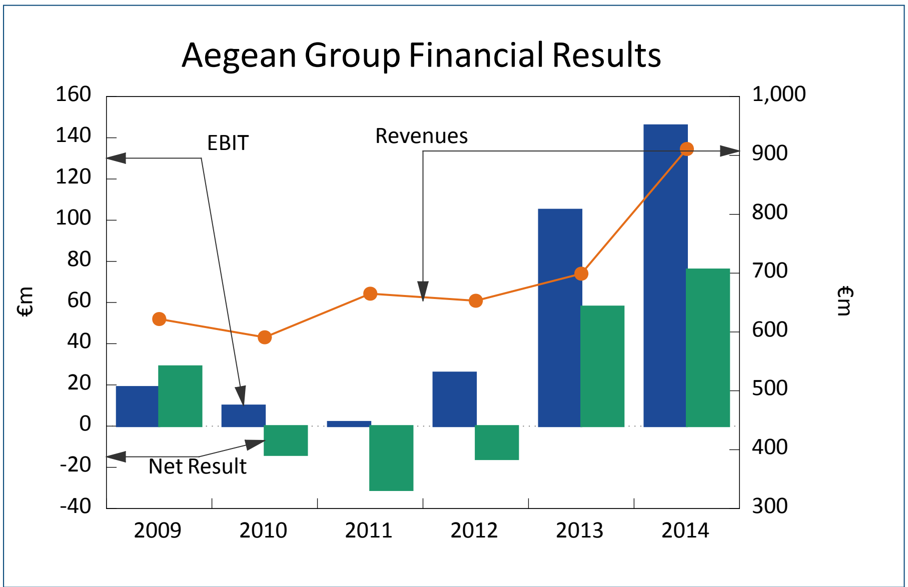
GREECE has suffered terribly in the recession — real GDP has fallen by 25% since 2007, unemployment is out of control, traditional political parties are in disgrace and a neo-Marxist party, Syriza, won the recent election but has, as it has rapidly discovered, almost no control over the austerity measures and debt repayments demanded by the Troika to bring down national debt. Yet Athens-based Aegean Airlines, a hybrid carrier, is showing a level of profitability second only to Ryanair.

At the end of March Aegean announced its 2014 financial and operational results:

- Capacity (ASKs) increased by 13.6%;
- Average load factor increased to 77.3% from 74.4%;
- Revenue for 2014 amounted to €911.8 m, 7% up from €850.0m in 2013;
- Operating profit totalled €146.4m, a margin of 16.0% (compared to easyJet at 13% and Ryanair at about 18%);
- Net profit amounted to €75.6m, a margin of 8.3%;
- The balance sheet has zero debt (liabilities from financial leasing contracts amount to €8.4m) while cash and cash equivalents stand at €218.4m.

If nothing else, these figures show how successful some companies in the Greek private sector can be in contrast to the profligate chaos of the public sector. There are three interrelated factors behind Aegean's performance.

First, Aegean has found a rare niche where the hybrid airline model works. The airline has a fleet of 36 A320 Family aircraft plus 12 Q400s and two Dash 100s (essential for the tiny PSO airports inherited from Olympic), carrying 10.1m passengers last year. The A320s are operated with a business class section at load factors in the upper 70s, comparable to network carriers rather than LCCs which are now averaging loads in the low 90s. Although there is important connecting traffic between the Greek islands and Athens, Aegean internationally is a point-to-point airline.

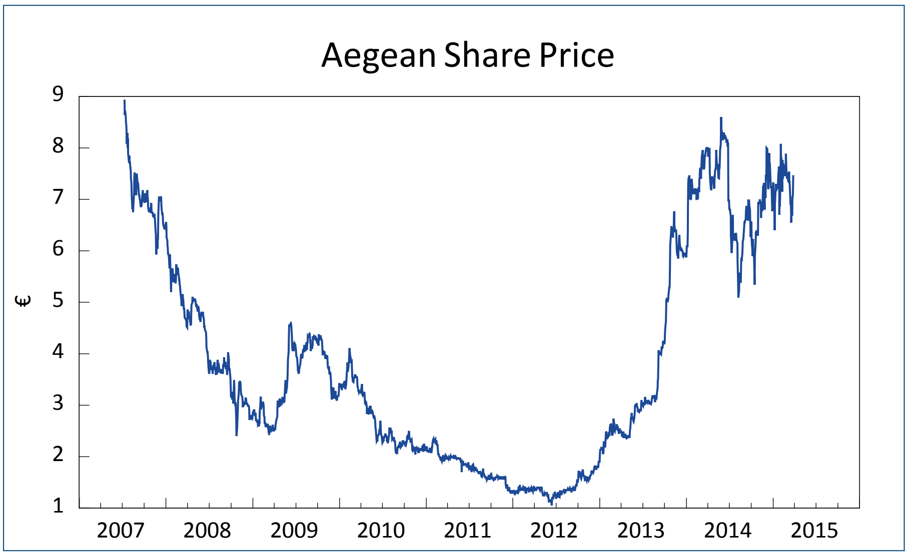


Aegean achieves average revenue per passenger of just under €100 compared to €94 for easyJet (with a much higher proportion of ancillaries in the total) but Aegean manages to control unit costs at LCC-type levels — its 4.6 cents per ASK ex-fuel is almost exactly the same as easyJet's.

The main base is at Athens (AIA), a modern, efficient airport, is a major asset despite the fact that it levies the highest airport charges in Europe. Significant discounts on new routes and services have, however, been implemented following the 2013 sale by Hochtief of its 40% share to a Canadian pension fund. AIA, unsurprisingly, rejected Ryanair's offer of delivering 10m passengers if fees were halved.

For Aegean the charge structure affords some protection from massive LCC incursion at its main base. In the summer peak 2014 Aegean accounted for 49% of seat capacity at Athens compared to 4% for easyJet and 6% for Ryanair.

Athens' geographical position on the southeast corner of Europe also limits competition from the major network carriers whose main interest in this market is for feeder traffic, supplemented by high yield lo-



cal passengers, to their main hubs. Aegean can easily compete on price for local traffic with BA and Air France, while, in the German market, it codeshares with Lufthansa as a Star Alliance member.

Second, Aegean was finally able to take over Olympic in 2013. Aegean since its start-up in 1999 had to endure state-subsidised competition from the grossly inefficient flag-carrier. But when Olympic was finally put up for privatisation in 2008, using an innovative structure which insulated the purchaser from legacy labour agreements and legal problems, Aegean did not join the bidding, assuming logically that the process would fail, as the previous five attempts had failed. In the event Olympic was bought by Marfin Investment Group (see *Aviation Strategy*, April 2010), and Aegean and Olympic immediately embarked on a vicious domestic fare war just before air traffic volumes collapsed as the economic crisis enveloped Greece. The rational response, with Olympic making huge losses and Aegean itself in the red (see graph on page xx) was a merger of the two carriers. However, the European Commission blocked this action, citing competition concerns, until a deal was agreed in 2013 when Aegean in effect took over Olympic.

The Aegean CEO, Dimitris Gerogiannis, has a reputation for efficiency (his background was in engineering in Germany), and under his direction the integration of Olympic appears to have gone smoothly. Indeed, the Olympic brand is being rationalised out of existence.

Third, Greek prices have fallen markedly as a result of the recession, restoring the competitiveness of the Greek tourism industry and causing traffic to rebound. Tourist arrivals in Greece rose by 15.4% in 2014 to about 23m. At Athens total passenger volume increased 22% to 15.2m, though this was still one million below the 2007 total.

Aegean is in expansionist mode, growing with the recovery in Greek tourism. In 2014 it increased its international destinations to 47 from 32 in 2013 and grew capacity by over 1m seats. In 2015 it will add a further 16 destinations — Helsinki, Toulouse, Deauville, Metz, Pisa, Malta, Amsterdam, Alexandria, Sharm-el-Sheikh, Paphos, Riyadh, Tallinn, Oslo, Tehran, Yerevan and Dubrovnic — and increase frequency throughout the network. About 2m seats will be added with seven new A320s being delivered throughout the year (one more than previously scheduled).

The strategic focus is on Larnaca in Cyprus where Aegean is in advanced negotiations with the Cypriot government to take over Cyprus Airways which has been in bankruptcy and grounded since last November. It is not clear what exactly Aegean would be buying but it plans to fly from Larnaca, where is bases four A320s, to London, Paris, Munich, Milan, Zurich, Tel Aviv, Kiev and Beirut. Ryanair strangely is also a bidder for Cyprus Airways though Aegean management now think that Ryanair will concentrate on more traditional service to Paphos, the other major airport on the island.

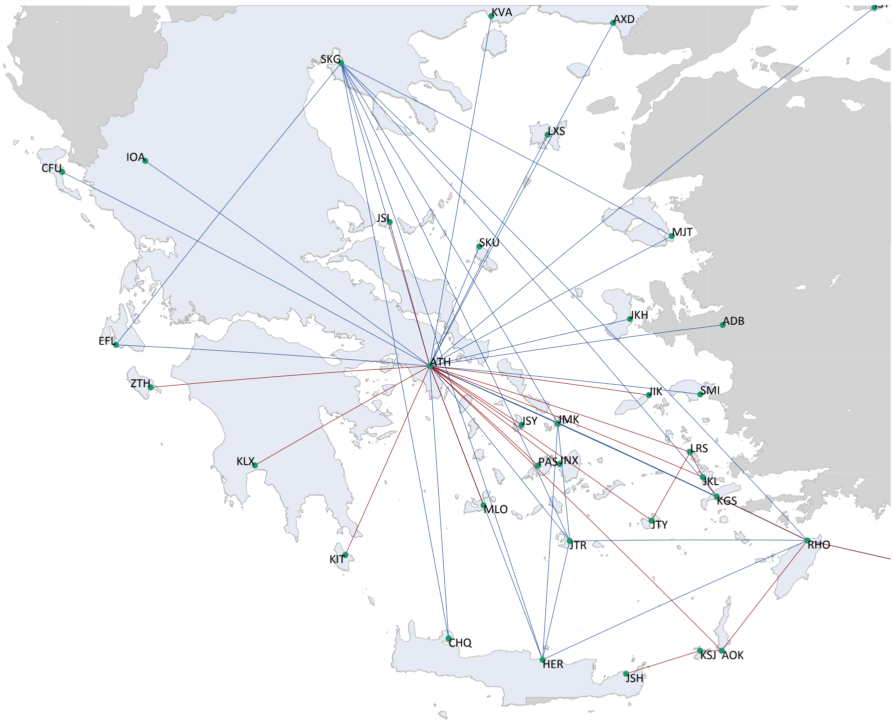
Ryanair's expansion into the Greek market is perceived as a threat to Aegean. But although it has instigated 13 routes into Athens (and will add Berlin later this year), Ryanair's focus appears to be on international and seasonal services to the island airports and Thessaloniki, Greece's second city in the province of Macedonia. In the peak season last year only 20% of Ryanair's Greek capacity was allocated to Athens. Because of the different networks and products Aegean should be able to live with Ryanair, just as Aer Lingus adapted its

Aegean Group Fleet

Aircraft	In service	On order
A320	28	7
A321	6	
A319	2	
Q400	10	
Dash 100	4	
Total	**50**	**7**

Aegean European Route Network

Aegean Domestic Route Network



model to Ryanair competition, and benefitted as a result.

The huge threat is Greexit. The large majority of Aegean's costs are in euros or dollars and would remain in them if Greece abandoned the euro. As a rough estimate 50% of its ticket revenue would have to be sold in New Drachmae, a currency which almost inevitably would depreciate rapidly. While it might be argued that joining the euro, using very dodgy national accounts, was a huge mistake for Greece and the EU, leaving the Eurozone would be catastrophic for dynamic Greek enterprises like Aegean which are essential to the country's fragile economic recovery.

The beginning of the end for Europe's charter airlines

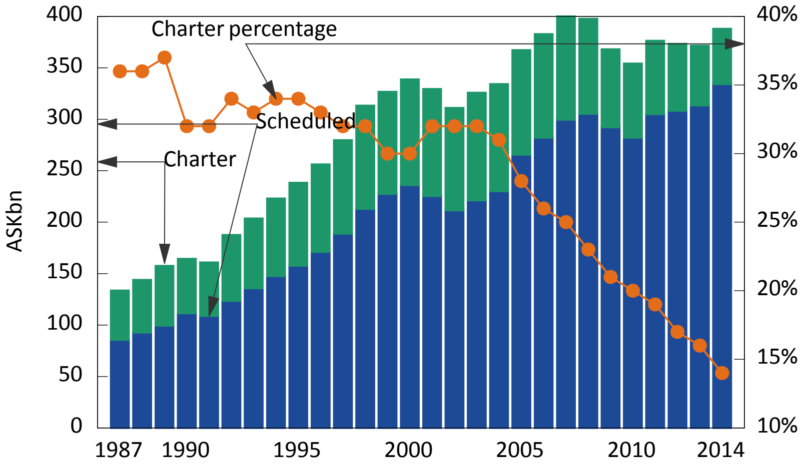
2014 was yet another year of structural decline for the All Inclusive Tour (AIT) market, and 2015 will be no different, despite the attempts of Europe's "Big Two" tour operators — TUI Group and Thomas Cook Group — to differentiate their products and shore up margins. But while the AIT market may survive for a while longer, it looks like the beginning of the end for the remaining charter airlines.

Aviation Strategy has been tracking the decline of the AIT market since 2002 (see the April 2013 issue for our last article), and the diminishing importance of the charter sector continues year-after-year. As seen in the chart (right), the number of UK charter passengers fell yet again in 2014 (for the 13th year in a row), by some 2.2m passengers in just 12 months, and the current annual total of 17.1m is a mere 50% of the level it was in 2002. In terms of the split of scheduled versus non-scheduled capacity offered by UK airlines (see chart, top right), non-scheduled ASKs fell to 14% in 2014, its lowest ever proportion.

This erosion of the market comes despite improvements in outbound economies through Europe. In its latest quarterly report (released in February), the European Travel Commission says that visitor nights outbound from Germany to Spain grew by almost 15% in 2014, with visitor nights to Spain out of the UK rising by an even better 16%. The problem, however, is that whereas 30 years ago the vast majority of summer trips to Spain from the UK and Germany were package holidays, in today's world a huge part of this demand "leaks" (from a charter industry point of view) onto scheduled airlines, and most specifically the LCCs.

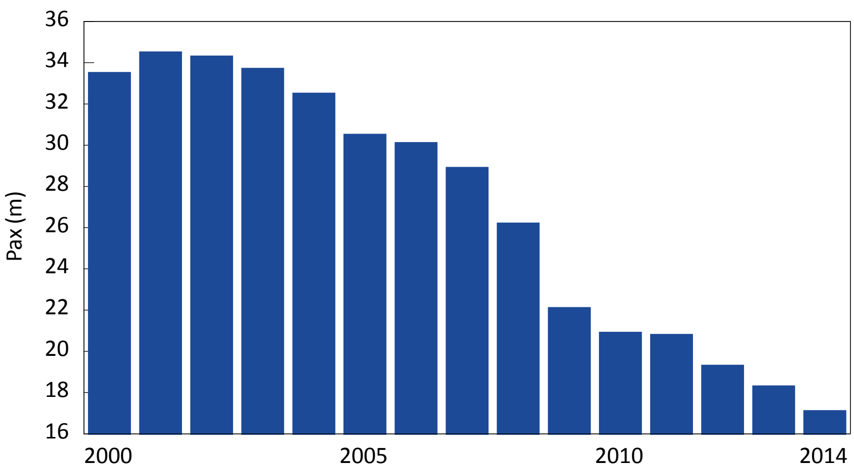
The only good news is that a procession of managers at Europe's AIT operators, who held an attitude that the fundamentals of the charter industry were inviolable, has finally been broken; and a new breed of executives have realised that structural decline — due to the ease of travellers being able to put their own packages of flights and hotels together from LCCs and independent travel websites — will never go away.

Relative Capacity of UK Airlines



Source: UK CAA

The Decline of UK Charter Passengers



Source: UK CAA

As we covered in our last article, the new emphasis from tour operators is on jettisoning lower margin holidays, becoming more flexible (particularly in terms of owning versus leasing assets) and building up a portfolio of more profitable specialist holidays and related services. At the same time both TUI and Thomas Cook have been cutting costs relentlessly through their travel empires. Inevitably the spotlight is now falling on their charter airlines, which are usually the lowest margin part of the tour operator value chain — and therefore the most vulnerable to being outsourced.

TUI Group

In June last year TUI Travel (formed in 2007 by the merger of the UK-based First Choice Holidays and the tour operating division of TUI AG, the Hannover-based German travel and shipping conglomerate) announced plans for a full merger with TUI AG — which at that point owned 56% of TUI Travel — with TUI Travel formally de-listing from the London stock exchange In December 2014.

The share price chart (right) shows the market's positive view of the progress that Crawley-based TUI Travel had made in changing its strategy in the two years prior to that de-listing. Though the newly-named TUI Group has had little time to build up a track record, its first quarter results for the 2014/15 financial year (covering October to December 2014) saw a 5.4% rise in revenue (on a like-for-like basis with the constituent parts of TUI Group under their previous ownerships) to €3.5bn, with an underlying EBITA loss of €120m compared with a €141m as of the same quarter a year ago. (It's important to note that western tour operators usually post losses in the first-half of their financial years as they have significant costs but relatively little revenue in the period before the summer holiday season). The group's net debt stood at €1.6bn as at December 31 2014 (compared with €1.8bn a year earlier).

Clearly TUI Group can only be assessed properly once the ongoing process of integration between TUI Travel and TUI AG (which owns 323 hotels and four cruise ships) is completed. Some analysts have been sceptical of the tangible benefits of a merger, though TUI estimates they will produce €45m of cost savings on an annual basis.

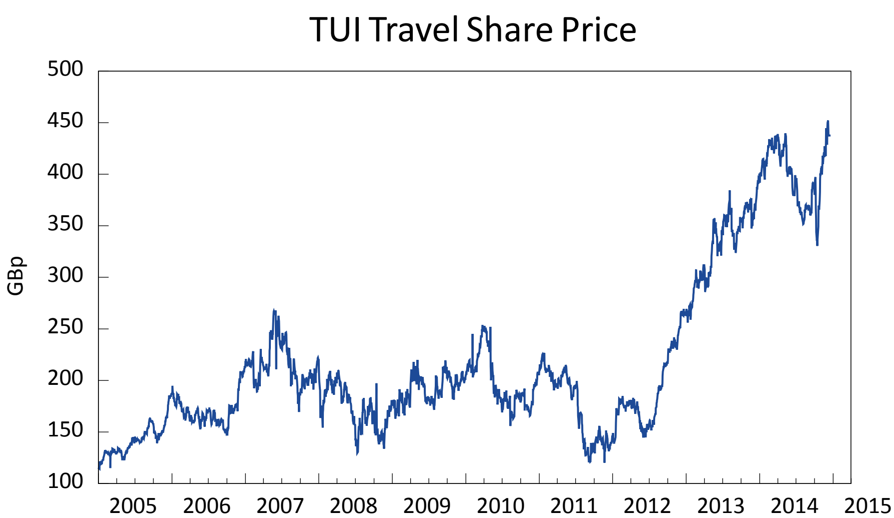
The immediate implications for TUI's mix of assorted charter airlines and myriad aircraft types (see table, above) — all inherited from TUI Travel — are still unclear; the fleet was not mentioned once in TUI Group's 64-page first quarter report.

There is an obvious need for a reduction in airline brands and aircraft types. The TUI Group fleet has a total of 120 aircraft (with 68 on order), comprising 33 737s, 14 757s five 767s and seven 787s at Thomson Airways; 25 737s at TUIfly; 17 737s, one 767, one 787 and two Embraer 190s at Jetairfly; four A330s and three 747s at Corsair; and six 737s and two 767s at TUIfly Nordic. On order are three 737-800s and 60 737Maxs (the latter or-

TUI Group Aircraft Fleet

Aircraft	Arke	Corsair	Jetairfly	Thomson	TUIfly	TUIfly Nordic	Total
737	5		17(1)	33	25(3)	6	86(4)
757				14			14
767	2		1	5		2	10
787	2(1)		1	7(2)			10(3)
A330		4					4
747		3					3
E190			2				2
Total	**9(1)**	**7**	**21(1)**	**59(2)**	**25(3)**	**8**	**129(7)**

Note: Orders in brackets



Note: TUI Travel delisted December 2014 der was placed in July 2013).

It's inevitable that rationalisation (or "bundling", as TUI Group sometimes refers to it) will occur, though this may not be easy given the ageing profile of some of the aircraft. An initial attempt to simplify the fleet has already run into trouble, according to a report by Bloomberg, when in early March negotiations between TUI and Group Dubreuil (which owns Guadeloupe-based Air Caraïbes) for the latter to acquire the Corsair fleet from TUI group broke down.

With A330s and 747-400s, Corsair is by far the most "ill-fitting" of the TUI Group airlines, as its aircraft are simply too big for charter operations (the 747s, for example, operate 533 seats in a two-class layout). As a result Corsair has been loss-making for TUI Travel (and now TUI Group) since 2008, but remarkably the previous TUI Travel did little to rectify the situation. Sources indicate that Corsair will still be sold sooner rather than later, with the emphasis then being on uniting the remaining airlines in the TUI Group, alongside model simplification.

Thomas Cook Aircraft Fleet

	Thomas Cook Airlines				
Aircraft	UK	Belgium	Scandinavia	Condor	Total
757	13			8	21
767	12			3(1)	15(1)
A320	16(7)	4	10	15	45(7)
A330			4	4	8
Total	**41(7)**	**4**	**14**	**30**	**89(8)**

Note: Orders in brackets

Thomas Cook Group

Like TUI, the Thomas Cook Group has changed strategy over the last few years, largely thanks to chief executive Harriet Green, who was appointed in July 2012 and set about transforming the tour operator by selling non-core assets, cutting costs by at least £350m annually (of which £140m are in the UK business and another £210m being group-wide initiatives).

In 2013/14 (the 12 months ending September 30th 2014) the group's revenue fell 7.8% to £8.6bn, EBIT crept up to £54m from £13m a year earlier, and the net loss improved from £163m in 2012/13 to £114m in 2013/14. For the October-December 2014 period (as with TUI, the first quarter of the 2014/15 financial year), Thomas Cook's revenue fell 8.3% to (£1.5bn), with an underlying EBIT loss of £53m, a slight improvement on the £56m loss in the comparative quarter a year earlier.

Significantly, however, Thomas Cook's effective turnaround commenced later than at TUI, and as a result there's much still to do — most notably with the group's debt pile, which still stood at £1.3bn as the end of December 2014, just £24m lower compared with 12 months previously. That debt includes £78m of commercial paper that matured in February this year, and a hefty £311m Euro bond that matures in another few months, in June.

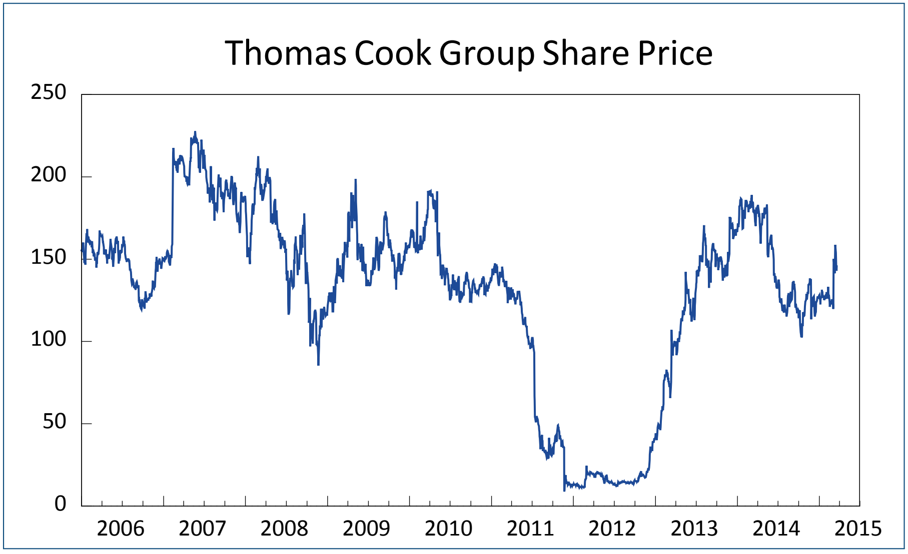
It therefore came as a shock to many analysts when Green left suddenly in November 2014, to be replaced by the then COO, Peter Fankhauser. In the statement announcing her immediate departure Thomas Cook mentioned the share price had recovered from a low of 14p to around 130p over the period she was at the helm — but despite denials by Green and Thomas Cook, it was clear to most analysts that the turnaround was not yet complete.

As with its key rival, the Thomas Cook Group has an assorted mix of airlines and models; the fleet currently includes 86 aircraft at Thomas Cook Airlines (14 A321, four A330s, eight 757s and three 767s); Thomas Cook Airlines Scandinavia (one A320, eight A321s and four A330s); Thomas Cook Airlines Belgium (one A319 and three A320s); and Condor (10 A320s, five A321s, 13 757s and 12 767s). And on order at Thomas Cook Airlines Scandinavia are four A321ceos.

As we noted in our last article on the AIT market, progress towards fleet rationalisation has been "glacial" — though there is now much better co-ordination between those group airlines in areas such as procurement, finance and IT.

However, a major shift in strategy appears to be occurring. The group already buys in 45% of its seat capacity (split equally between charter and scheduled airlines), and in its latest annual report (released in January) Thomas Cook says that "in recent years there has been a significant increase in airline capacity, specifically in low-cost carriers, which has led to very competitive pricing".

It may be coincidental with the timing of Green's departure (and maybe not, according to one analyst), but there is significant chatter among analysts that the group is touting its airline assets to other airlines. All Thomas Group will say on the matter



is that "we see it as an important part of our business and a support of our profitable growth strategy, but of course, we are always open for opportunities˝. That's clearly not an outright denial, and a sale of all (or at least a major part) of its aircraft capacity) must now be realistic possibility in the short- to medium-term.

That's assuming a buyer can be found at the right price; as TUI found out with Corsair, prospective buyers will no doubt be extremely hard negotiators on price in what is effectively a fire sale of an eclectic mix of aircraft in an overwhelmingly buyers' market for second-hand aircraft.

Though it's unlikely to reverse any strategic decision to sell the fleet, it's interesting to note that in March the Shanghai-based conglomerate Fosun International bought a 5% stake in the Thomas Cook Group for £92m, and has vowed to increase its share to 10% over time through buying shares on the open market.

Fosun acquired French tour operator Club Med for €939m in February this year, and though initial external analysis has focussed on the potential for attracting Chinese holidaymakers into Europe, in a statement Thomas Cook Group calls Fosun's move a "strategic partnership", and specifically mentions the potential for "collaboration opportunities with Fosun's other travel and leisure businesses, including Club Med".

Monarch Airlines

Monarch will disappear from the diminishing ranks of charter airlines in June this year when it fully turns into an LCC. The troubled airline (see *Aviation Strategy,* October 2010) was sold to London-based Greybull Capital in October 2014 just hours before its licence with the CAA expired. Greybull now owns 90%, with the remainder held by the company's pension fund.

Based at London Luton airport, the airline's fleet has eased down to 40 aircraft, comprising 27 A321s, eight A320s, two A330s, two 757s and a single A300. In October last year — just a week after its change of ownership — it ordered 30 737 Max 8s, for delivery from 2018 until 2020, which join an order for two A321s that will be delivered this year.

The airline's new strategy is clear — the A330s, 757s and A300 will all go in the short-term and eventually the airline will become a 737 Max 8 specialist, concentrating (from this summer) on European short-haul routes on a scheduled basis and under a low cost operating model.

700 redundancies from the pre-deal workforce of 3,200 are being accompanied by a reduction in pay of as much as 30% for the surviving positions, and Monarch's operations at East Midlands will close this summer, leaving five operational bases — Luton plus London Gatwick, Manchester, Birmingham and Leeds-Bradford.

As an LCC, Monarch will compete head-on with easyJet, Ryanair and others, but ironically maybe its charter heritage will help pick it up substantial seat business from Thomas Cook Group if that company does sell off its charter assets.

Monarch Airlines Fleet

Aircraft	In service	Orders
A320	35	1
A330	2	
737 MAX 8		30
757	2	
Total	**39**	**31**

Copa: Latin America's sole high-flyer

LATIN America is currently a tough market for airlines because of the region's economic slowdown, currency woes, weakening demand and plummeting yields. But, once again, Panama's Copa stands out from the crowd for its resilience and continued lofty profit margins.

Copa has seen its share of the past year's challenges. Its heavy exposure to the Venezuelan market (about 9% of its revenues in 2014), has meant that it has been hit hard by Venezuelan currency remittance issues. It has had to reduce capacity by 40% in those markets and scramble to shift to US dollar sales, resulting in a sharp decline in yields and revenues. At year-end 2014 Copa still had $485m (42% of its total cash) trapped in Venezuela.

Because of concerns about Venezuela, Copa's share price plummeted by 40%, from around $150 to $87, between late July and mid-December 2014. Since then the price has recovered only modestly, to the low $100s.

The combined effect of the Venezuelan changes and demand weakness in many South American markets was to cause Copa's yield and unit revenues to fall by 11% and 13%, respectively, in the fourth quarter.

Copa's total revenues fell by 3.8% and operating income by 26% in Q4. Adjusted net profit declined by 12% to $125.3m. That was before sizable extraordinary losses: $89.1m associated with the mark-to-market of fuel hedge contracts (and $0.4m related to the devaluation of the Venezuelan bolivar).

Yet, Copa still achieved a 17.7% operating margin in the fourth quarter — down from 23% in the year-earlier period but among the highest for airlines in the Americas.

The reason, of course, was a sharp decline in unit costs, which partially offset the RASM shortfall. While total CASM fell by 6.9%, ex-fuel CASM saw a 4% reduction. Other than fuel, Copa benefited from lower sales-related costs, 10.4% growth in ASMs and a 7.2% increase in the average stage length.

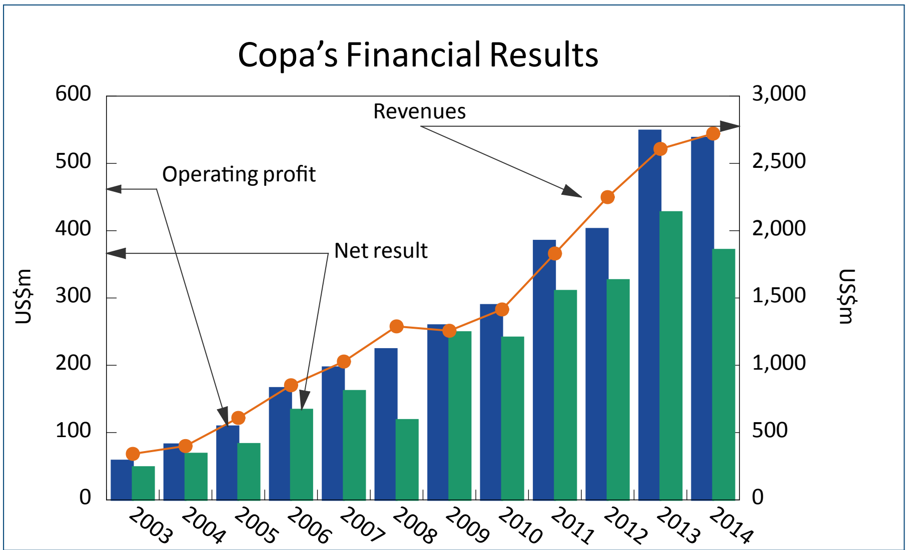
For 2014, Copa reported an operating profit of $538.1m, which was similar to 2013's, and an underlying net profit of $494.6m, up by 6%. Revenues rose by 4.3% to $2.7bn. The operating margin was 19.8%.

Copa has been profitable at this level for more than a decade. Its annual operating margins have been in the 17-21% range since 2003, despite its brisk capacity growth in that period.

Copa has roughly doubled its capacity every 4-5 years, though it has always reduced growth in difficult economic periods, including the late 2000s. 2011 and 2012 saw brisk 23% annual ASM growth, but the rate moderated to 14.4% in 2013 and 9.5% last year.

Recent months have seen a further weakening of economic growth and air travel demand in Latin America, especially in key markets such as Brazil and Chile, as well as continued weakening of South American currencies against the US dollar. Although Copa's monthly traffic growth has slowed only slightly to 7-8% and load factors are holding up, it has been at the expense of yield (which is also affected by Copa's increased average length of haul).

In response, Copa has trimmed its planned 2015 ASM growth to around 7%. This is to try to mitigate a sharp decline in unit revenues, which the airline currently expects to be down 9.9% in 2015.



But Copa is benefiting from lower fuel prices and is anticipating a 16-18% operating margin in 2015. Furthermore, given its history of conservative forecasts and the fact that its 2015 guidance is still based on an assumption of crude oil averaging $75 per barrel this year, many analysts believe that higher profits will materialise.

Copa has one of the strongest balance sheets in the industry. At the end of 2014, it had only $1.1bn of aircraft/other equipment-related bank debt. Excluding the money trapped in Venezuela, adjusted net debt/EBITDAR ratio was only 1.6 times and cash amounted to $675.3m or 25% of last year's revenues.

Copa also treats its shareholders well. It pays 40% of its net income as dividends. In November the board approved the carrier's first-ever share repurchase program, totalling $250m.

Some investors have wondered why Copa still has relatively sizeable operations to Venezuela. The reason: Panama-Venezuela is still a viable market, with significant business traffic and regular ethnic traffic generated by the large Venezuelan community in Panama. The market is not as lucrative as it used to be, but it is still "very profitable".

Although there appear to be no solutions in sight for the repatriation of the Venezuela funds, Copa has taken successful action to mitigate further damage. It has managed to shift 90-95% of the sales in that market to points outside Venezuela (based mainly in US dollars). Copa is also burning its huge stockpiles of bolivars at a rate of $4-5m a month to pay down local expenses.

With some of that clarified by Copa's management in February and with the share price so low, more analysts have raised their recommendation on the stock to "buy". Copa, which made its debut on the NYSE in December 2005, looks set to recapture its former image among many investors as a safe and attractive way to participate in the Latin American airline industry.

Copa's unique strengths

Copa's continued success is due to a multitude of factors, including the following:

✈ Business model/the Tocumen hub

Copa has a hugely successful "Hub of the Americas" strategy, which channels traffic between North, South and Central America via the Panama City hub. The airline operates a streamlined, modern fleet of 737NGs and E190s and focuses on underserved thin markets where in most cases point-to-point service is not an option.

The strategy works because the Panama hub is highly efficient and because Copa offers convenient schedules, high-quality service and excellent on-time performance. Copa strives to be the "best option for intra-Latin America travel".

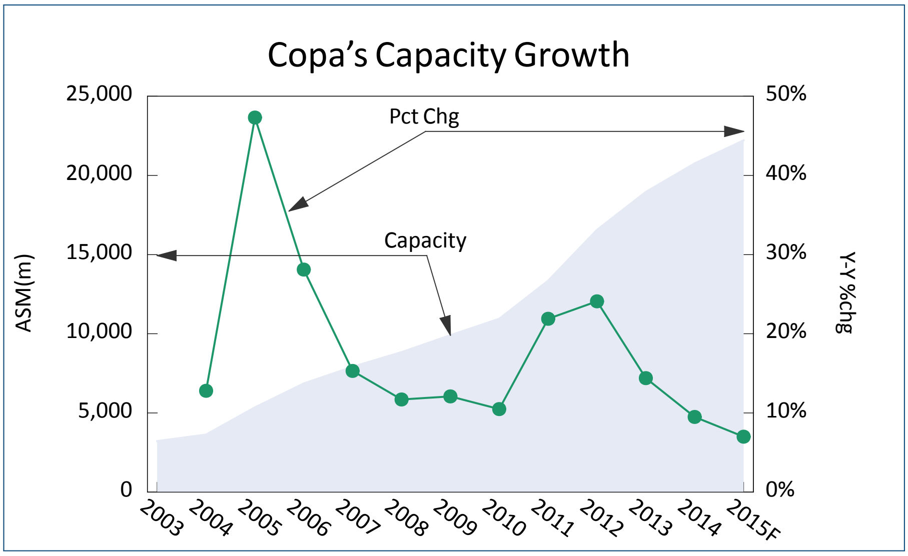
The Panama hub is geographically well located, allowing 737NGs to fly nonstop to practically anywhere in the Americas. The airport benefits from a sea-level location and favourable weather.

Because of its manageable size and Panama's policies accommodating transfer passengers, the airport offers easy transfers and short connecting times.

Tocumen is the only airport in Central America with two operational runways. It is one of the few major airports in the region where infrastructure provision has kept pace with airlines' needs.

Two expansion phases since 2004 have increased Tocumen's total gates from 14 to 34 and have provided new taxiways and ramp and support areas. The current expansion phase, which is due to be completed by 2017, will add a new $680m south terminal, with 20 additional gates and new areas for customs, immigration, security and baggage handling.

But Copa executives noted recently that although the airport was building "the right capacity at the right moment", it was none too soon. At peak times the airline is already short of gates and has to use remote positions. The executives felt that by the time the 20 new gates are ready,



the airport will have to embark on the next expansion phase of building 10 additional gates.

Another advantage is that Tocumen has competitive user fees. It is operated by a government-owned entity that is by law required to use a significant portion of its revenues for airport expansion and improvements. Since Copa accounts for some 80% of Tocumen's traffic, it wields much influence with the airport authority and can ensure that the new facilities are optimised for its hub operations and connectivity.

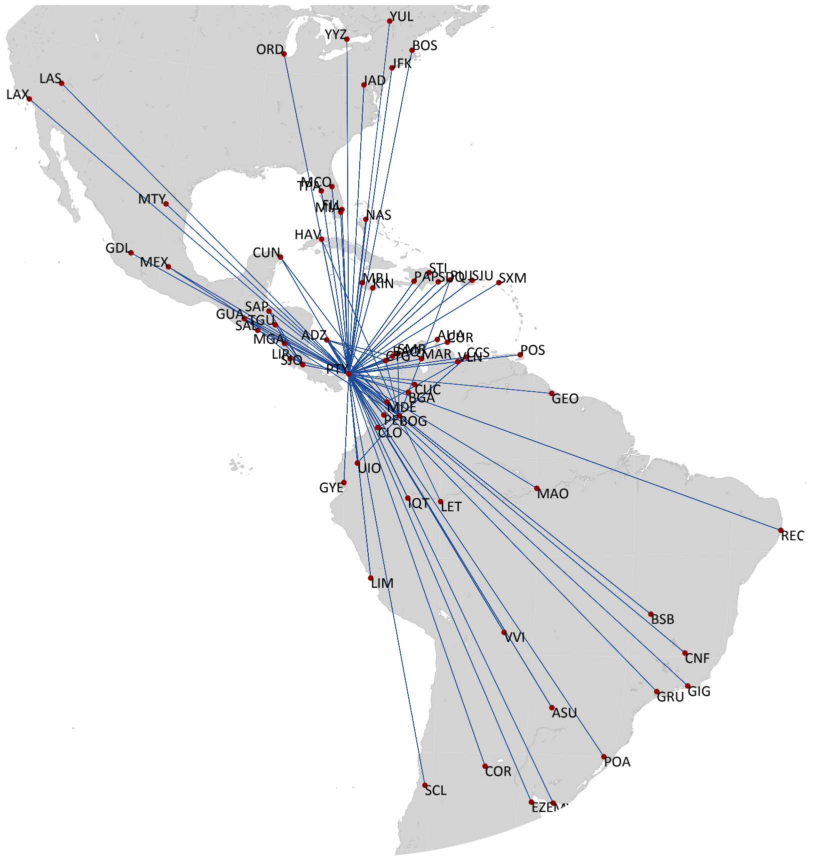
✈ Panama's strong economy

Copa benefits from Panama's stable, dollar-based economy, free-trade zone and growing tourism. Panama has been one of the fastest growing Latin American economies over the past decade, recording 8.4% average annual real GDP growth in 2004-2013. Copa faces less of a currency risk than other major Latin American carriers (also because of its diversified network). And thanks to Panama's low tax environment, Copa's effective income tax rate in 2015 is only 10-12%.

Panama's GDP growth slowed to 6.4% in 2014 and is projected to be around 6% in 2015, but it will still far outperform the rest of the region. The IMF predicted in January that Latin America/Caribbean would see only 1.3% GDP growth in 2015 — a figure that many now believe is an overestimate.

The expansion of the Panama Canal has provided an enormous economic boost. The project, which began in 2007 and is due to be completed by 2016 (at least 16 months behind schedule), will double the Canal's capacity and allow the new generation of super-containerships to transit.

Copa's Panama Hub Network



Note: Azimuthal Equidistant map projection centred on Panama. Great circle routes appear as straight lines.

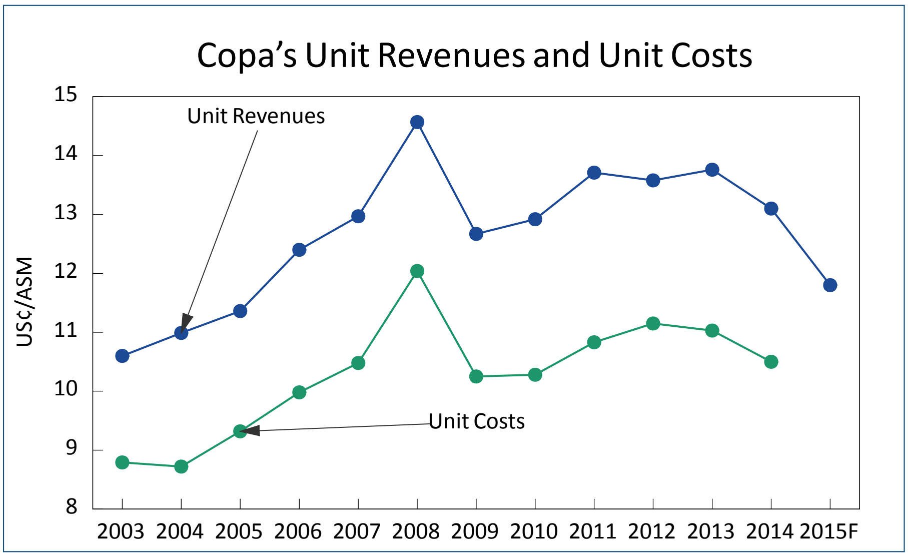
In 2010 the three main rating agencies all upgraded Panama's sovereign ratings to investment grade. As a result, Panama, which has long been home to many regional offices of multinational corporations, has attracted significant new foreign investment and strengthened its role as a major financial, trade, shipping and international business centre.

Panama is also a growing tourist destination, following in Costa Rica's footsteps. Recent years have seen a construction boom, fuelled by tourism and retirees from the US, Canada and Spain buying second and third homes in Panama.

These trends, combined with Panama's steady population growth and emerging middle classes, have meant rapid growth in local traffic. While Copa has historically depended on transit traffic (Panama's population is only 3.7m), by 2013 its traffic was equally split between Panama O&D and transit traffic. Point-to-point traffic tends to be higher-yield. A strong local traffic component will make Copa's business model more sustainable in the longer term.

✈ Premium unit revenues, low unit costs

Copa enjoys the very unusual combination of premium unit revenues and low unit costs. Despite the high transit traffic volumes, Copa's RASM is strong because of its high business traffic content (about 50%) and the lack of competition. A world-class product offering



and a strong brand also help.

A comparison by Morgan Stanley Research in 2012 showed that Copa had the highest length-of-haul adjusted PRASM among a group of leading carriers that included Delta, United and LAN. The analysis also found that Copa had LCC-level unit costs — amazing for a hub-and-spoke carrier.

Copa attributes its low unit costs to a modern fleet, efficient operations and Panama's low labour costs. Its aircraft utilisation is relatively high (11 hours daily in 2014), helped by an average stage length of 1,213 miles.

Copa reduced its ex-fuel CASM by 7% between 2007 and 2011 (to 6.73 cents), thanks to ASM growth, distribution cost savings and efficiency improvements through technology and automation. Since then ex-fuel CASM has fallen further still, to 6.6 cents in 2014, and is expected to remain flat in 2015.

✈ Longtime alliance with Continental/United

Copa has benefited enormously from its unusually deep partnership with Continental, which transitioned seamlessly to United after the 2010 merger. The relationship dates back to 1998, when the two sides forged a comprehensive alliance and Continental acquired a 49% stake in Copa. Since Panama had signed an open skies ASA with the US in 1997, the alliance secured early antitrust immunity (ATI) in the US.

From the start, Copa's brand was closely associated with Continental's. Its logo, livery and aircraft interiors were similar. Copa also adopted Continental's OnePass FFP (now MileagePlus) and participates in the airport lounge programme. Copa noted in its 2013 annual report that the co-branding "helped leverage the brand recognition that Continental already enjoyed across Latin America" and had enabled Copa to compete more effectively against Avianca, American and others.

Copa has also benefited from its US partner's technology, know-how and economies of scale. Among other things, it shares its partner's Sceptre inventory management system, which allows it to pool spare parts with the larger carrier. The partnership has enabled Copa to secure more competitive rates for aircraft, insurance and fuel purchases and for third-party maintenance work.

Although Continental fully disposed of its stake in Copa in 2005-2008, the partnership was so strong that Copa left the SkyTeam alliance concurrently with Continental in October 2009 and followed it to Star in June 2012. A UAL executive still sits on Copa's board (currently UAL's SVP for Alliances).

✈ Benign competitive conditions

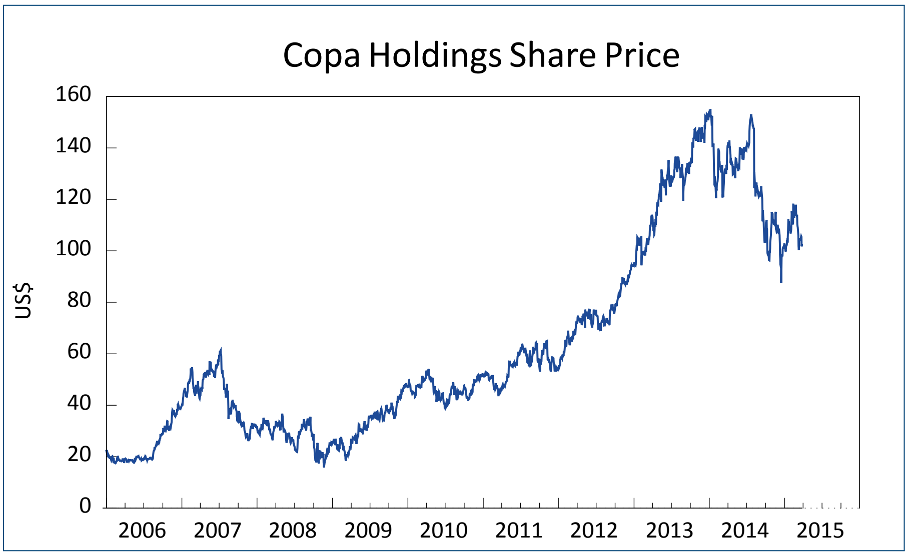
At first glance Copa's business model might seem very vulnerable to other airlines, such as LCCs, launching point-to-point services that bypass Panama, but so far at least that threat has not materialised. The vast majority of Copa's O&D markets are so small (typically less than 50 passengers per day) that other airlines cannot serve those destinations profitably on a nonstop basis.

Competition for Copa is mainly from other hubs, but even on that front it seems far from fierce. Avianca, formerly one of Copa's main rivals, is now a Star partner; the two joined at the same time in 2012 and have codeshared since June 2013.

✈ High-quality management

Copa's CEO Pedro Heilbron is one of the longest-serving and is regarded as one of the most capable CEOs in the global airline industry. He has been at the helm since three families (including his own) and other local investors bought 99% of Copa in the late 1980s. Heilbron instigated and guided Copa through key strategies such as the Tocumen hub operation (1992), international alliances (mid-1990s) and complete fleet renewal (1999-2005).

Copa has a highly regarded management team. One of its less obvious accomplishments has been to create a Southwest/JetBlue-style employee culture "based on teamwork and focused on continuous improvement". (Recent years have seen labour tensions, but evidently the culture and service standards have not suffered.)



Growth plans

Copa's network strategy is to continue to strengthen the intra-Latin America operations and the Tocumen hub with more destinations and frequencies, and to capitalise on opportunities at Copa Colombia.

The past two years have seen many new destinations. In 2014 Copa added Montreal (its second Canadian city), Ft. Lauderdale, Georgetown (Guyana), Campinas (8th point in Brazil) and Santa Clara (second point in Cuba). That brought the network to 59 destinations in 30 countries.

Of the "several new destinations" planned for 2015, so far only one has been named: New Orleans, which will become Copa's 11th US city in June. But most of 2015's 7% ASM growth will come from the full-year effect of the flights added in 2014.

In 2015 Copa originally planned to take eight 737-800s from Boeing, lease another three 737-800s and return five aircraft to lessors, resulting in a net addition of six aircraft. But Copa now wants to limit the net addition to two aircraft at most, and it has been evaluating options to reduce this year's deliveries.

At year-end 2014, Copa and its Colombian unit operated a 98-strong fleet, consisting of 54 737-800s, 18 737-700s and 26 E190s. There are firm purchase or lease commitments for at least 34 additional 737NGs plus 10 options. The plan is to add 737-800s and slightly reduce the 737-700 fleet over time.

Copa secured a foothold in Colombia in 2005, when it acquired an initial 85.6% stake (now 99.9%) in AeroRepublica, now Copa Colombia. Colombia is Latin America's third largest market in terms of population, shares a border with Panama and represents a significant market for many Panamanian businesses (for historic, cultural and business reasons). But Copa also faced the challenge of turning the smaller carrier around financially, while fending off growing domestic competition in Colombia.

Copa has replaced the unit's old fleet, significantly reduced its domestic operations and refocused it on the international market out of Colombia. The Bogota-based carrier has taken over most or all of Copa's Colombia-Panama operations and also expanded its network to 10-plus international destinations elsewhere in the Central America/Caribbean region and Mexico. The indications are that Copa Colombia has turned the corner financially.

While Copa has no plans to operate to other world regions, Panama is poised to attract many new 787 and A340 services from distant corners of the globe, especially when additional capacity becomes available at Tocumen. Much of it will mean increased feed to Copa's services.

Star alliance member Lufthansa recently announced plans to launch Frankfurt-Panama A340-300 flights from November 2015; the German carrier will be selling 50 beyond-Panama destinations as part of an expanded partnership with Copa.

Investing to improve the passenger experience is a top priority for Copa. Current initiatives include adding more Copa Clubs and launching its own loyalty programme in July 2015. The latter will be in addition to Copa's participation in MileagePlus, and there will be full reciprocity with Star programmes.

Copa has also invested in SabreSonic CRS — a move that should bring about attractive new ancillary revenue opportunities.

While Copa's business model is clearly very "defensible", the airline is wise to diversify with ventures such as Copa Colombia and to explore ancillary revenues, because in the future some of its larger (and most lucrative) markets are likely to attract point-to-point operators. The economic slowdown has slowed everyone in their tracks, but when demand recovers LCCs will become interested in some of those city pairs.

By Heini Nuutinen
hnuutinen@nyct.net

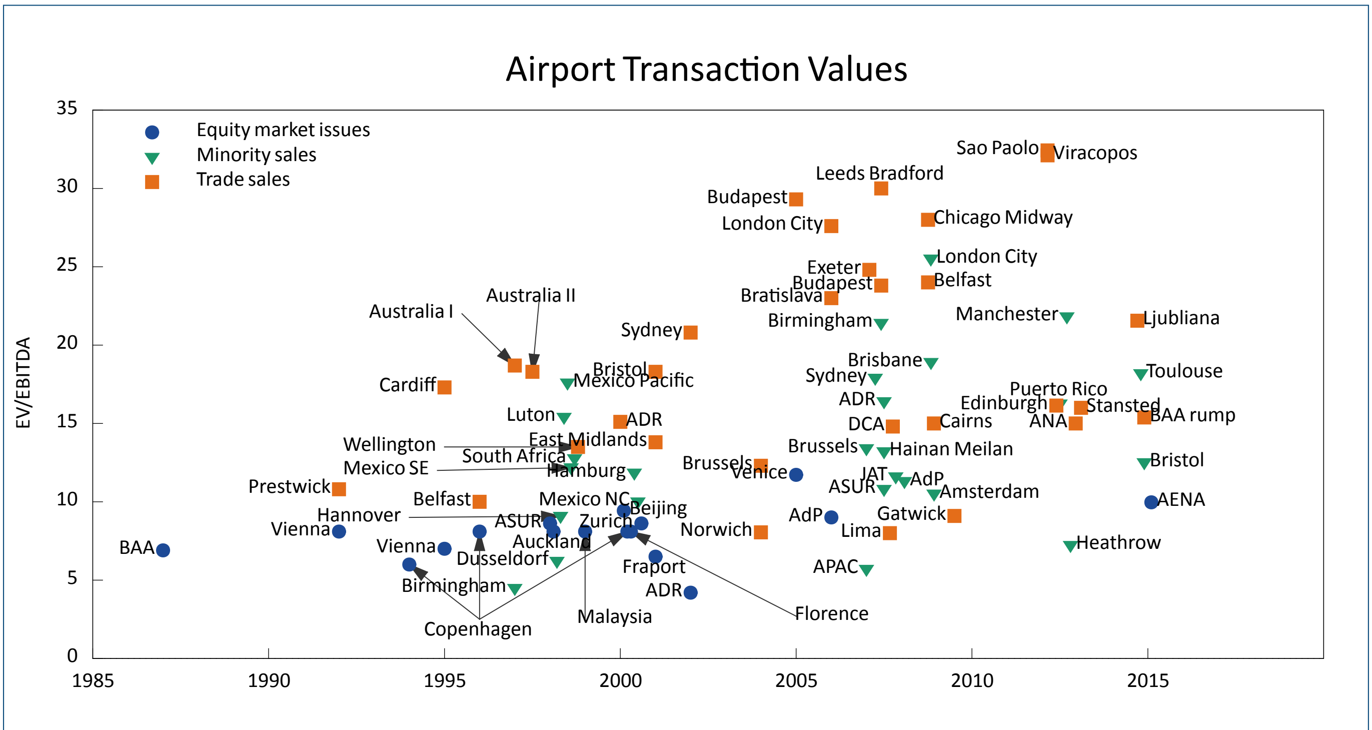
Airport Valuations Update

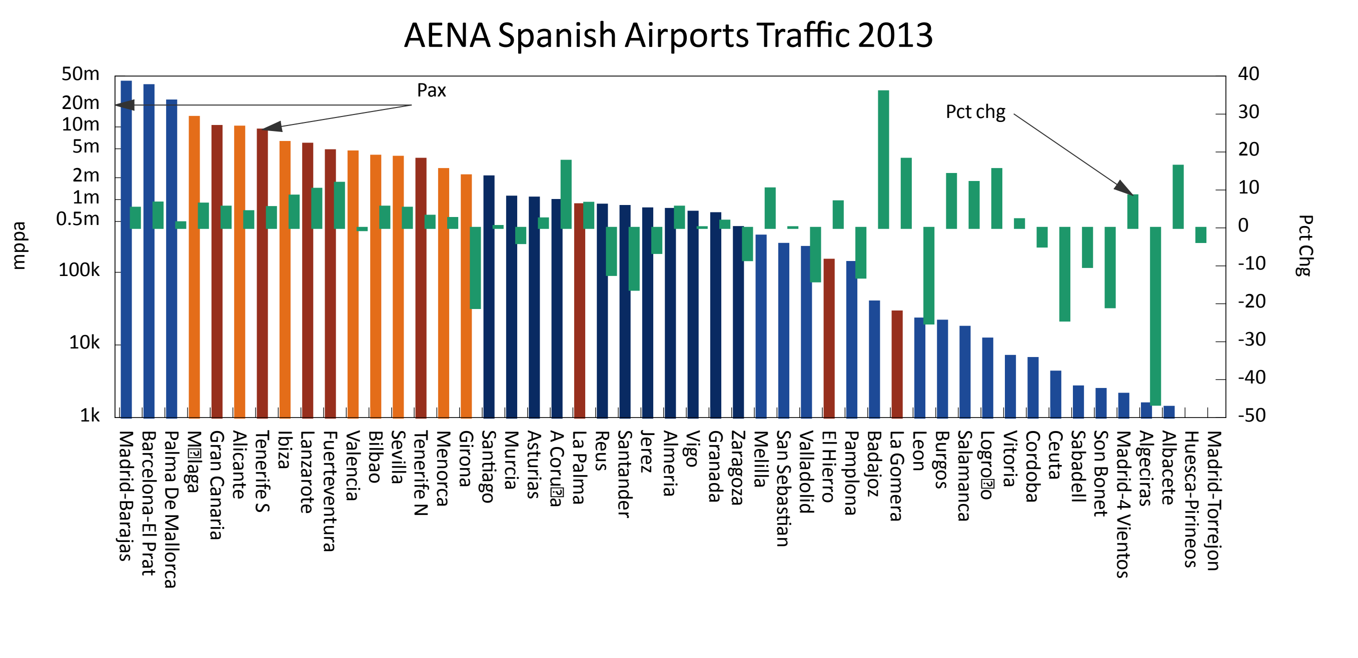
THE chart below is our latest update from our database of airport transactions and valuations, and includes Ljubljana, Toulouse, the former BAA airports now known as AGS (Aberdeen, Glasgow and Southampton) and AENA Spanish Airports. Infrastructure funds remain keen on airport investments, viewing them as relatively low risk, medium return assets; airport owners may have become more wary of the funds and the debt that accompanies transactions.

Recent transactions have produced valuations (Enterprise Value/Operating Cashflow) averaging around 15, generally well below the ratings achieved in the speculative boom pre-Lehmans and in the recent round of Latin American airport sales. However, it is probably not wise to read too much into the prices reported for the recent transactions, as they ranged from Fraport's minor investment in Ljubljana to the most important IPO in Spain since the mid 2000s.

The long awaited IPO of Spanish airport monopoly AENA took place in January this year, the government selling 49% on the Madrid stock exchange. Priced at €58 a share and marketed as a "turn-around" investment, hopefully indicative of a recovery in the whole Spanish economy, AENA currently has its shares quoted at €97 and a market capitalisation of about €14.5bn. AENA boasts that it is the largest airport group in the world — with 46 airports and two heliports in Spain, majority 51% ownership of London Luton, two airports in Colombia and a 6% stake in Grupo Aeroportuario del Pacifico in Mexico. Overall in 2014 it claims responsibility for 196m passengers throughout its airports, and recently announced full year results showing EBITDA of €1.9bn up by 16% on the previous year on turnover of €3.2bn up by 8%.

The sale of French regional airports has been under discussion for the past twenty years. Finally in 2014 the first — that of Toulouse — was achieved. Surprisingly the buyer was not French, but a Chinese consortium of state-owned Shandong Hi-Speed Group and Hong Kong-based investment firm Friedmann Pacific Asset Management who acquired a 49.99% stake for €308m. The airport handles around 7.5m passengers per year, and has an annual turnover of €117m. With the success of the Toulouse sale it is expected that more French re-





gional airports will be put up for sale — including Lyon St-Exupéry and Nice Côte d'Azur.

Heathrow Airport Ltd (the airport group formerly known as BAA) announced the sale of the three remaining non-Heathrow airports to a consortium of Ferrovial and Macquarie in a deal worth £1.05bn. Ferrovial remains the largest shareholder in Heathrow with a 25% stake.

However, the finalisation of the sale of Greek regional airports has become mired in politics. Fraport won a bid for the 40-year concession, in partnership with Greek energy group Copelouzos, to run 14 regional airports for €1.2bn, which was at the top end of expectations. The new government then absurdly froze the sale, but seems since to have relented as its struggles to find money to meet its debt repayments. The question now is whether Fraport shareholders are still happy for the deal to be completed.

The Japanese regional airport sales process, part of the Abenomics economy recovery package, appears to be moving ahead slowly, directed by the Ministry of Transportation (MLIT). At present negotiations are taking place for the granting of a 45 year concession for operating Osaka Airports which consist of Kansai International (domestic and international services, with a new LCC base, handling 19m passengers a year) and Itami (a downtown airport, domestic only, 15m passengers a year). The successful bidder is likely to be an international infrastructure fund allied to local Japanese interests. The asking price is an upfront payment of up to ¥500bn ($4.2bn) and an annual fee of around ¥50bn.

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