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HNA Group: creating a mysterious global conglomerate

This issue includes

Page

THERE are few conglomerates in the world of aviation born out of the establishment of an airline, and none seemingly with such overwhelming ambition as the HNA Group. Chairman and founder, Chen Feng, has stated that "by 2020 we can become one of the world's top 100 companies and by 2030 we want to become one of the top 50". And yet it is privately owned; its ownership, financial data and structure obscure and opaque.

HNA Group grew out of Hainan Airlines, now China's fourth largest airline. The airline, based in the historically piratical tropical island of Hainan, was formed by Chen Feng in 1993 in an unusual public/private partnership with the regional government of Hainan Province, later in 1995 helped by a small initial $25m investment from George Soros' Quantum Fund apparently creating the first sino-foreign "joint venture" airline. The *group* itself was established in 2000 — at the same time as as the CNAC's domestic industry reforms that created and promoted the top three holding companies of Air China, China Southern and China Eastern. Grand China Airlines was established as a parent company for the listed Hainan Airlines and the group acquired control of a handful of smaller carriers: Chang'an, Xinhua and Shanxi Airlines.

Now HNA Group is multinational, a sprawling conglomerate with fingers in many pies primarily relating to transport and tourism, boasting revenues of RMB190bn ($30bn) in 2015, assets of over RMB600bn and major or controlling stakes in 11 listed companies.

It lays claim to a fleet of over 820 aircraft, carrying over 77m passengers on 700 routes involving 210 domestic and international destinations (how it justifies this claim is unclear); ownership of at least 8 airports, 330 retail stores, 440 hotels, a fleet of 40 ships of various types, a shipbuilding yard, the world's largest container leasing operation, and the world's fourth largest aircraft leasing business.

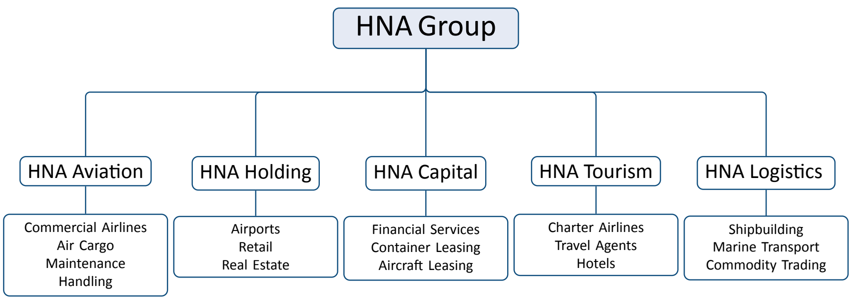
The group structure seems to be set out under five main "pillars":

✈ **HNA Aviation**

The aviation segment is the core of the scheduled airline business based around Hainan Airlines and its domestic Chinese subsidiaries. As shown in the ownership chart of Hainan Airlines on page 5 (extracted from a recent capital issuance filing) HNA Group only has a direct shareholding of less than 5% in the capital of Hainan Airlines, and indirect interest of around 8% before eliminating cross-shareholdings but maintains management control.

It states that it operates and manages Hainan Airlines, Tianjin

HNA GROUP: FIVE CORE PILLARS



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Airlines, Deer Jet, Lucky Air, Beijing Capital Airlines, West Air, Fuzhou Airlines, Urumqi Air, Beibu Gulf Airlines, Yangtze River Airlines, Guilin Airlines, MyCargo (Turkey), Africa World Airlines (based in Ghana), and French based Aigle Azur (48% owned). It also has a 45% stake each in Hong Kong Airlines and HK Express. In addition it has recently acquired a small 6% stake in the South African regional carrier (and British Airways franchise partner) Comair, plus a 24% stake in Azul in Brazil, a David Neeleman airline, which in turn is in the process of buying 40% of TAP Air Portugal.

✈ HNA Holdings

The "Holdings" pillar appears to incorporate the group's investments in airports, retail and real estate.

Under HNA Airports it claims ownership and operation of eight airports in China, with maybe five others under "cooperation projects", dealing in total with 35mppa. These encompass Haikou Meilan, Sanya Phoenix, Qionghai Bo'ao, (all three on Hainan Island), Yichang Sanxia (Hubei Province), Weifang Nanyuan (Shandong Province), Manzhouli Xijiao (Inner Mongolia), Anqing Tianzhushan (dual military/civil in Anhui Province), Tangshan Sannühe (dual military/civil in Heibei Province) and Songyuan Chaganhu Airport (new build, Jilin Province, due to open 2016). Haikou Meilan and Sanya Phoenix are the two largest airports on Hainan with passenger throughput of over 16mppa each, while Qionghai Bo'ao is a new build on Hainan island that opened in March.

The group is looking for investment further afield and had been short-listed for a bid to acquire London City airport with a £2bn price-tag. (They apparently narrowly missed out to Ontario Teachers).

As of the end of 2015 the company states that HNA Real Estate held investments in over 40 cities, with 41 projects covering around 6 million m^2 under construction. It holds 20 property projects including office buildings, businesses, hotels, and apartments, with an area of 867,000m^2 and is currently developing 10,000m^2 Hainan's CBD and a 49,000m^2 Pearl River man-made island.

HNA Retail claims ownership of brands like (quoted) Xi'an Minsheng department stores, Hunan Joindoor supermarkets, Baoji Retailing, Shanghai Jiadeli supermarkets, Hainan Seaview International Plaza, and nearly 330 outlets with operational areas of over 1.2 million m^2.

✈ HNA Capital

HNA Capital is the Group's financial sector arm. There is not a lot of information. The group states that "its main businesses are leasing, insurance and trust etc. It has traditional and innovative financial services such as securities, banking, futures, fund, investment banking, insurance and

HNA AIRPORTS

wealth management etc, and has obtained licenses covering all financial industries."

In this core segment lies its investment in quoted Bohai Leasing in partnership with which, following the acquisitions of SEACO and Cronos from GE, it has become the world's largest container leasing company.

In 2010 the group acquired Australian Allco, transferred its base of operations to Hong Kong as an aircraft lessor and changed its name to Hong Kong Aviation Capital (later partly reversing it into Bohai).

Following the acquisition of Avolon in 2015 the group has emerged as the world's fourth largest aircraft leasing company. It obviously has further ambitions and was reputed at the and of 2015 to have been in talks to acquire AWAS from Terra Firma for something over $2bn.

✈ HNA Tourism

Under HNA Tourism the group owns tourist agency Caissa Touristic, which it claims to be China's top outbound tour operator, with more than 200 retail stores. It also owns TransForex — China's first non-financial institution that is qualified to provide individual domestic and foreign currency exchange service and has 52 service outlets covering 23 cities.

Under this pillar it also includes "HNA Hospitality Group" which it states owns and manages over 450 hotels "at home and abroad" (including brands such as Tangla Hotels and Resorts and NHA Hotels and Resorts). In addition, perhaps within this sector is included the group's 29% shareholding in Spanish hotel group NH Hoteles.

In 2015 the Tourism group signed a strategic alliance with Pierre & Vacance-Center Parcs involving HNA Group taking a 10% stake in the French listed company and a promise of a $1bn investment in Center-Parcs developments within China.

✈ HNA Logistics

The "logistics" pillar includes shipbuilding (through Jinhai Heavy with an annual build capacity of 6m dwt), marine transport (with 50 ships "of different kinds"), along with cold-storage solutions and logistics payment exhanges. Through subsidiary Tianjin Tanhai (formerly Tianjin Marine Shipping) the group acquired in early 2016 Californian-based IT supply chain management company Ingram Micro for $6bn.

✈ HNA Ecological Technology

HNA appears to have created a sixth "pillar" to be positioned as the holding group for hi-tech businesses. We have no idea what this will entail except that it may have something to do with "big data".

Acquisition trail

HNA Group was proud last year to be able to announce that it had got into the Fortune Global 500 list of the world's largest companies at num-

HNA GROUP AIRLINES' FLEETS

	Capital Airlines	*Chang'An Airlines*	*Fuzhou Airlines*	*Grand China Air*	*Hainan Airlines*	*Hong Kong Airlines*	*HK Express*	*Lucky Air*	*Tianjin Airlines*	*Urumqi Airlines*	*West Air*	*Yangtze River Express*	*MyCargo*	*Total*
190									41					**41**
195									2					**2**
ERJ-145									22					**22**
737 Classic												19		**19**
737 NG		4	7	3	116			22		6		2		**160**
A320	54					9	13	7	22		20			**125**
767					3									**3**
787					10									**10**
A330	2				22	18								**42**
747												3	4	**7**
Total	**56**	**4**	**7**	**3**	**151**	**27**	**13**	**29**	**87**	**6**	**20**	**24**	**4**	**431**

Source: Ascend

ber 464 (with $26bn of revenues but only $206m of profits — a margin of 0.8%). Among aviation companies, it is not far behind IAG in the rankings, and nominally shows revenues only 40% below those of American Airlines — the highest ranked airline in the Global 500 list at number 257 (see chart on the next page).

To live up to the wish to become one of the top 100 by 2020 and in the top 50 by 2030, it will probably need to generate average annual growth in revenues of over 25% a year in the next five years (asssuming the rest of the world stands still). It is very unlikely to be able to do this organically.

As a result it has been on an accelerating acquisition trail in the past five years (see table on this page); and in 2015 itself seems to have spent something over $12bn buying among other things Swissport and Avolon, and stakes in Comair and Azul. It kicked off 2016 by acquiring Ingram Micro for HNA Logistics for yet another $6bn and apparently injecting another $1bn into Avalon/Hong Kong Aviation Capital.

It has been rumoured to be in other discussions — among other things to acquire a major stake in Spanish tourist group Globalia, or to buy aircraft lessor AWAS. It may even be interested in joining the bidding war for Virgin America, currently subject to approaches separately from JetBlue and Alaskan.

Some of the acquisitions seem to have little commercial logic — although to be fair it may just be a different logic.

The acquisition of a 48% stake in Aigle Azur in 2012 was said at the time to be to allow it to develop routes from Europe into China using French traffic rights whereas it, through Hainan Airlines, was restricted by the PRC policy of one Chinese airline per international route.

It might have been thought possible to lease an A330 to the French operator to access eg Paris-Beijing. In April 2015 the two companies announced a code share on Hainan Airlines' three times a week Paris-Xi'an-Hangzhou service.

Equally it seems difficult to understand how beneficial it can really be to hold a 6% stake in Comair (when Hainan does not fly to South Africa), or a 24% stake in Azul (when it does not fly to Brazil). We can only assume that there is some very long term view of strategy that we are missing.

Opacity

Analysing a privately owned conglomerate is not an easy task — the company is under no obligation to make public any information it does not want to, or justify any public statements it *does* make.

In April 2015 the group issued $350m 5.5% two-year bonds in Hong Kong (listed in Singapore) through Grand China Air (HK) — a wholly owned subsidiary of Grand China Air — and guaranteed by them and quoted Hainan Airlines. In the offering circular they showed the ownership relationships between the group and Hainan Airlines. We show a *simplified* form of the organisational holdings in the chart on the next page. This representation of the structure perhaps raises more questions from what is missing than it answers from what it shows.

The internal ownership structure

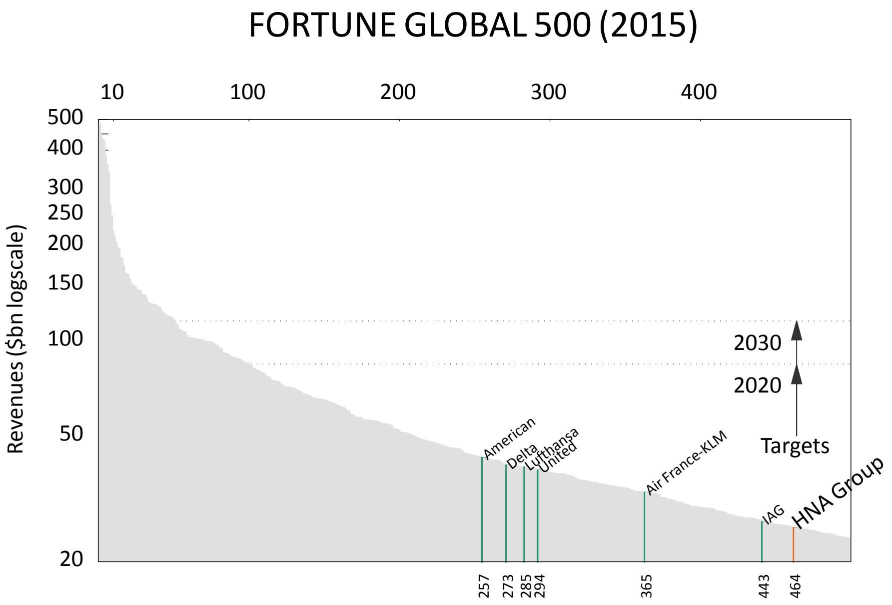
HNA GROUP: SELECTED RECENT ACQUISITIONS

Target	Stake*	Year	Sector	Country	Est Value (US$m)
Australian Allco Rental†		2010	Aircraft leasing	Australia	150
SEACO		2011	Container leasing	US	1,050
Ghanaian AWA	49%‡	2012	Aviation	Ghana	na
Aigle Azur	48%	2012	Aviation	France	40
TIP Trailer Leasing		2013	Trailer leasing	Netherlands	400
NH Hoteles	29%	2014	Hotels	Spain	900
Cronos		2014	Container leasing	Caribbean	600
Swissport		2015	Aviation	Switzerland	2,800
Avalon		2015	Aircraft leasing	Ireland	7,600
PVSA	10%	2015	Tourism	France	na
Reuters HQ Office		2015	Real estate	London, Canary Wharf	280
Comair	6%	2015	Aviation	South Africa	13
Azul	24%	2015	Aviation	Brazil	450
Ingram Micro		2016	Logistics	US	6,000

*Notes: † seat transferred to Hong Kong, renamed as Hong Kong Aviation Capital. Later part reversed into Bohai Leasing. ‡ Regional start-up. Estimated maximum foreign ownership. * stake if less than 100%.*

looks as if it might be designed to confuse — and may be reminiscent of the structure of, for example, the Korean Chaebol, in that management control in "subsidiaries" is maintained within a family of investors with minimal direct equity investment and convoluted indirect shareholdings. We assume that many of the other parts of HNA Group by extension will be organised in a similar fashion.

The difficulty with this structure is that the ultimate holding company has no right to consolidate the finances of its holdings (particularly the cash and cash flow). This also raises the question of where the money is coming from to fund the acquisitions. While things are going well this may not be a problem.

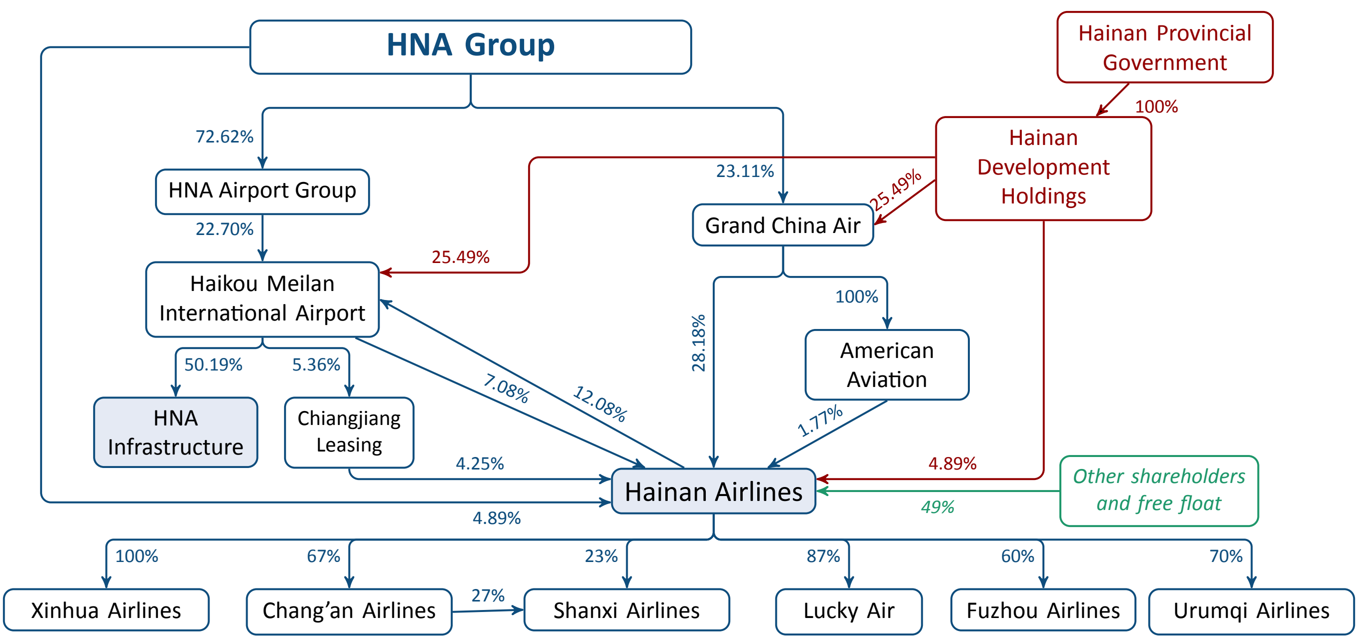


The world's top 500 corporations ranked by revenue
Source: fortune.com

The group states that "*HNAers* [its employees] *will always bear in mind the vision of* 'constructing a world-class conglomerate with China Dream', *carry forward the entrepreneurship of* 'brave to explore, persist in change, continue to innovation, strive for excellence', *and make greater contribution to the society and mankind, and* ***establish a world-class conglomerate****. It is a due responsibility of 180,000 HNAers to fight for the rejuvenation of Chinese nation and contribute to realisation of the China Dream*".

HNA Group appears particularly well connected politically — in its home base of Hainan Island and the PRC. It may well achieve its plans. The rest of the world (and investors) beware.

HAINAN AIRLINES OWNERSHIP STRUCTURE



Note: shaded boxes represent listed entities.

Rationalising the intra-European market

ALTHOUGH the low cost carrier is established as the most efficient model for short/medium haul travel in Europe, and the network carriers' short haul operations generally continue to lose money, and the traditional charter carrier business is evaporating, the LCCs still represent less than one half of intra-European capacity.

The industry remains remarkably fragmented, with at least seven segments.

✈ The five main LCCs — Ryanair, easyJet, Wizz Air, norwegian, plus the rapidly growing Pegasus. Ryanair remains the market leader, adapting its ultra low cost strategy to higher-yielding business orientated markets with "Always Getting Better" soft product improvements, and further strengthening its finances. Meanwhile, easyJet, having led the LCC advance into business markets, is being forced to refocus on its cost base and retreat from major cities like Rome. Wizz has unit costs similar to Ryanair's and a solid central European core, but is the most threatened of the LCCs by Brexit, the UK's possible withdrawal from the EU, as about 30% of its traffic is between East Europe and the UK. Norwegian continues to pursue an innovative, but risky, long-haul expansion, and continues to come up against US protectionism. Pegasus is as yet a relatively unknown presence outside the rapidly growing Turkish market.

✈ The short haul networks of the three global network carriers, of which only one, IAG, is currently financially successful, while the other two, Lufthansa Group and Air France/KLM are struggling. The network carriers have retreated to various degrees from non-hub operations, leaving them with their core hub feeding role.

✈ The lower cost subsidiaries of the network carriers — Vueling, Eurowings, Transavia. Of these subsidiaries only Vueling is clearly a viable proposition largely because of its role as the *de facto* flag carrier of Catalonia. Transavia and Eurowings are faced with unresolved labour and network problems; their growth plans are aspirations rather than realities.

✈ The remaining independent or quasi-independent national carriers — SAS, LOT, TAP, SN Brussels, etc.

✈ A subset: Etihad-invested airlines — airberlin, Alitalia, Air Serbia, Meridiana (potentially), etc. Their future depends on the willingness of Abu Dhabi to maintain this particular aspect of its oil diversification investment strategy.

✈ The residual charter industry, which continues to display an element of resilience as evidenced by Monarch's turnaround from an apparently hopeless situation.

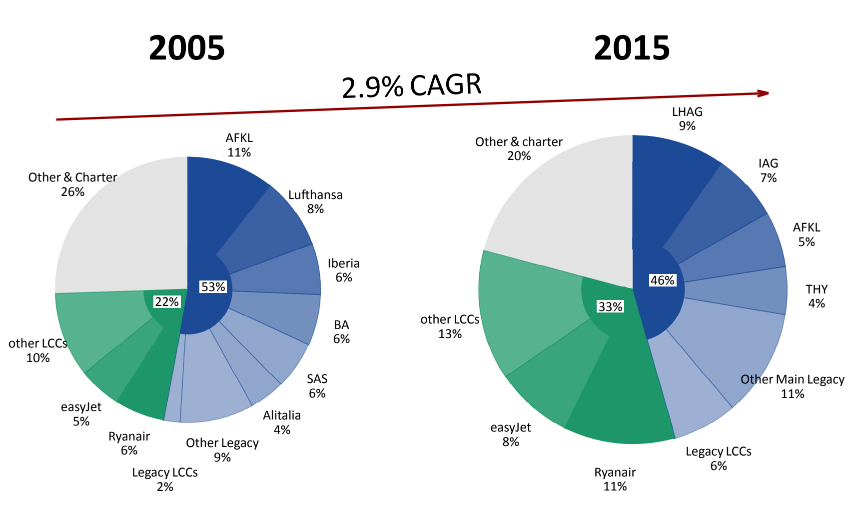
✈ The niche carriers, notably Aegean (successful hybrid but exposed to Greek crisis) and Volotea (stimulating unlikely traffic flows in niche markets).

The pie charts on this page summarise the total intra-European market in terms of capacity. It is notable how restrained total capacity growth has been over this period.

Looking at some key traffic trends, pulled together from various sources:

✈ The total intra-European market has grown at an average annual compound rate of 4% in the last ten years

INTRA-EUROPEAN SUPPLY BY CARRIER TYPE



in terms of passengers carried to an estimated 650m.

✈ LCCs have provided substantially all the growth — a compound annual growth rate of 12% a year over the past ten years. The LCCs as a broad group account for 45% of intra-European passenger traffic up from 23% ten years ago.

✈ The former AEA carrier group meanwhile have seen passenger numbers virtually static with annual average growth of 1%.

✈ The three main network carrier groups (IAG, Air France-KLM and LHAG) have seen no growth in intra-European passenger traffic after accounting for acquisitions; but their LCC subsidiaries and affiliates have been increasing capacity at a compound annual rate of over 10% in the past five years, albeit from low bases.

✈ Traditional charters have seen their business decline by about a third over this period.

There is a tendency to overestimate how quickly rationalisation of this market will occur. Different airline models will continue to co-exist, but there are clear trends as to the dominant LCC model increasing its market share at the expense of the network carriers' short haul operations, while two of their low cost subsidiaries appear to be vulnerable.

The most definite indication of the future comes from the firm order book — approximately 1,600 narrow bodies as at the end of 2015.

✈ The main LCCs account for 55%.

✈ The three network carriers, 12%.

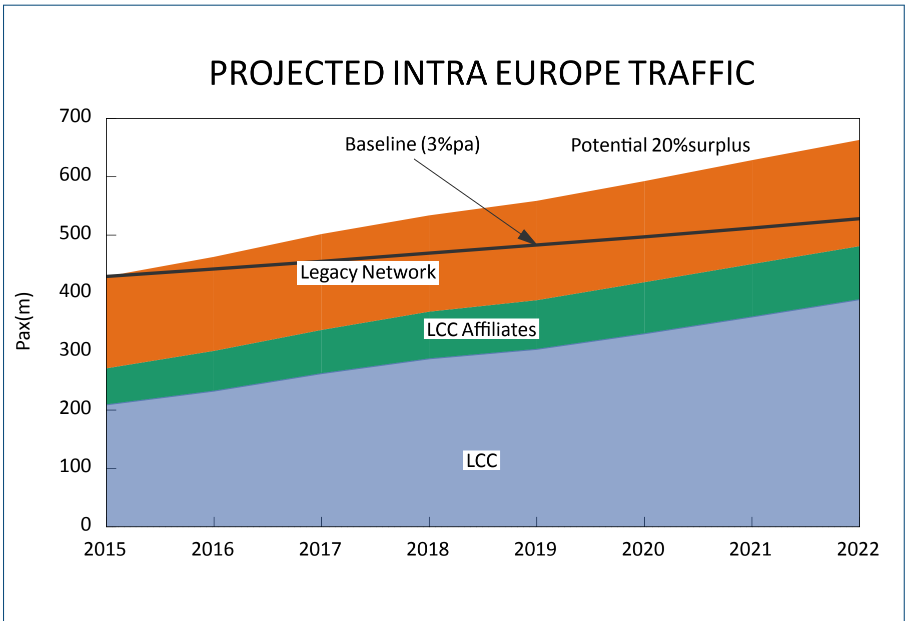
✈ The LCC Subsidiaries of the network carriers, 6%.

✈ Charters, 6%.

✈ Others, 21% (of which THY accounts for nearly 11%).

A forecast

We have generated a traffic forecast for the "core" intra-European market based on the explicit fleet expansion plans of the main LCCs, the three network carriers and their three LCC subsidiaries. To focus the analysis, we have only used the fleet plans of the most significant players for the period to 2022: the LCCs (Ryanair, easyJet, Wizz and norwegian); the Network carriers (IAG, Lufthansa and Air France-KLM); and the LCC subsidiaries/affiliates (Vueling, Transavia and Eurowings). Note that all the numbers quoted below refer only to the intra-European operations of this core group (estimated to account for about 80% of total intra-European traffic).



The central forecasts made by the airlines themselves have been used wherever available. Various estimates have had to made, particular in the case of Lufthansa and Air France-KLM and their subsidiaries, where fleet plans have not been quantified beyond a few years. Retirement profiles have also been factored in.

The next stage is to convert the annual fleet projections into a seat capacity forecast by multiplying the number of units by the average number of annual seats generated per aircraft (based on 2014/15 data), In turn the capacity estimates are converted into passengers by applying the latest annual average load factors. Finally, an "efficiency" factor is added to the equation reflecting a modest expected improvement in aircraft utilisation and/or load factor over the forecast period.

So we end up with a traffic forecast for the three sectors which is consistent with the fleet plans as they stand at present. An implicit assumption is that economic conditions will be benign; a major recession would cause easyJet, for example, to radically downsize its growth plans.

Overall the market continues to be driven by the LCCs whose combined growth rate 2015-2022 is estimated at 9.3% pa, back to close to the rate before retrenchment in 2009-2014. The network carriers' growth rate is 2.1% pa, while that of the LCC affiliates is put between the other two sectors, at 5.6% pa.

The overall intra-European growth rate then works out at 6.4% pa for 2015-2022.

It should be remembered that the LCC fleets plans are firm, or at least are explicit, and two of the leading LCCs also provide base passenger forecasts for the long term (which are broadly compatible with our calculated future volume). By contrast, the network carriers, with the exception of IAG, are much vaguer with fleet projections beyond the very short term. The affiliates' plans are even more fluid, again with the exception of IAG's Vueling, dependent on union negotiation and setting hopeful targets, notably Lufthansa's claim that Eurowings will somehow emerge as Europe's third LCC.

The total market growth rate of 6.4% pa looks compatible with LCC-type expansion but is high for the total intra-European market. The historic traffic growth rate was around the 3-4% mark; and our assessed baseline assumption is 3% going forward. The Airbus intra-European traffic forecast, albeit for a longer period to 2034, predicts just 1.5% pa. There is significant difference in passenger totals derived from 3% compounding and 6.4% compounding growth rate. In fact, as the graph on the previous page below illustrates the implication is for a theoretical 20% surplus by 2022.

Although there are various ways this potential surplus could be resolved — lower LCC delivery profiles, new LCC markets, total collapse of the Charter industry and/or smaller flag carriers — market trends point to the major impact being absorbed by the network carriers (and their subsidiaries), Lufthansa and Air France-KLM in the main.

The fundamental reason is the unit cost advantage the LCCs hold in a market where other factors, like claimed service quality or brand loyalty, continue to decline in importance. One can also trace the evolution of LCC traffic in three phases:

- ✈ 2002-2009 Rapid Growth: Stimulation of new markets and thinner routes, converting VFR and Charter passengers to the LCC mode, opening up in Eastern Europe, concentration on secondary points.
- ✈ 2010-2014 Consolidation: Slowdown in deliveries, initial "land grab" completed, emergence of new LCC models, more focus on primary points.
- ✈ 2015-2022? Move into network carrier core markets: Focus on higher yielding routes, LCC rebranding and product improvement, primary airports, new distribution models, interlining, new feed agreements; network carriers forced to retrench further and concentrate on long-haul.

LCC subsidiary — an unviable model?

One of the fundamental problems with low cost subsidiaries is that they are compromises. The parent airline's aim is usually to counteract low–cost competition but it has to do this without either disturbing its own unions or undermining its core network business. Consequently, a series of conflicts arise.

Airport base: To leverage the benefits of a low–cost subsidiary, the optimal place to locate it would be at the main hub where yields are strongest (despite the fact that airport charges are likely to be high there). This is rarely if ever possible because of fears of brand pollution and union agreements.

Locating at a secondary airport at the incumbent airline's main city base then seemed to be a good idea: establishing Go at Stansted, it was thought, would not only inhibit the growth of Ryanair but would also tie up slots at London's third airport. That didn't work for BA — Go helped stimulate the overall low-cost market and cannibalised BA's Heathrow traffic.

The French version of Transavia is based at Orly, where it can indirectly impact AF's CDG traffic. The Dutch version is starting a new base at Munich where it will face a typical dilemma — it will be under intense pressure from the incumbent carrier, Lufthansa, and if it does succeed in building a presence, the markets it stimulates are likely to be grabbed by efficient LCCs.

Eurowings is based at a variety of secondary airports — Düsseldorf, Hamburg, Cologne, Vienna — where it may have a certain brand loyalty but again will be the target of genuine LCCs.

Labour relations: These have been fraught; unions tend to be deeply suspicious of such ventures,

FORECAST CORE INTRA-EUROPEAN MARKET 2015-2022

	LCCs	LCC affiliates	Network Carriers	Total
Passenger CAGR				
2015-2022	9.30%	5.60%	2.10%	6.40%
Market Shares				
2015	49%	14%	37%	100%
2022	59%	14%	27%	100%

regarding them, quite correctly, as a potential threat. Their response is to attempt to ring–fence the subsidiaries' activities — which frustrate the subsidiary's employees who are denied the opportunities which come from rapid company growth; their aspirations to move to a better post in the parent company are also blocked.

Fleet growth: Although the parent airlines have ambitious fleet plans they appear to be aspirations rather than reality. The subsidiaries generally lack direct access to finance to fund major fleet growth. Eurowings has 22 units on firm order, Transavia 17 — in contrast to Vueling's 60 let alone Ryanair's 260. Without mega-orders the subsidiaries cannot attain major discounts, which again leaves them at serious cost disadvantage to the genuine LCCs.

In summary, Lufthansa's and Air France-KLM's rationale for low–cost subsidiaries is questionable. They probably do not provide a solution to loss-making short haul networks nor to the incursion of LCCs into core Legacy carrier markets.

New LCC feeder model

LCCs have greatly complicated network carriers' feed strategies. Traditionally short haul flights to a long-haul hub relied on a high proportion of point-to-point passengers in the total traffic mix. The reason was that these passengers were higher yielding than the connecting passengers, which was partly the result of internal accounting conventions that pro-rated through ticket revenue on a distance basis. The LCCs have eroded those network economics by capturing more and more of the point-to-point traffic either at airports within the city capture zone or, increasingly, with services to the major airport hub.

In the future it would be logical to expect LCCs to play a significant role in feeding traffic to the network carriers at the intercontinental hubs.

LCC interlining/connecting models do exist — JetStar Asia interlines with several full services carriers collecting feed at its Singapore base. COPA, the high successful Panama-based LCC, has signed interline agreements with Emirates and Star Alliance airlines. But the European model, as yet a matter for speculation only, would involve, for instance, easyJet providing AF with feed at CDG or Ryanair taking over LH's short haul service to Munich or even Frankfurt.

These are some of the issues which used to be intractable but may no longer be so:

- ✈ Distribution used to pose a major barrier but with the leading LCCs experimenting with GDS and IT systems becoming cleverer interline bookings should no longer be an issue, though there still may be yield management conflicts.
- ✈ Product: the short haul experience on LCCs and network carriers has converged to such an extent that economy passengers would have little cause for complaint, but the Legacies will always want to protect their brand.
- ✈ Primary vs secondary airports: again what used to be a major distinction, but increasingly the LCC are operating to the major hubs.
- ✈ Operating to major hubs will inevitably change an LCC's cost structure — not just higher airport charges but also decreased aircraft utilisation because of longer turn-around times; but with no need to stimulate traffic, the higher yields should more than compensate.
- ✈ For the network carrier the significantly lower costs should be compelling, but outsourcing a vital part of the network to a LCC remains a frightening proposition, fraught with implementation risks.

Finnair: East by Northeast

FINNAIR'S share price doubled over 2015 as the airline focused on its core business and concentrated on profitability rather than growth. Can the momentum of Finland's flag carrier continue through 2016 as it starts a new growth phase and, if so, could it prove a valuable acquisition for a larger airline?

Based at Helsinki's Vantaa airport, Finnair was launched as far back as 1924 — making it one of the oldest airlines in the world — and though it has had ups and downs, under state control it has happily stuck to its mission of serving its tiny home market domestically and internationally with reasonable success ever since.

Its core disadvantage, however, is its location at the northern extreme of Europe, which means that it struggles to attract any through passenger traffic in Europe other than to/from the Nordic countries and east/south to the Baltics and parts of Russia. That tough geographical positioning is reflected in its financials, where it has lurched between profitability and loss for a number of years.

In 2015, however, despite reporting just a 1.7% increase in revenue to €2.3bn, Finnair turned an operating loss of €36.5m in 2014 into a €23.7m operating profit in 2015. Similarly, an €82.5m net loss in 2014 became a €89.7m net profit last year.

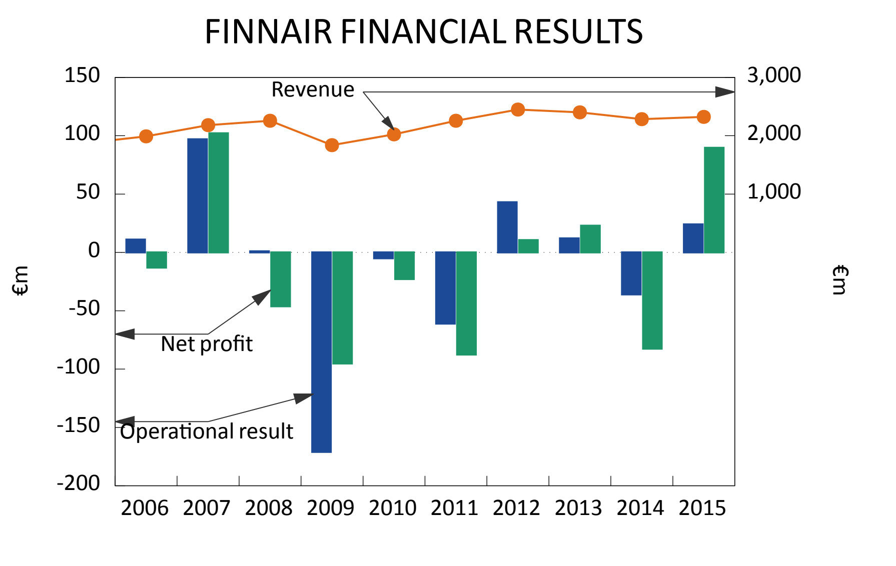
The reasons for that creditable result (and the subsequent improvement in share price — see chart on page 14) are multiple. At a macro level Finnair has benefited from an upturn in the Finnish economy — after three years of recession, GDP grew by 0.4% in 2015. More importantly perhaps, cost-cutting has been a key priority for many years, initially starting after the post-September 11 traffic downturn, with — for example — its group workforce steadily shrinking from just under 10,000 in 2003 to 4,900 as at the end of 2015. However, that has led to significant disputes with unions over the years, either directly or as a by-product of clashes between unions and the state over collective labour agreements and conditions. Nevertheless, the necessity to reduce costs remains — as can be seen in the chart on page 12, there is no permanent clear gap yet between unit revenue and costs.

Asia routes

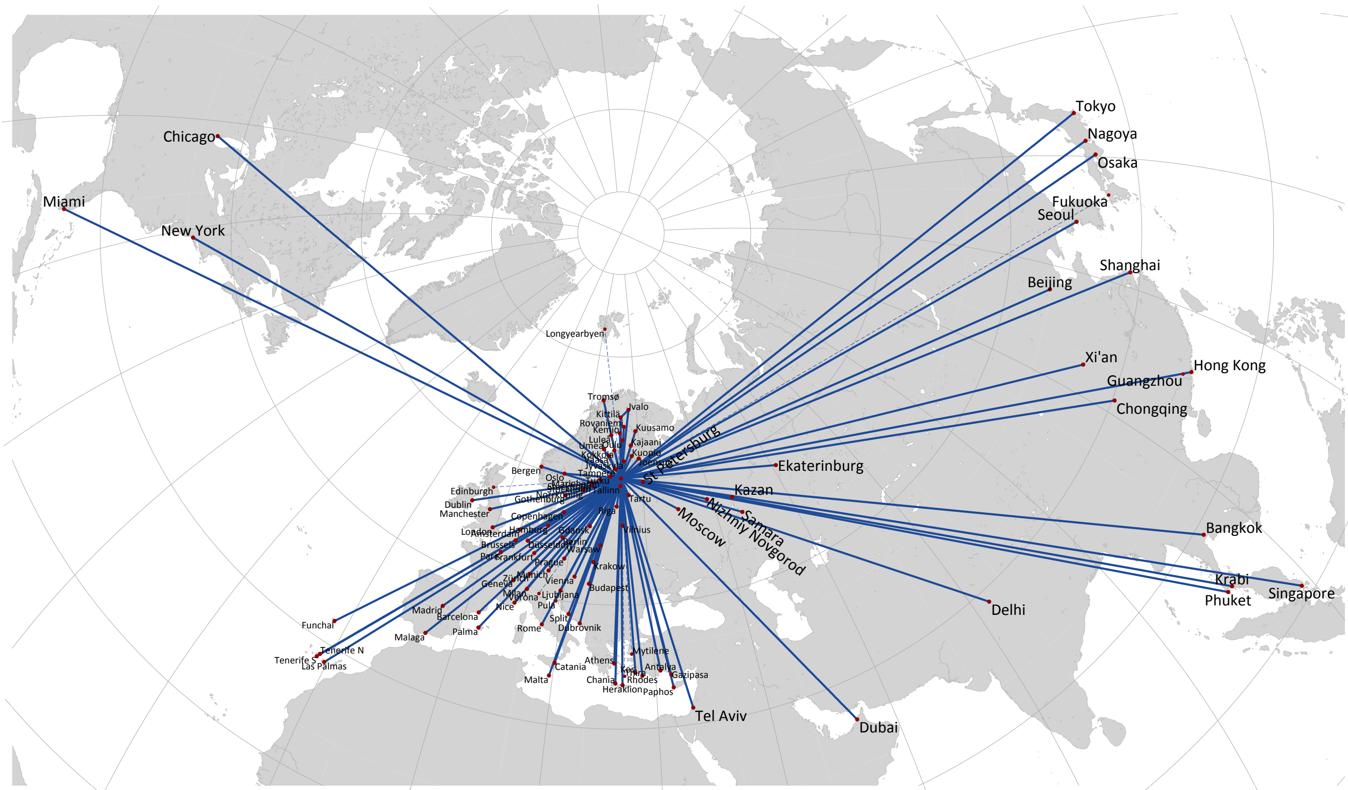
Just as important as cost measures is the continuing attempt to turn Finland's geographical isolation within Europe into an advantage in terms of its proximity to Asia, where the fastest connections between many European cities and what it calls "Asian megacities" fly over Finland and then Russia. This has been an aim for Finnair for several decades (its first Asian route, to Bangkok, started in 1976), but in May last year, as part of a strategic review, Finnair adopted a new target of doubling traffic to/from Asia by 2020 compared with the 2010 level.

Currently the airline operates to 15 Asian cities in nine countries (both leisure and business destinations) and this May it will boost the network through new routes to Fukuoka in Japan and Guangzhou in China. At the former Finnair will benefit from its close relationship with Japan Airlines, which is a fellow member of **one**world.

Finnair's relative proximity to north-east Asia means that it can operate routes with aircraft on a



FINNAIR ROUTE NETWORK



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

24-hour round-trip rotation, which it points out "enables very high aircraft utilisation and reduces the need for additional crews due to flight time restrictions". From a passenger point of view, the routes are around two hours less on average compared with one-stop flights from European hubs (though clearly this varies considerably depending the specific airport the comparison is with), and more than four hours shorter compared with flights connecting through the Gulf hubs.

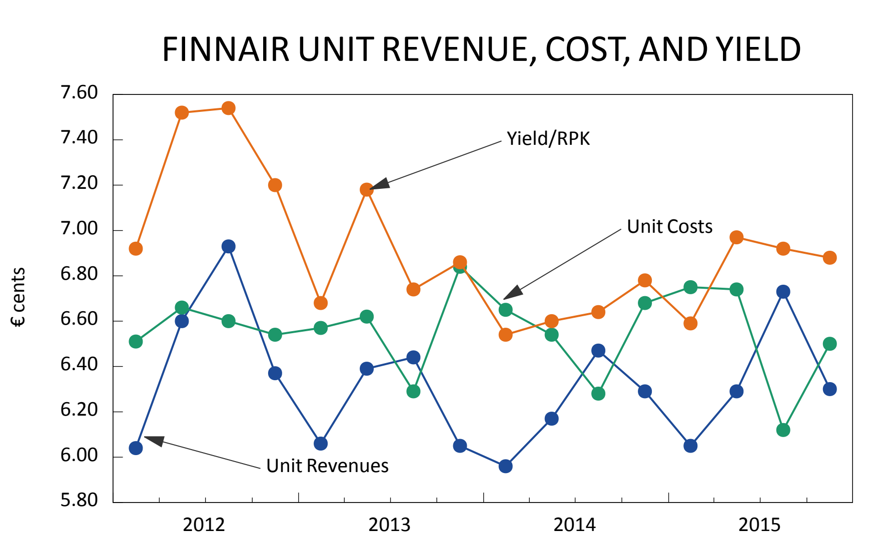
But while Helsinki airport has three runways and relatively short connection times, it's a tough sell to persuade European travellers not based in northern Europe to connect to Asia though Finland. The traditional Mercator projection of the world perpetuates a concept that to go East you travel towards the East, whereas the great circle and therefore shortest route from the center of European population can well be to the North and over Helsinki anyway. Another challenge here is the faltering economies of several countries in Asia, not least China, though Finnair says it has not seen any signs of weakening Chinese demand as yet.

Nevertheless, last year Asian routes accounted for half of Finnair's total traffic, and the airline says that in total it has an approximate 4.6% market share of traffic between Europe and Asia — though that was down from 4.8% as of 2014, which perhaps indicates the level of competition that Finnair faces.

Finnair's only other long-haul routes are to North America (to New York, Chicago and Miami), but although these are doing well in the premium segment, Finnair says that in economy it "suffered from intense competition and overcapacity" in the fourth quarter of 2015. A note released by HSBC Global Research in February says that it "harbours some concerns about the limited feed available for Finnair's US flights, given Helsinki's geography and the poor economics of Russia, which is a natural feed market for Finnair's US flying".

A350 investment

Altogether the long-haul network is served by a fleet of 16 aircraft, comprising eight A330s, five A340s and



three A350s. The fleet is being renewed through the 297-seat A350 XWB, 19 of which were on order (with 11 placed in 2007 — making Finnair the European launch customer for the model — and eight more in 2007), with three delivered in 2015 (the first in October) and four others arriving this year, four in 2017 and the remaining eight coming by the end of 2023. The remaining five A340s will be phased out by the end of 2017, four of which are being sold back to Airbus.

On short-haul Finnair operates to around 60 destinations in Europe with 30 owned and leased A320 family aircraft, but although this fleet has an average age of more than 12 years it has no firm orders at present. Instead Finnair's strategy in Europe currently revolves around operating larger aircraft to fewer destinations, and the first stage of this involves the lease of two A321s that arrive in May this year (each on one year contracts), before leasing four A321s (on eight year terms) from BOC Aviation for the first-half of 2017. Finnair will also add extra seats to 22 A320 family fleet in 2017 by reducing storage and technical space at the front and aft of aircraft; this will increase capacity by between six to 13 seats for each aircraft.

For its domestic network (which unsurprisingly is loss-making) and some European routes Finnair contracts Vantaa-based Nordic Regional Airlines (Norra) to operate on its behalf, and the Norra fleet comprises 12 ATR 72-500ss, two E170s and 12 E190s.

Norra was previously known as Flybe Nordic, which was created in 2011 when Finnair and Flybe bought respective 40% and 60% stake in Finnish Commuter Airlines (at a total price of €25m), which was then renamed Flybe Nordic. However, the airline's losses persuaded Flybe to exit and sell its 60% stake for just €1 to Finnair in March 2015 (after which it was renamed as Norra), although this was a temporary arrangement before that same 60% stake was sold on to two Finnish companies — StaffPoint Holding (with 45%) and Kilco (15%) — in November 2015 for the same €1 price. StaffPoint is a staffing/recruitment agency with 15,000 employees, while Kilco is an investment company that part-owns StaffPoint.

As for cargo, Finnair runs hubs at Helsinki, Brussels and London, with all its cargo capacity now in the belly of its passenger fleet after discontinuing separate cargo freighter operations in 2014 and after Helsinki-based Nordic Global Airlines (in which Finnair owed 40%) ceased business in May last year. An exception to this is a wet-leased freighter that the company operates as a cargo ˝air-bridge˝ to connect its network with that of BA in London integrating the Asian flows with IAG Cargo. Finnair meanwhile is investing €80m into a new cargo terminal at Helsinki over the next few years, which will replace its present cargo terminal that will be decommissioned in 2017.

However, cargo is a tricky business for Finnair at the moment as there is significant overcapacity in the market between Europe and Asia, and as a result the airline said it experienced "further weakened average yields and load factors" in Finnair's primary markets for cargo traffic in 2015. Finnair's total cargo tonnes carried fell 12.4% last year, cargo unit revenue was down by 7.5%, and cargo revenue fell a substantial 20.6% to €183.7m.

The airline business (both passenger and cargo) accounted for 91.1% of all revenue in 2015 — the rest is made up of Travel Services unit, which comprises tour operators

FINNAIR FLEET

	In service	Orders
A319	9	
A320	10	
A321	11	
A330	8	
A340	5	
A350	3	16
Total	**46**	**16**

and travel agencies, and which experienced a fall at both the revenue and profit level last year.

A bright future?

Pekko Vauramo, CEO of Finnair, says that "we are heading in the right direction". While this is broadly true, significant risk must be present from increasing competition.

Within Europe Finnair — like all other flag carriers — faces intense competition from LCCs, although its northern position means that if faces no direct competition from easyJet, and Ryanair operates routes only from Tampere (in southern Finland) to Bremen and Budapest. The main LCC competitor is Norwegian (see *Aviation Strategy*, December 2015), which operates from Helsinki to 28 destinations directly, of which 24 are international and four domestic (Ivalo, Kittilä, Oulu and Rovaniemi), and from Oulu to two international destinations. As a result, Norwegian has an approximate 12% market share at Helsinki airport, and given its fares structure is Finnair's fiercest competitor, ahead of SAS, which has just eight routes between five Finnish airports and its hubs at Stockholm, Oslo and Copenhagen.

Finnair says it has a 57.9% share of the market in European traffic to/from Helsinki last year — which rose by 5.5% compared with 2014 — but share isn't everything, and it's critical that Finnair continues to maintain its average yield, as it has done over the last couple of years following a worrying period of decline through 2012 and 2013 (see chart on the facing page).

Finnair does have some room for manouevre given that it's strong in terms of the balance sheet. As at the end of 2015 Finnair's interest-bearing long-term debt stood at €271m — 19.8% down year-on-year — while cash and cash equivalents totalled €280.5m, some €197m higher than 12 months previously. In October last year strengthened its finances by issuing a €200m bond and selling and leasing-back two A350s with GECAS. Further A350s will be sold and leased-back with GECAS in 2016 and 2017.

2016 will be crucial for Finnair, as the modest capacity growth of last year (just 3.1%) will be replaced by significant growth. HSBC forecasts it will be around the 10% mark thanks to the delivery of more A350s, new Asian routes and an expansion of the short haul network. HSBC believes that underlying profitability should rise in 2016 because although yield will fall due to competition, unit costs will drop by almost 9% year-on-year, thanks mainly to falling oil prices. Those oil costs will compensate for rising expenditures elsewhere; for example, the arrival of the A350s is leading to a significant expansion of long-haul staff recruitment, with 100 new pilots and 300 new cabin crew members arriving from this year onwards.

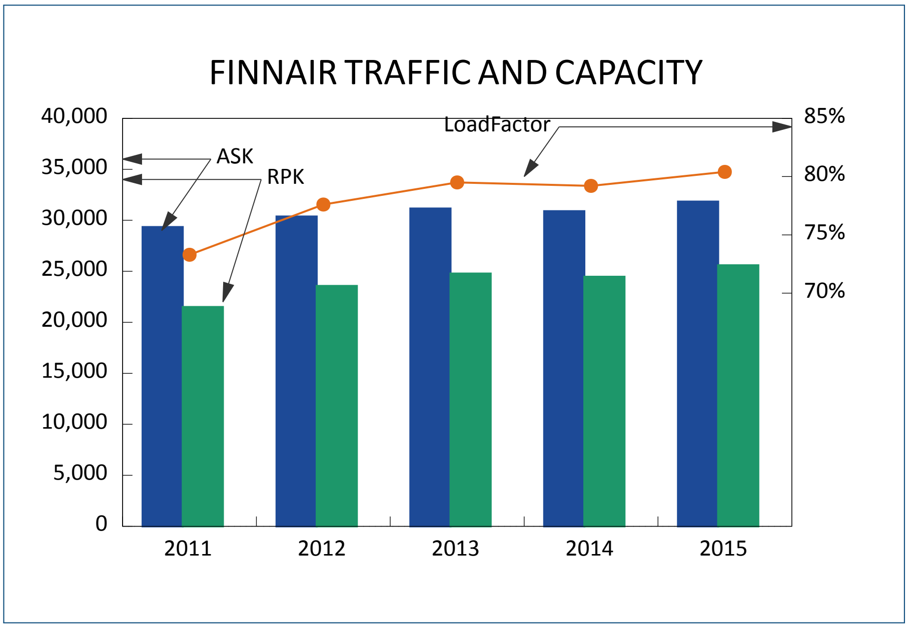
Yet the macro-economic oil situation should be seen as nothing more than a short-term phenomenon (as very few people argue that low oil prices are with us permanently), and once that compensating factor evaporates — and with limited scope for further significant non-fuel cost savings giving Finnair's structurally high-cost location — Finnair will inevitably be stuck with the underlying problem of compensating for unrelenting yield pressure.

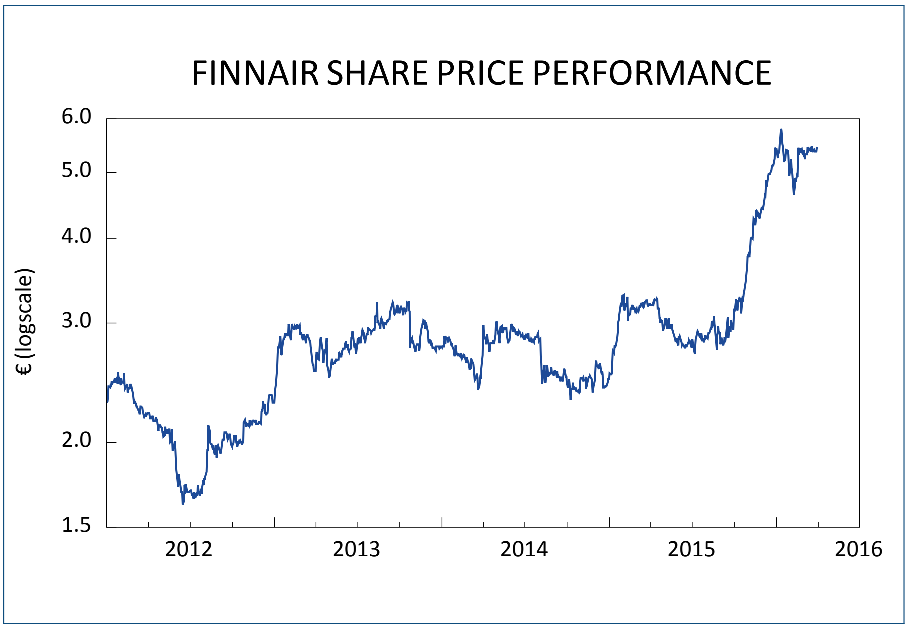
To be fair, it's a risk that Finnair management must be fully aware of, and that's why the airline is pushing ahead in other areas, such as ancillary business; ancillary service revenue per passenger grew 23.7% in 2015 compared with 2014, to €10.2 per passenger, bringing in total revenue of €104.6m over the year.

Value to IAG?

Though quoted on the Helsinki stock exchange since 1989, the Finnish state still owns 55.8% of the airline, and the government would have to change its status as a "national strategic asset" before it could sell its majority stake.

There has been growing speculation that such a move may be immi-





nent, and that if it does then fellow **one**world member IAG is likely to be at the head of the queue to buy the state's shareholding. Yet it's hard to see what value Finnair would really deliver to IAG. Even if it can establish a sustainable gap between unit costs and revenue, given its tiny home market it will never be a generator of substantial cash and profits for IAG.

Essentially that leaves Finnair's share of the European market into north-east Asia as the main rationale for a purchase, but that share is relatively small and totally dependent on Russian over-fly rights that potentially could disappear at some point (particularly given Russia's frosty relationship with the UK at present). In any case, what further revenue could be driven by buying Finnair that isn't or couldn't be achieved by **one**world and the existing joint venture it and IAG have with JAL on Europe-Japan routes?

In a sense the logic for IAG acquiring Finnair is a negative one, in that while buying Finnair might not bring huge benefit to IAG, if it fell into the hands of Star or SkyTeam that would be problematical to say the least. Not only would it create a hole in the Nordic region for **one**world, but if Star acquired Finnair that alliance would dominate the Nordic region (thanks to the combination of SAS and Finnair, not to mention Lufthansa just to the south). The situation wouldn't be much better if a SkyTeam member bought Finnair, as Aeroflot and Finnair would have a grip on the fastest routes into north-east Asia.

Fear of losing an asset to a competitor is never a great rationale for an acquisition, but that logic may prove just strong enough for IAG to acquire Finnair if/when the Finnish state puts it up for sale.

LATAM: Impressive cost cutting and fleet restructuring

LATAM Airlines Group, created when Chile's LAN completed its cross-border acquisition of Brazil's TAM in June 2012, has weathered the tough economic and airline industry conditions in South America relatively well.

Despite its heavy exposure to the Brazilian domestic market (30% of its ASKs), where demand has fallen sharply due to recession, and the depreciation of all of the local currencies in South America, LATAM managed to improve its operating margin by one percentage point to 5.1% in 2015.

But the net result was again negative — a loss of US$219m or 2.2% of revenues — as a result of a massive $468m foreign exchange loss mainly related to a 49% depreciation of the Brazilian real last year.

Revenue trends were dismal. Because of the currency devaluations and macroeconomic malaise, LATAM saw its operating revenues plummet by 18.8% in 2015. And its unit revenues and yield fell by 20.5% and 18.1%, respectively, in US dollar terms.

But LATAM's famously capable ex-LAN management team, which has guided LAN through many recessions in the past, again rose to the challenge, implementing what may be the sharpest cost reductions of recent times among global carriers.

On top of significant fuel cost savings, LATAM achieved $325m of new non-fuel cost savings in 2015, which far exceeded the target of $200m and helped reduce non-fuel CASK by 11.5%. The airline benefited from having a solid cost-cutting programme already in place when the region's economic problems worsened last year. In 2014 the group had announced plans to reduce non-fuel costs by $650m by 2018. The programme, which consists of a multitude of small initiatives, is running ahead of schedule.

Second, LATAM has managed to reduce its 2016-2018 fleet commitments by $2.9bn or almost 40% since January 2015 — an impressive reduction for a global airline that is not in bankruptcy, though for LATAM some of it was still fleet rationalisation related to the merger.

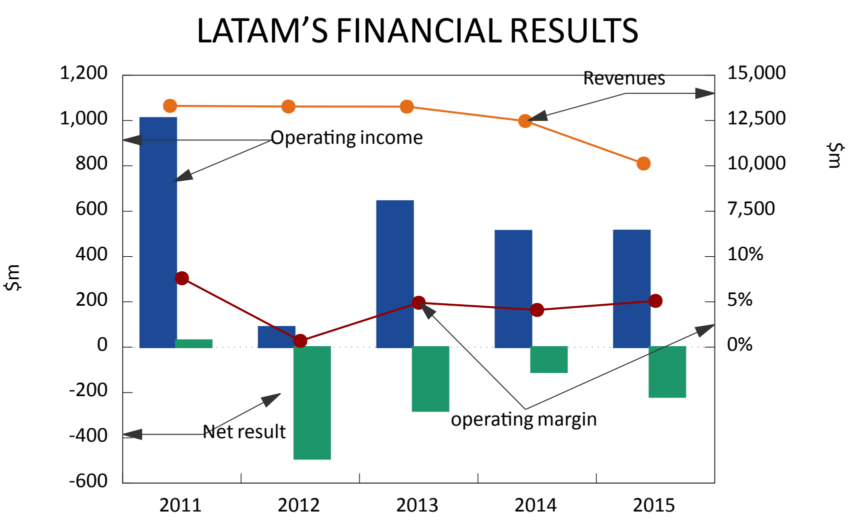
LATAM must also be commended for its robust response to Brazil's recession. TAM cut its domestic capacity in Brazil by 9.4% in the fourth quarter — the sharpest reduction in the industry — and by 2.5% in 2015.

On the negative side, LATAM has now reported net losses for four consecutive years and has made little progress in repairing its balance sheet.

LAN had been consistently profitable up to an including 2011 and had earned double-digit operating margins and solid net profits since the mid-2000s. But the merger changed all that. The combine immediately lost LAN's long-held investment-grade credit ratings, essentially because of TAM's high debt levels. And LATAM went on to incur net losses totalling $1.1bn in 2012-2015.

LATAM's share price performance has been dismal. After a long and steady decline, the NYSE-listed ADRs were trading at $6-7 in mid-March, down from their $26-plus value in June 2012, though there had been a slight improvement since the shares hit $4.50 in January.

It seems that LATAM is taking rather long to integrate key aspects of



Note: 2011 and 2012 are pro forma figures (LAN and TAM merged in June 2012).
Source: LATAM Airlines Group

LATAM'S FLEET PLAN

	At year-end			
	2015	**2016**	**2017**	**2018**
Passenger aircraft				
A319-100	50	48	48	48
A320-200	154	146	136	130
A320neo		2	16	24
A321-200	36	47	47	47
A321neo				6
Total narrowbody	**240**	**243**	**247**	**255**
A330-200	10			
767-300	38	37	36	34
A350-900	1	7	11	13
777-300ER	10	10	10	7
787-8	10	10	10	10
787-9	7	12	14	18
Total widebody	**76**	**76**	**81**	**82**
Cargo aircraft				
777-200F	3	3	2	2
767-300F	8	7	6	6
Total cargo	**11**	**10**	**8**	**8**
TOTAL FLEET	**327**	**329**	**336**	**345**

Note: This table excludes three 767-300Fs and one 777-200F that LATAM currently leases out.
Source: LATAM Airlines Group

LAN and TAM. The airlines even continue to have separate FFPs. Notably, though, 2016 will see the start of a three-year process of moving to a single brand.

But, most importantly, the merger is clearly helping LAN and TAM weather the current tough conditions. One example: LATAM has been able to compensate for some of the Brazil demand decline by developing international connecting traffic through Brazil and shifting the point of sale to stronger markets elsewhere in South America.

Tough environment

It is ironic that the very reason LAN wanted TAM — the huge Brazilian market — has, in the short term at least, turned into one of its biggest problems.

In the fourth quarter of 2015, TAM's domestic Brazil unit revenues (RASK) fell by a staggering 37.8% in US dollar terms, despite the 9.4% capacity reduction. In Brazilian real terms, RASK declined by 2.3%, reflecting weaker corporate demand. The Brazilian economy contracted by 3.8% in 2015.

While LATAM's other passenger network segments — "International" and "Domestic Spanish speaking countries" (SSC, which include Chile, Peru, Argentina, Colombia and Ecuador) — also saw RASK declines (22.8% and 13.3%, respectively), both of those segments offered some modest growth opportunities.

In other words, LATAM has been able to redeploy some of the aircraft currently not needed in Brazil (domestic or international) in SSC Domestic or in international service to and from the Spanish speaking countries.

Travel demand in SSC markets remains healthy, especially in Argentina and Peru. But RASK has suffered because of the weakening of local currencies, which has also dampened demand for international travel out of those countries. In Q4, the Colombian, Argentine and Chilean pesos had declined 41%, 19% and 17% against the dollar from the year-earlier period.

Argentina is apparently an exception in that outbound demand from there remains strong. That is because the government abolished a 35% tax on purchases made on credit cards internationally. Argentina' new President Mauricio Macri has abolished capital controls, meaning airlines can now sell there as in any other country.

In the fourth quarter, LATAM's total international ASKs rose by 11.6% and SSC Domestic ASKs by 5.5%. Including the Brazil contraction, system ASKs were up by 3.4%.

But LATAM continues to suffer from a multi-year cargo slump. In the fourth quarter, its cargo revenues fell by 26.8%, driven by a 13% decline in FTKs and a 15% fall in cargo yields.

Cargo demand is especially weak in the Brazilian domestic and international markets. Connecting cargo traffic at São Paulo Guarulhos has been affected by an ongoing strike by Customs personnel.

To manage the cargo slump, LATAM currently leases out three of its 11 767-300Fs and one of its four 777-200Fs to operators outside the region.

With the worsening economic outlook for Brazil, LATAM has issued new 2016 capacity guidance that sees a bigger contraction in Brazil and lower overall growth internationally. Domestic Brazil ASKs are now projected to decline by 8-10% this year, while international ASKs will grow by 3-5%. The latter will be driven by a further 25% reduction in Brazil-US capacity in the second half of 2016.

LATAM still expects to growth its Domestic SSC operations by 6-8% in 2016, which would be higher than the 4.8% growth rate last year. Cargo ATKs are expected to decline by up to 2%, similar to last year's 1.9% contraction.

Overall, LATAM expects its capacity to be flattish in 2016. The current projection for system ASKs is somewhere between a 1% decline and a 2% increase.

LATAM is currently guiding for a 4.5-6.5% operating margin in 2016, which would be similar or slightly higher than last year's. The forecast assumes the price of oil averaging $52 a barrel and the real/dollar exchange rate averaging 4.25.

On the positive side, it looks like the Brazilian domestic market will see a sizable 7% reduction in industry capacity in 2016, with the two smaller players (Azul and Avianca Brazil) for the first time joining TAM and Gol in cutting capacity.

But there is significant uncertainty about the demand environment. GDP projections for Brazil have come down in recent months; the IMF is currently forecasting a 3.5% contraction in 2016.

Brazil strategy

Before the economic crisis, LATAM was actually doing quite well in Brazil, having turned TAM's domestic operations profitable relatively quickly (in 2013).

The turnaround was a result of capacity reductions, cost cutting and improved yield management and market segmentation. The latter enabled TAM to maintain its corporate market share in Brazil. TAM's long-haul passenger operations were restructured and cut back. Its oldest A330s were replaced with LAN's 767s. TAM and American began codesharing, and TAM joined **one**world — the global alliance selected by LATAM.

In the past couple of years, LATAM has made two important hub-building moves in Brazil. First, it has been developing São Paulo's Guarulhos as TAM's main hub for regional and long-haul traffic in South America. Second, it has been building Brasilia, the country's capital, into a secondary hub.

Both of those strategies appear to be paying dividends. Thanks to easy connections, TAM's long-haul services out of Guarulhos now get significant feed from countries such as Argentina and Chile. New long-haul routes such as São Paulo-Barcelona (October 2015) and planned routes such as São Paulo-Johannesburg (pending approval) would probably not be possible without feed from elsewhere in South America.

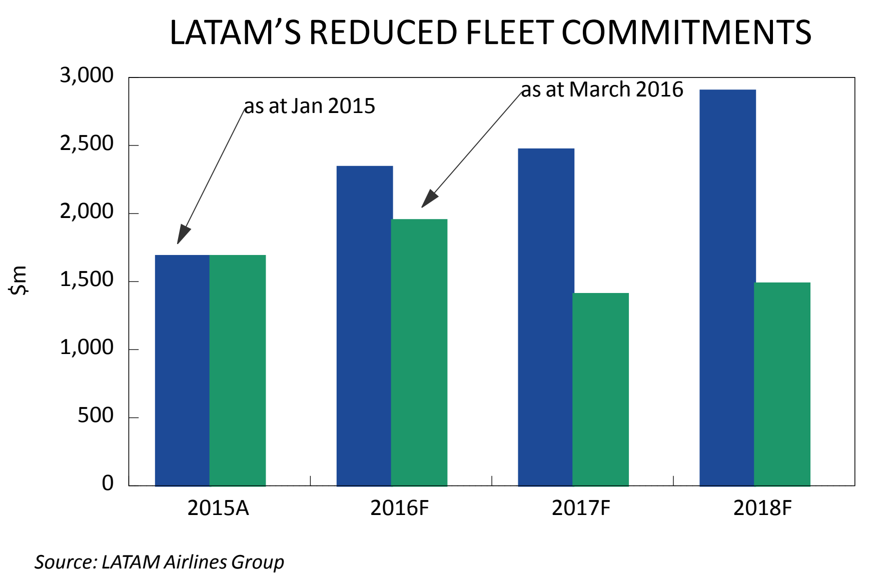
Brasilia has the attributes for a successful hub: strong local traffic, high GDP per capita, good geographical location for capturing domestic traffic flows and infrastructure for further growth. TAM already had a 45% passenger share there when it began expanding those operations in earnest in early 2015.

It is indicative that while pulling out of the Belo Horizonte-Miami market this month, TAM boosted its Brasilia-Miami services from three to six per week. However, Brasilia is getting its share of this year's Brazil-US service rationalisation; TAM is pulling out of the Brasilia-Orlando market.

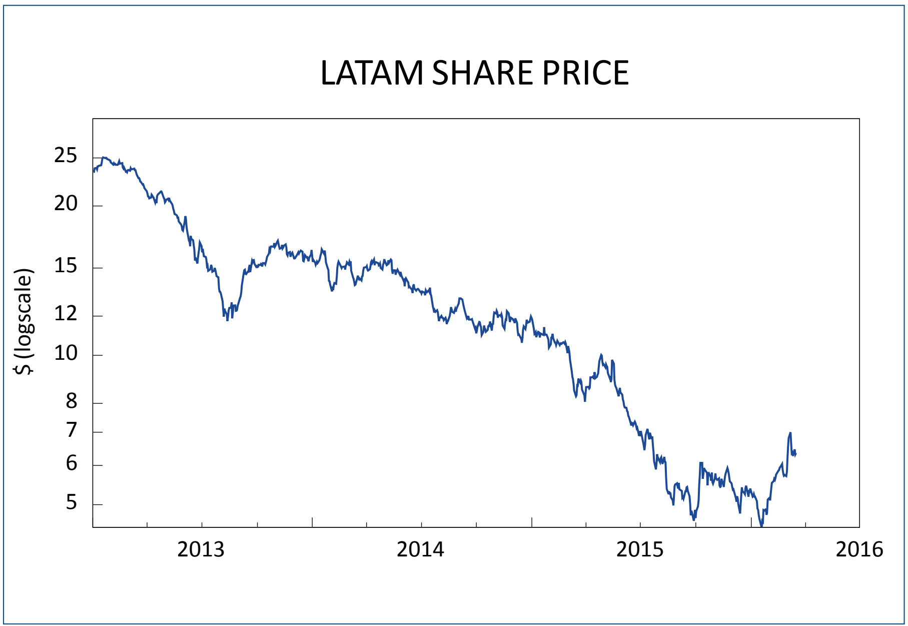
Connectivity is the new buzz word at LATAM. The group's executives have stressed that while reducing capacity in Brazil, LATAM has been careful to protect its hub strategy and connectivity and to maintain a focus on corporate passengers.

In April 2015 LATAM announced that it was exploring developing a new hub for the Northeast region of Brazil and that it would decide between three locations — Fortaleza, Natal or Recife — by year-end. The main objective would be to expand operations between Europe and South America.

The move makes sense, but it is turning out to be tough to decide on the location. In November LATAM delayed the decision until at least the first half of 2016, saying that it needed



Source: LATAM Airlines Group



more time to analyse the timing of airport infrastructure, which is one of three key criteria — the other two are passenger experience and cost competitiveness.

Fleet renewal and cash preservation

LATAM has made good progress with fleet renewal, which aims to reduce the number of types and replace older models with the latest-technology, more efficient aircraft.

The process has accelerated considerably in the past year or so, because LATAM decided that it needed to "adjust capacity to the prevailing market conditions in Latin America" and reduce capital spending to maintain a healthy balance sheet and adequate liquidity.

So, through aircraft sales, lease returns and order deferrals (after extensive negotiations), LATAM has reduced its total fleet obligations in the 2016-2018 period from $7.7bn in January 2015 to $4.8bn in March 2016.

2017 and 2018 will see the biggest reductions in commitments ($1.1bn and $1.4bn), but this year's $391m reduction will also help. LATAM is disposing of as many as 20 older aircraft in 2016. As there are currently 22 new deliveries scheduled (11 A321-200s, six A350-900s and five 787-9s), the fleet will grow by only two units in 2016.

Although the fleet obligations will peak this year at about $2bn, fleet capex will be only $900m as the remainder will be financed through sale-leasebacks. And the $900m capex is already financed (with $500m of EETCs issued in mid-2015, plus $400m of ECA-backed financial leases and commercial loans).

The 2017 and 2018 fleet obligations are now very manageable, with only 7-9 deliveries and $1.4-1.5bn of commitments each year. This will help LATAM preserve its cash position, which at year-end amounted to $1.5bn (including available credit facilities) or 14.5% of 2015 revenues. LATAM described that as "adequate under current market conditions", but it is a little low by international airline standards.

With continued significant widebody aircraft deliveries, it is hard to see LATAM not increasing its debt, which stood at $9bn at year-end. Adjusted net debt/EBITDAR ratio was 5.8. It is not too bad, but LATAM is clearly a long way from returning to investment grade.

As to the aircraft types, LATAM's fleet renewal can be summarised as follows:

In the short-haul fleet, two types were completely phased out in 2014: the Dash Q400 and the 737-700. LATAM is also slightly reducing its A319/A320 numbers in favour of taking more of the larger A321s.

The first two A320neos will arrive this year and that fleet will build rapidly to 24 by the end of 2018. The first six A321neos will enter the fleet in 2018.

As to the long-haul fleet, LATAM has phased out its A340s and will have disposed of its 10 remaining A330s by the end of this year. Four of the A330s have been sold, three have been returned to lessors and three are currently for sale, with their exit planned in the second half of 2016.

Having received ten 787-8s and seven 787-9s as of the year-end, LATAM plans to build the 787-9 fleet to 18 units by the end of 2018.

In December LATAM received its first A350-900, becoming the first airline in the Americas to operate the type. The A350 fleet will grow to 18 units by the end of 2018.

With cargo, LATAM's focus has shifted to filling bellyhold capacity, especially with the arrival of the A350s and 787s. The company foresees reducing its current 11-strong freighter fleet (excluding four aircraft that are leased out) by three units by the end of 2017.

Longer-term prospects

LATAM clearly has the potential to return to the double-digit operating margins and solid net profits it was earning before the merger, but that will not happen until Brazil makes an economic recovery.

But even if that takes a while, the tough times have not changed LATAM management's thinking on the merger. It was a unique opportunity to create a dominant airline combine for a region that will one day again see robust economic and air travel demand growth.

In the meantime, there is still much work to be done in terms of integration. Having focused on internal processes, network optimisation and fleet restructuring and modernisation in the initial three years, last summer LATAM announced a single brand for LAN, TAM and their affiliates. Its implementation will be a gradual, three-year process. LATAM is moving cautiously in part because both LAN and TAM have strong brands.

LATAM still has the toughest hurdle in merger integration ahead of it: a move to a single reservations system. The combine earlier selected the Sabre technology, which LAN adopted in 2012, for the common platform, and last year there was talk of a possible 2017 switchover.

Having a single reservations system will unlock opportunities, especially on the revenue side. So there could be additional revenue tailwinds and the original targeted $600-700m annual synergies could be exceeded.

Another potential bright spot on the horizon is the development of immunised JVs. It is not clear why these moves took so long, but in January LATAM finally submitted applications for deeper JVs with its two key **one**world partners, American and IAG.

LATAM believes that securing regulatory approvals in different countries could take 12-18 months, so it will not be possible to start developing the JVs until 2017 at the earliest. An immunised JV on the US-Brazil routes is also not possible until Brazil has ratified the open skies agreement between the two countries.

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Name ______________________
Position ______________________
Company ______________________
Address ______________________
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Country ______________________
Postcode ______________________

DATA PROTECTION ACT

The information you provide wil be held on our database and may be used to keep you informed of our products and services or for selected third party mailings

PLEASE RETURN THIS FORM TO:

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London EC1V 7ET, UK
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