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Air Berlin, Lufthansa and TUI: A Teutonic solution

AIR BERLIN has announced yet another restructuring. This time it aims to shrink the scale of operations, abandon the core charter and seasonal "tourist routes", and (unfashionably) turn itself into a full-service hub carrier based on what it calls "dual hubs" at Düsseldorf and Berlin. It will concentrate on developing long haul services with connecting feed from major cities in Europe.

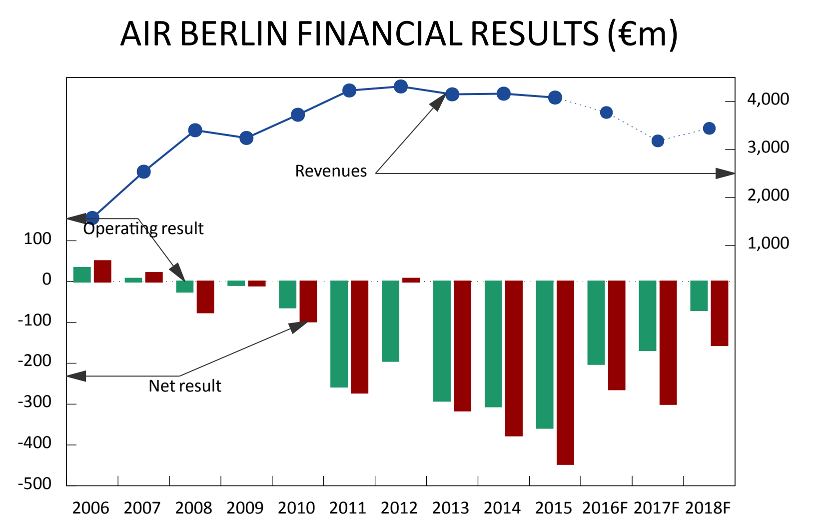
As part of this plan it has come to an agreement to wet-lease 40 A320s to Lufthansa for the next six years from April 2017 (subject to regulatory approval). At the same time it is ring-fencing its leisure oriented operations (including its Swiss and Austrian subsidiaries Belair and Niki) into what might be described as a "bad Air Berlin". This will involve a further 25 aircraft (including the 737s currently wet-leased to airberlin from TUIFly).

Then ˝good Air Berlin˝ will have a fleet of 61 aircraft — 30 A320 family, 14 A330s and 17 Q400s — down from an operational fleet totalling 136 at the end of June. In addition it plans to acquire ten more short haul jets, another three A330s and one more regional aircraft to leave it with a fleet of 75 — an effective 50% cut.

Subsequently it announced that it is in talks with TUI and Etihad to turn the rump of the leisure oriented businesses — the "bad Air Berlin" — into a new European airline.

What does all this mean? Air Berlin is in effect bankrupt, only supported as a going concern through its 29% shareholder Etihad. As the latest CEO, Stephan Pichler has admitted, it has been operating with a unit cost comparable to the Legacy airlines, but a unit revenue similar to European LCCs. Indeed, in each of the past ten years since its IPO, its average unit revenues have been lower than its unit costs, and it has lost a total of €1.8bn at the operating level and €2bn net over this period.

In the first six months of the current year, despite benefits from the lower fuel price, all key performance indicators deteriorated. Capacity in ASK terms was down by 5.2% year on year but demand in RPKs fell by 5.4% causing average load factors to dip. Unit revenues declined by 3.4% to



Source: Company reports, Aviation Strategy analysis, HSBC forecasts.

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6.75€¢ (with a 5.9% year-on-year decline in the second quarter) but unit costs only fell by 1.3% to 7.72€¢; the company reported an operating loss for the period of €235m compared with a loss of €176m in the prior year. The net loss came in at €272m against a loss of €248m the year before.

The balance sheet is pretty much shot to pieces. On-balance sheet debt at the end of June stood at €1.3bn with cash of around €400m (it looks as if Etihad and its owners provided another €330m in loans in the period). To this should perhaps be added Etihad's €300m 8% perpetual convertible bond (plus €37m accrued interest), which is treated as quasi-equity in the accounts.

Long term assets stand at €650m, but this includes €400m intangible assets (essentially reflecting slots capitalised on the acquisition of dba and LTU). Overall net shareholders' funds (excluding the perpetual and intangibles) stood at a negative €1.7bn.

The company has been selling and leasing back what aircraft it owned — and all are now off-balance sheet. Capitalising the lease rentals might add an additional €5.5bn in debt. Under new accounting standards — see *Aviation Strategy* April 2016 — this will be required to be reported on balance sheet but will also be matched by a balancing asset amount.

There are three traditional airline management methods to return an airline to profitability. The first is to grow fast (organically or by acquisition) in order to reduce unit costs while hoping that unit revenues will not fall at the same rate. The second is to stagnate and forcibly cut admin, overhead, personnel and operational costs in order to cut unit costs while hoping that unit revenues will not fall. The third is to shrink to what are thought to be a core of profitable routes and hope that unit revenues will rise faster than unit costs. Air Berlin has exhausted the first two methods.

While Etihad (or rather its owner) has deep pockets, it is likely that its CEO James Hogan is getting a little fed up having constantly to top up its financial exposure to Air Berlin (although it does not report subsidiary losses on its own balance sheet). Legally Etihad as a non-EU shareholder cannot be seen to exercise control over a European airline despite its 29% shareholding (which would rise to an illegal 70% if it were to convert the perpetual convertible to equity), but it does have two seats on the board of directors and has parachuted in a couple of ex-Etihad executives onto the management team.

The prime focus for Etihad through its Etihad Airways Partners (which includes Alitalia, Darwin, Air Serbia and Jet Airways) is to support a full service network feed operation through its main hub in Abu Dhabi.

AIR BERLIN: BALANCE SHEET DATA

€m	Jun 2016	Dec 2015
Equity and reserves	678	594
Retained earnings	(2,003)	(1,719)
Equity due to Etihad	337	326
less Intangible assets	(401)	(405)
Net Assets	**(1,389)**	**(1,204)**
LT Debt	(1,239)	(1,010)
ST Debt	(86)	(34)
Cash	398	165
Capitalised Leases	(5,450)	(4,959)
Net Debt	**(6,377)**	**(5,836)**
Cash % revenues	9.8%	4.0%

Source: Company reports, Aviation Strategy analysis

FLEET CHANGES

	Before				After		
	Air Berlin	TUIFly	Eurowings	Brussels	"New" Air Berlin	"Bad" Air Berlin	Eurowings
737-700	5					5	
737-800	7	30				37	
A319	11			20			
A320	61		20	9	40	21	85
A321	19						
A330	14		4	9	17		13
Regional	17		10	10	18		20
Total	**134**	**30**	**34**	**48**	**75**	**63**	**118**

To this end Air Berlin's scheduled services from Berlin and Düsseldorf to Abu Dhabi, and its code-share on connecting European services may complement Etihad's German routes, which are limited to Frankfurt, Düsseldorf and Munich. There may also be questionable modest benefit for connections from (and maybe through) Abu Dhabi onto Air Berlin's long haul routes. There may also be benefits from moving assets and combining resources between the EAP members. But the Air Berlin's short haul non-hub services are an irrelevancy.

Lufthansa in turn has said it will use 36 of the wet-leased A320s in its new "low cost" Eurowings unit and push the remainder into Austrian (subject to regulatory approval which it will surely receive).

On the matter of the ACMI wet-lease arrangement, from Air Berlin's perspective it may provide it with a modest margin over cost (although Lufthansa states that the rates will be ″commercially competitive″) and obviate the need to find even more redundacy payments, while for Lufthansa it provides capacity without the need to take on the responsibility for employees and without capital exposure. The alternative for Lufthansa could have been simply to acquire the bits of Air Berlin that Etihad doesn't want, but that would have been political dynamite for its belligerent unions who are still battling the concept of Eurowings. This is despite the fact that the main unions at both Air Berlin and Lufthansa come under the umbrella of Ver.di. (Meanwhile, the aptly acronymned UFO cabin-crew union at Eurowings is threatening strike action.)

Lufthansa could have walked away from the Air Berlin deal, but it appears that Lufthansa doesn't want Air Berlin to fail, at least in the short term — a weak rival in comfortable duopolistic competition might help to restrain the expansion of Ryanair, easyJet and Wizz (let alone Air France-KLM's Transavia) into its domestic market.

Nevertheless, taking on these wet-leased aircraft will propel Eurowings towards its ambitious aim of becoming one of the top three European LCCs adding to its current fleet of 21 A320s, 2 737-800s, 4 A330s and 10 CRJs — albeit still a long cry from Ryanair's 350 737s, easyJet's 257 A320s or Vueling's 110 A320s, let alone considering Norwegian's plans. And Ryanair, easyJet and Norwegian have lots of planes on order.

Just to complicate matters even further, Lufthansa has finally decided to exercise its option to acquire the 51% of Brussels Airlines it does not own; and it will consolidate the Belgian flag carrier from the beginning of 2017.

Brussels Airlines is now marginally profitable with an operating margin of 4% in 2015 on €1.1bn of revenues — at the top of the cycle. It operates 48 aircraft (30 A320s, 9 A330s, 1 737-300 and 8 RJ100s) through a hub operation at Brussels Zaventem. It is relatively low cost for a legacy flag carrier, the result following the demise of Sabena in the wake of Swissair's bankruptcy of the merger between Sabena's regional subsidiary DAT (renamed SN Brussels) and low cost hopeful Brussels-based Virgin Express. It has a niche position in the provision of virtually monopolistic services to the former Belgian colonies in Africa — where Lufthansa itself is weak (although SWISS is relatively strong).

Lufthansa has bizarrely suggested that it could incorporate Brussels Airlines into Eurowings, giving rise to concerns over national identity and branding — always important when dealing with flag

carriers. If it does, it is possible that it will doom the Eurowings project to abject failure.

TUI meanwhile is another German operator in deep trouble. Its 2009 investment in Air Berlin, with a contra-deal to wet-lease 737s to Air Berlin's "leisure based" operations, has been a failure. It is faced with the disturbing thought of not having sufficient in-house capacity for its substantial tour operations on the traditional sun, sea, sex and sand leisure inclusive tours routes.

There have been rumours suggesting that TUI has been in talks with easyJet. The latter is deeply worried by the result of the UK Brexit referendum and has stated that its intention to acquire a European AOC to maintain an ability to fly between points in Europe that do not touch the UK should the UK lose full access to European open skies. One possible reading of the plan by Etihad, Air Berlin and TUI to set up a new European airline out of the "bad Air Berlin" could be an intention to sell the resulting combine to easyJet with a ready-made AOC — a rather expensive and complicated proposition which easyJet could not possibly fall for.

There are further complications arising from Brexit.

Ryanair plans to expand its fleet by 50% over the next eight years and will be adding a net 25 aircraft a year for the foreseeable future. With the possibility of restricted economic growth in the UK it has stated that it will primarily base these aircraft in airports other than London Stansted (its largest base), focusing on markets that can provide growth. It has a low penetration in Germany — only a 6% traffic share — but is currently on the offensive.

It should also be remembered that Air Berlin PLC is a UK registered company. If the UK is excluded post Brexit from the European open skies, it would presumably need to re-register as a German holding company to ensure it retains its principal place of business within the EU. This will mean adhering to the *Mitbestimmungsgesetz* concept inherent in German corporate law — the principal of co-determination with employee representatives on both the shareholder-elected Supervisory Board (*Aufsichstrat*) and Management Board (*Vorstand*). *Not* a concept with which Etihad is conversant.

Will Air Berlin's latest restructuring work? Our best guess is that it will be able to reduce its losses, cash outflow and drain on Etihad's resources. It is however likely to remain as a main obstacle to a true restructuring of the German aviation market.

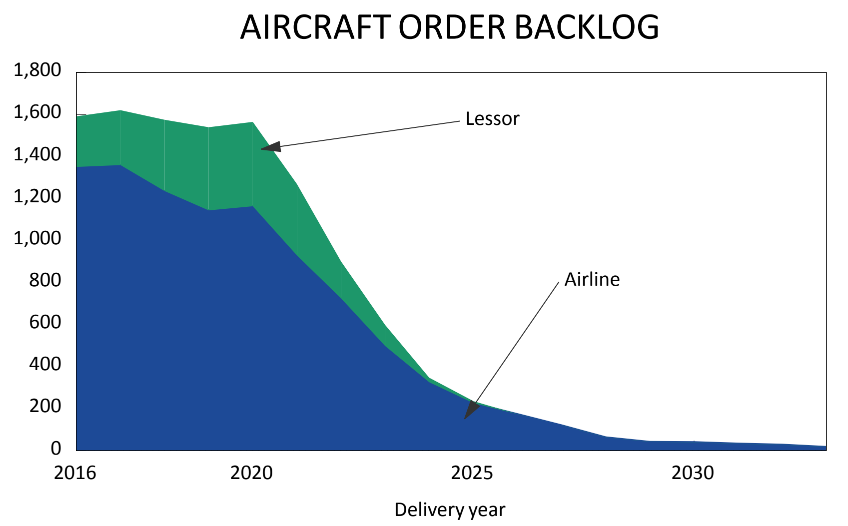
For the European industry to rationalise we need the barriers to exit to be minimised, for efficient carriers to be allowed to succeed and for inefficient carriers to be allowed to fail. That happened to a large extent through the clamp-down on state aid for flag-carriers. But Abu Dhabi has introduced another major distortion to the European industry.

Operating lessors: Resilient business enters consolidation phase

THE OPERATING leasing business has been more than resilient throughout the economic cycle, growing during 2008-2012 economic recession, with no casualties despite the numerous failures of small, under-capitalised airlines. It has now moved into a consolidation phase.

It seems clear that some western owners of lessors are trying to exit at what may be the cyclical pricing peak through an IPO or a trade sale. If the latter route then the majority of the prospective buyers are Chinese financial institutions. The attractions of the operating leasing industry are the promise of good financial returns and the ownership of moveable assets with apparently solid residual values.

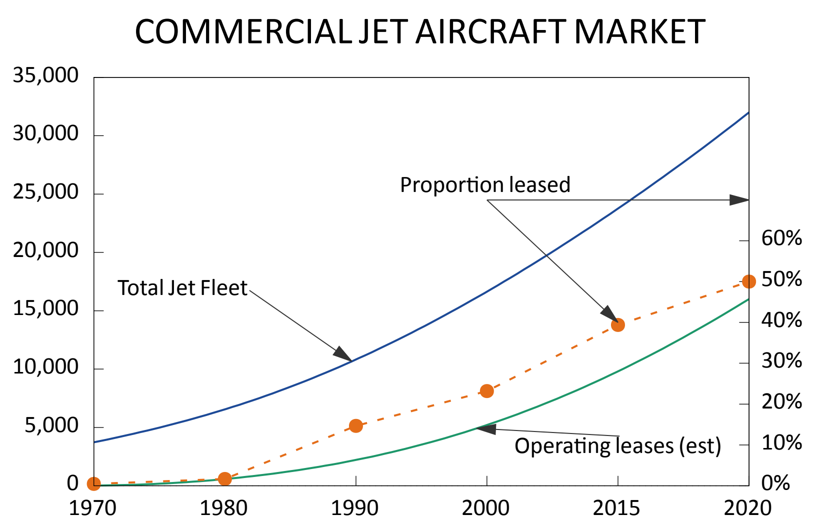
In October, Avolon, owned by Beijing-based Bohai Capital, announced an agreement to acquire the aircraft leasing business of CIT Group, the transaction being expected to close in early 2017. This will elevate Avolon to third place in the lessor rankings, with a combined fleet of about 600 aircraft plus 264 on firm order. The combined owned in-service fleet will have an average age of 4.6 years and an average remaining lease term of 6.7 years.



Source: Ascend, Boeing, Airbus, Aviation Strategy

The price to Avolon is reported as $10bn, some $600m above CIT's net asset value of $9.4bn as at mid-year.

From an integration perspective, merging leasing companies should be a much less complex exercise than merging airlines — staff are mostly highly specialised marketing or financial experts and there are certainly no union issues, and IT systems are fairly well standardised through the industry. The success of otherwise of a purchase, of course, depends on getting the price approximately right — reflecting the future value of the fleet and the reliability of the lessees.



Source: Airline Monitor, Boeing, Airbus, Aviation Strategy

Economic conditions have generally been favourable for the leasing industry in recent years. In particular, minimal interest rates have reduced the cost of debt to 2-3%pa for the better-quality lessors, while lease rates, although they have declined,

MAJOR LESSORS

Company	Total portfolio	Change†	Orders Boeing	Orders Airbus	Orders Total	Orders Change†
GECAS	1,450	-90	130	120	250	-26
AerCap	1,202	-65	138	224	362	-14
Avolon (inc CIT)	596	102	79	185	264	55
SMBC Aviation Capital	455	36	90	112	202	-9
BBAM	408					
Air Lease Corporation	278	31	179	196	375	-11
ICBC Leasing	269	81	23	27	50	6
BOC Aviation	265	9	101	110	211	30
ACG	265	5	68	31	99	-6
AWAS	240	-80		15	15	10
Macquarie AirFinance	213	43				
Aircastle	179	18				
BCC	175	-55				
ORIX Aviation	170	10				
CDB Leasing	130	20	26			26
SkyWorks Leasing	102	2				
MCAP	100					
Total	**6,497**	**67**	**834**	**1,020**	**1,828**	**35**

Note: This table includes jet lessors with at least 100 owned or managed aircraft; we exclude entities set up solely to manage the leasing activities of a specific airline. † Change from 12 months ago

still represent a 9%-plus yield (annual rentals as percentage of value). In turn, investors' expectations of risk-adjusted return on equity have softened from 15-16% to around 8%.

The impact of very low fuel prices has also generally been beneficial in that it has reduced financial pressures on airlines and reduced the risk of lessee defaults. On the other hand, lessors have invested heavily in new technology types, and a question has arisen as to whether these aircraft will maintain the lease premium over standard types needed to justify the higher purchase prices paid by the lessors.

A more general concern is the lessors' exposure to a serious downturn in the global airline industry in the next couple of years, or even a slow-down in Asia-Pacific growth. The lessors' orders are skewed towards the shorter term, whereas airlines have much longer-dated delivery schedules (see graph on the preceding page). A slump in aircraft demand would likely have to be absorbed primarily by the lessors.

Annual survey

Aviation Strategy's annual survey of the leasing industry (see table above) reveals that the total fleet for lessors with a portfolio of more than 100 owned or managed aircraft is 6,497 — slightly lower than last year's total of 6,534 (see *Aviation Strategy,* October 2015).

The Big Two — GECAS and AerCap — have seen their dominance of the 100+ lessor fleet decline again, accounting for 40.8% of that fleet compared with 42.9% a year ago and 45.6% figure as of two years ago. Avolon, following the CIT purchase, has leapt from 15th to 3rd in the table of lessors. Despite another year of growth for SMBC Aviation Capital, this lessor lost a place in the ranking. ICBC, adding 81 aircraft, has risen from 11th place last year to 7th, while Lease Corporation continues its steady ascendancy up the ranks, rising from 9th to 6th place. The biggest faller was AWAS, down from 6th to 11th place in a year as it sold off a large chunk of its portfolio.

In terms of firm orders, of the top 10 lessors only ICBC Leasing, BOC Aviation and Avolon increased their order book year-on-year — all the rest either reduced their orders or had none outstanding to begin with. The Big Two now account for 33.5% of the total outstanding orders from lessors with 100+ aircraft, compared with 36.4% as of 12 months ago.

Despite a small reduction, Air Lease Corporation still has the biggest lessor order book (with 375 aircraft), and it's still just ahead of AerCap, which has 362 orders outstanding.

Over the following pages *Aviation Strategy* profiles the leading lessors — which we define as owning or managing more than 100 jet aircraft — in descending order of portfolio size.

General Electric Capital Aviation Services (GECAS)

It was another year of portfolio trimming for GECAS, with its total jet fleet of 1,450 owned and managed aircraft some 90 units fewer than 12 months ago — and almost 400 aircraft lower than its jet portfolio as of five years ago.

For the first time in a while the age profile of GECAS's fleet had become older. As at the end of June this year, 39.8% of GECAS's owned portfolio by value is five years old or less — compared with 48.6% a year ago.

As at mid-year 2016, narrowbodies accounted for 71% of the total jet portfolio by value (compared with 74.1% as of a year ago), with 23.7% being widebodies (20.9% 12 months ago) and 5.2% cargo variants (5.0%).

GECAS's portfolio is placed with more than 270 customers in 80 countries, but Europe has now overtaken the US to become its most important market, accounting for 25.7% of the lessor's fleet by value, just ahead of the 24.9% accounted for from the US (and which has fallen from 29% three years ago and 47% in 2009). The next most important market for GECAS is the Pacific Basin, with a 19.4% share.

Based in Stamford, Connecticut, GECAS is part of the GE conglomerate and also has 25 other offices around the world, employing more than 500 staff in total. In the second quarter of 2016 GECAS posted a 1% increase in net profit year-on-year, to $366m.

GECAS's order book has fallen by 26 aircraft in a year, and now stands at 250, comprising 130 Boeing aircraft and 120 units from Airbus.

AerCap

In the first six months of 2016 AerCap posted revenue of $1,240m — 7.3% down year-on-year — and reported net profit of $456m, which was 25.5% down on H1 2015. AerCap says the reduced profits were due to a number of factors, including "sales of older aircraft during, lower net gain on sale of assets and higher interest expense".

AerCap has continued to trim its portfolio following the purchase of ILFC in 2014, to reach 1,202 aircraft today — some 65 fewer than 12 months previously. Of that total portfolio, 1,070 are owned — which is 60 fewer than 12 months ago — and they have an average age of 7.7 years, thanks to ongoing disposal of older aircraft. In the second quarter of 2016 alone AerCap sold 32 of its owned aircraft, with an average age of 14 years.

The majority of the owned fleet is comprised of narrowbodies, including 446 A320 family aircraft and 313 737NGs. Other important models include A330s (111 aircraft), 777s (62), 767s (38) and 787s (40). As of the end of the first-half of 2016 99.4% of the fleet was out on lease to more than 200 airlines in around 80 countries.

AerCap is based in Dublin and also has offices in Amsterdam, Los Angeles, Shannon, Fort Lauderdale, Miami, Singapore, Shanghai, Abu Dhabi, Seattle and Toulouse. It has continued to buy-back its shares during 2016, purchasing more than 15.4m as of early August; since completing the purchase of ILFC in May 2014 it has spent more than $1.25bn on share repurchases.

AerCap's total outstanding firm orders stand at 224 Airbus aircraft (161 A320neos, 49 A321neos and 14 A350-900s) and 138 Boeing models (100 737 MAX 8s, 38 787-9s). All of the new aircraft it is receiving through to the end of 2017 have been leased, while 90% of deliveries through 2018 have also been contracted out.

Avolon and CIT Aerospace

As discussed above the CIT transaction should complete by early 2017.

Avolon became a fully-owned subsidiary of China-based Bohai Leasing (part of the Chinese conglomerate HNA Group), after the $2.6bn acquisition was completed in January this year (and with Avolon delisting from the New York Stock Exchange).

Bohai also owns Hong Kong Aviation Capital and as part of the deal Avolon took on management of that fleet, which was the driving force behind the substantial increase in Avolon's portfolio over the past 12 months, when it added 92 aircraft and built its owned and managed fleet to 244. The 222 owned aircraft have an average age of three and a half years. and are largely narrowbodies, including 116 A320 family ceos and neos and 66 737-800s.

The fleet is placed with 84 airlines in 41 countries, with the largest market for Avolon being the Asia/Pacific region, where around 50% of aircraft are leased, followed by the Americas, where 22% of the fleet is placed.

Avolon employs just over 100 staff, with a headquarters in Dublin and other offices in Connecticut, Dubai, Shanghai and Singapore, and with an office in Hong Kong launching in June this year.

In the second-half of 2016 Avolon will complete the acquisition of a portfolio of 45 aircraft from GECAS, which are currently on lease to 29 airlines in 15 countries. Avolon also has 133 aircraft on outstanding order (which includes 70 A320 family neos on order from HKAC).

Owned by giant US bank holding company CIT Group, **CIT Aerospace** is based in Dublin and operates other offices in New York, Fort Lauderdale, Los Angeles, Washington, Toulouse and Singapore.

CIT Aerospace increased its fleet by 10 aircraft since last year, bringing its portfolio up to 352 aircraft, of which 286 are owned. That owned fleet has an average age of six years and an asset value of $9.8bn, and the majority are narrowbodies — including 117 A320 family aircraft and 86 737s — though it also has 40 A330s. The portfolio is leased to more than 100 airlines in 50 countries.

The CIT Group, as a bank holding company, is subject to increasingly stringent capital adequacy regulations (and with over $50bn of assets is subject to enhanced prudential regulation under the Frank-Dodd Act) which significantly constrains the ability to grow an aircraft leasing business through the order book. Finding that its own share price did ˝not reflect the value of the commercial air leasing business˝ it initiated the process to separate CIT Aerospace earlier this year. Among the reported "invited" bidders were the HNA Group, ICBC, CDB and ORIX, and in October CIT agreed to sell the business to HNA's Avolon for $10bn, with the deal expected to be completed by the end of March 2017.

CIT Aerospace's order book has fallen by 12 units, to 143 aircraft, but the lessor has nearly $1bn of new aircraft scheduled for delivery in the next 12 months — all of which already have lease commitments.

SMBC Aviation Capital

SMBC Aviation Capital has increased its total portfolio yet again, adding 36 aircraft over the year to bring the total number in its fleet to 455 aircraft. Of these 300 are owned and 155 managed, and the owned fleet is made up almost entirely of narrowbodies, including 123 A320s, 122 737-800s, 31 A319s and 15 A321s.

The portfolio is placed with customers all around the globe, including United and American in North America; BA and Air France in Europe and China Eastern and Qantas in the Asia/Pacific region.

SMBC Aviation Capital is part of the Sumitomo Mitsui Banking Corporation and employs 160 staff in its headquarters in Dublin and at other offices in New York, Miami, Toulouse, Amsterdam, Tokyo, Hong Kong, Beijing, Shanghai and Singapore.

SMBC's outstanding order book has come down slightly over the past year, to 202 aircraft that comprise 90 737 MAXs 110 A320neos and two A321ceos.

BBAM

BBAM's portfolio has remained flat over the last year at 408 managed aircraft, including 175 737NGs, 146 A320 family aircraft, 29 777s, 13 787s, 12 757s and 10 A330s.

They are leased to airlines that include Air China and China Southern in the Asia/Pacific region; Lufthansa and Air France in Europe; American and Air Canada in North America; and Etihad and Emirates in the Middle East.

BBAM has 120 staff at its headquarters in San Francisco and other offices in New York. London, Zurich, Santiago, Singapore, Dublin and Tokyo. BBAM has no outstanding orders, and it remains the only Top 10 lessor not to have any.

Air Lease Corporation

Air Lease corporation expanded yet again over the last year — though at a slower rate than the previous 12-month period — by adding 31 aircraft and bringing its total jet portfolio to 278 aircraft, of which 245 are owned and 33 managed. Incidentally in December last year ALC agreed to sell its fleet of 25 ATRs to Nordic Aviation Capital, and is now concentrating on the jet business.

Based in Los Angeles and Dublin, the lessor's portfolio has a net asset value of $11.7bn and an average age of under four years. The owned fleet is mixed, though overweight with narrowbodies that include 101 737NGs, 75 A320 family aircraft and 22 Embraer 175/190s. Widebodies include 22 A330 and 20 777s.

The portfolio is placed with 91 airlines in 53 countries across the world. By net book value the largest market for ALC is still the Asia/Pacific region, accounting for 45.3%, followed by Europe with 29.5% and the Middle East and Africa with 8.6%.

In the first six months of 2016 Air Lease Corporation recorded revenues of $693m, 18.9% higher than H1 2015, with net profit almost doubling — from $95.4m in January-June 2015 to $184.7m in the first half of 2016. That financial growth will continue as new aircraft steadily arrive from an order book for 375 units — still the largest of any lessor.

ICBC Leasing

ICBC Leasing is based in Beijing and is owned by the Industrial and Commercial Bank of China. It leases everything from aircraft and maritime vessels to trains and excavation vehicles, and has other offices in Tianjin and Dublin.

The lessor has increased its portfolio substantially in the last 12 months, to 269 aircraft, of which narrowbodies form the majority — including 88 A320s, 76 737s and 27 A321s. This has helped the lessor jump four places in the lessor table over the last 12 months.

It has 48 customers around the globe, with a large concentration of customers in the Asia/Pacific region, including AirAsia, Singapore Airlines and China Airlines. In Europe its customers include easyJet, Virgin Atlantic and British Airways.

The lessor has outstanding orders for 27 A320 family aircraft, 21 737-800s and two 737 MAX 8s.

BOC Aviation

BOC Aviation's portfolio rose by another nine aircraft over the last 12 months, bringing the total portfolio to 265, of which 226 are owned and 39 are managed.

The most common type in the owned fleet is A320 family aircraft (numbering 111), followed by 737NGs (76 aircraft), 777-300ERs (13) and A330s and Embraer E190s (11 each).

The portfolio has an average of less than three and a half years, and is placed with 64 customers in 31 countries, with 55% of the revenue earned in the first-half of 2016 coming from airlines in the Asia/Pacific region, and most of the rest located in Europe (22%) and the Americas (17%).

In total BOC Aviation recorded revenue of US$579m for the first six months of 2016, 8.2% better than January-June 2015, and saw net profit rise 23.8% to $212m.

BOC Aviation is based in Singapore and other offices in Dublin, London, Seattle and Tianjin. Majority-owned by the Bank of China, BOC Aviation listed on the Hong Kong stock exchange in June 2016, which was the largest aircraft leasing IPO in history and raising $1.1bn from the sale of new and existing shares.

In November last year BOC ordered 11 737-800s and 11 737 MAX 8s, for delivery in 2018-2021, helping its outstanding orders to rise by 30 over the last 12 months (the largest rise of any lessor) and bringing the total order book to 211.

Aviation Capital Group

A subsidiary of US insurance group Pacific Life, Aviation Capital Group (ACG) is based in Newport Beach, California and operates other offices in Beijing, Dublin, Santiago, Seattle, Shanghai and Singapore.

ACG's fleet of owned or managed aircraft has increased by an estimated five aircraft over the last 12 months, to 265, thanks largely to the purchase of 20 737-800 and A320 aircraft (with have an average age of four years) from GECAS in the second-half of 2015. More than 95% of the portfolio are narrowbodies, and the fleet is placed with 100 customers in around 45 countries.

In 2015 ACG's lease revenue rose by 4.6% to $833m, with net income increasing 18.8% to $107m. Its outstanding order book has dropped by six aircraft, to stand at 99.

AWAS

AWAS's portfolio fell by 80 aircraft over the last 12 months, to 240, after it sold a tranche of 87 very young aircraft to Macquarie AirFinance for $4bn.

The sale was part of the plan by AWAS's owners — private equity house Terra Firma (which owns a majority stake) and the Canada Pension Plan Investment Board — to maximise returns at the top of the leasing cycle. However, an intended sale of AWAS to one of several Chinese suitors (including Bohai Leasing) failed to materialise, reportedly because Terra Firma thought the bids were too low. However, it appears that Terra Firma is planning to restart the sales process in early 2017, again targeting Chinese investors, and it is very likely that AWAS will have new owners by the time *Aviation Strategy* conducts its next leasing survey.

AWAS's remaining portfolio includes a mixture of narrowbodies and widebodies that are placed with more than 90 customers in 49 countries. AWAS is based in Dublin and has offices in New York, Miami and Singapore, and its order book stands at just 15 aircraft, derived from an order placed in June this year for 12 A320ceos and three A321ceos.

Macquarie AirFinance

Macquarie AirFinance delivered a second consecutive year of significant growth by adding 43 aircraft over the last 12 months, bringing its portfolio to 213 aircraft (of which all but two are owned).

The portfolio is largely made up of narrowbodies, with the owned fleet including 117 A320 family aircraft and 79 737NGs, supplemented by nine A330s, three E-Jets, two 777s and a single 757.

They are placed with 94 customers in 51 countries around the world, with the most important market being the Asia/Pacific region (where 77 aircraft are placed to customers that include China Southern, AirAsia and Qantas), overtaking Europe in the last 12 months (where 63 aircraft are contracted, to airlines that include BA, Norwegian and Vueling). The next largest market is the Americas, with 61 aircraft.

Macquarie AirFinance is based in Dublin and is owned by finance giant Macquarie Group, with other offices in London, Singapore and San Francisco. The lessor has no aircraft on firm order.

Aircastle

Aircastle's increased its portfolio by 18 aircraft over the last year, and it now stands at 169 owned and 10 managed aircraft, which have a net book value of $6.8bn.

The owned fleet comprises 120 new generation narrowbodies, 34 new generation widebodies, nine freighters and six classic generation aircraft, with a total average age of under eight years, (compared with an average age of more than 11 years as of six years ago) as it continues to "de-risk our portfolio" through a strategy of shifting its fleet mix to younger aircraft with longer remaining lease terms.

It has sold 43 aircraft since the first half of 2015 and in the in the first six months of 2016 acquired a total of 22 aircraft for around $660m (almost all of which were narrowbodies). Over the past five years the percentage of classic generation aircraft in its fleet as a percentage of net book value has fallen from 12% to 1%, while freighters have gone from 31% to 9%.

The portfolio is placed with 63 airlines in 35 countries, but the most important market for the lessor has changed over the last few years, with the Asia/Pacific region now accounting for 37% of total aircraft net book value (compared with 20% as of seven years ago), ahead of 24% for the European market (compared with 46% in 2009).

Aircastle is based in Connecticut and has offices in Dublin and Singapore, and its largest single customers (each accounting for more than 6% of total fleet net book value) are Avianca Brazil (leasing 10 aircraft), Chile's LATAM (three aircraft) and Lion Air (11).

In the first half of 2015 Aircastle recorded a 6.3% fall in revenue to $373.7m, while net profit was down by a third to $56.3m. This was partly due to lower gains from the sale of aircraft, lower maintenance revenue and impairment charges for an A330 after it completed a review of its widebody and freighter aircraft "given weaker market dynamics for these aircraft". Aircastle has no outstanding orders from Airbus or Boeing.

Boeing Capital Corporation

Boeing Capital Corporation (BCC) is based at Renton, Washington, and supplies "last resort" finance for all of Boeing products. Over the last 12 months BCC has reduced its commercial aircraft exposure significantly, and its portfolio of fully- and partially-owned aircraft has fallen to an estimated 175 (55 less than a year ago).

In the first six months of 2016 BCC's revenue fell by 26.4%, to $148m, with earnings from operations falling by 25.8% to $23m. As at the end of June 2016, the net value of BCC's portfolio's value was $3.8bn, compared with $3.9bn as of December 31st 2015 and significantly down on the portfolio value of $6.4bn as of seven years ago.

Much of this portfolio is placed with US airlines, and a majority of aircraft types are out of production models such as the 717 and MD-11; the BCC site currently lists a number of aircraft for sale, including six MD-11Fs that were all manufactured in the 1990s.

ORIX Aviation

ORIX Aviation is part of the Orix Corporation, a Japanese financial services group, and operates out of Dublin, and its owned and managed fleet has increased by 10 units to 170 aircraft.

The lessor has a mixed portfolio of narrowbodies and widebodies, and these are placed with more than 60 airlines in around 30 countries around the globe, including Air China and China Southern in the Asia/Pacific region and BA and Ryanair in Europe. There are no aircraft on outstanding order.

CDB Leasing

Based in Shenzhen, CDB Leasing is majority-owned by the giant China Development Bank and underwent an IPO on the Hong Kong stock exchange this summer — though this raised just US$800m, lower than the hoped-for range of US$1bn to US$1.1bn.

The company leases a variety of equipment, including ships, construction machinery and rail stock, and over the last 12 months has added an estimated 20 jet aircraft, bringing its total portfolio to 130 aircraft, of which the majority are narrowbodies. As would be expected, most of CDB's customers are Chinese airlines, plus customers in the wider Asia/Pacific region.

CDB has outstanding orders for one 737-700 and 25 737-800s.

SkyWorks Leasing

SkyWorks Leasing is based in Greenwich, Connecticut and has other offices in Dublin and Hong Kong. It manages a fleet of 102 aircraft, up by just two units over the last year.

The diverse portfolio includes A320 family aircraft, 737NGs, 757s, 767s, 777s A300-600Fs and 747-400Fs, though the lessor has no aircraft on order.

MC Aviation Partners

MC Aviation Partners (MCAP) is a subsidiary of Japanese conglomerate the Mitsubishi Corporation and its 70 staff work at headquarters in Tokyo and other offices in Dublin and Los Angeles.

MCAP's portfolio of owned and managed aircraft has remained flat at 100 units over the last 12 months, with 90 of the fleet being narrowbodies, including 46 A320s and 41 737-800s. The Asia/Pacific region remains its single largest market, accounting for 52% of placed aircraft, followed by the Middle East (14%) and Europe/Africa (13%).

It has no outstanding orders.

Note that Dublin-based Standard Chartered has dropped out of our table this year as it has just dipped under the 100-aircraft portfolio that we use at the minimum entry point for our survey. It has two A330-300s on order.

OTHER LESSORS

	Orders		
	Boeing	Airbus	Total
Alafco	28	97	125
CALC		102	102
HKAC		70	70
International AirFinance Corporation		47	47
Amedeo		20	20
Alphastream		15	15
Global Aircraft Trading		11	11
Sberbank Leasing	10		10
Intrepid Aviation	6		6
Standard Chartered		2	2
Total	**44**	**364**	**408**

Other lessor orders

Other lessors with outstanding orders (but currently with less than 100 aircraft in their leasing portfolio) include **Alafco**, majority owned by the Kuwait Finance House, which has 125 Boeing and Airbus aircraft on order.

China Aircraft Leasing Company (CALC) has 102 Airbus aircraft on order, while **Hong Kong Aviation Capital (HKAC)** has outstanding orders for40 A320neos and 30 A321neos.

Dubai-based lessor **International AirFinance Corporation** has orders for 30 A320ceos and 17 A330-300s, while Dublin-based **Amedeo** has 20 A380s on order.

AlphaStream Capital Management is a Swiss lessor with outstanding orders for 15 A320 family aircraft while Singaporean lessor **Global Aircraft Trading** has 11 Airbus models on order

Moscow-based **Sberbank Leasing** has 10 737-800s on order, while **Intrepid Aviation** — based in Connecticut — has six aircraft on order.

Argentina: Emerging hotbed of LCC activity

ARGENTINA does not currently seem like a welcoming place for low-cost carriers. The economy is mired in a deep recession. Infrastructure costs are high. The government continues to set minimum air fares. Labour unions are militant (as was illustrated by the mid-October strikes at both Aerolíneas Argentinas and LATAM Argentina). And the country's airports are not ready to cope with any significant increase in competition.

Yet, recent months have seen a surge of interest in airline projects in Argentina. The list of people who have paid a visit reads like a Who's Who of global airline investors. There have already been some notable announcements.

Brazil's Synergy Group, majority-owner of Colombia's Avianca Holdings and 100% owner of Avianca Brasil, got there first. Earlier this year, Synergy secured a foothold in the Argentine domestic market by acquiring Macair Jet, a small turboprop operator, which it plans to rebrand and expand.

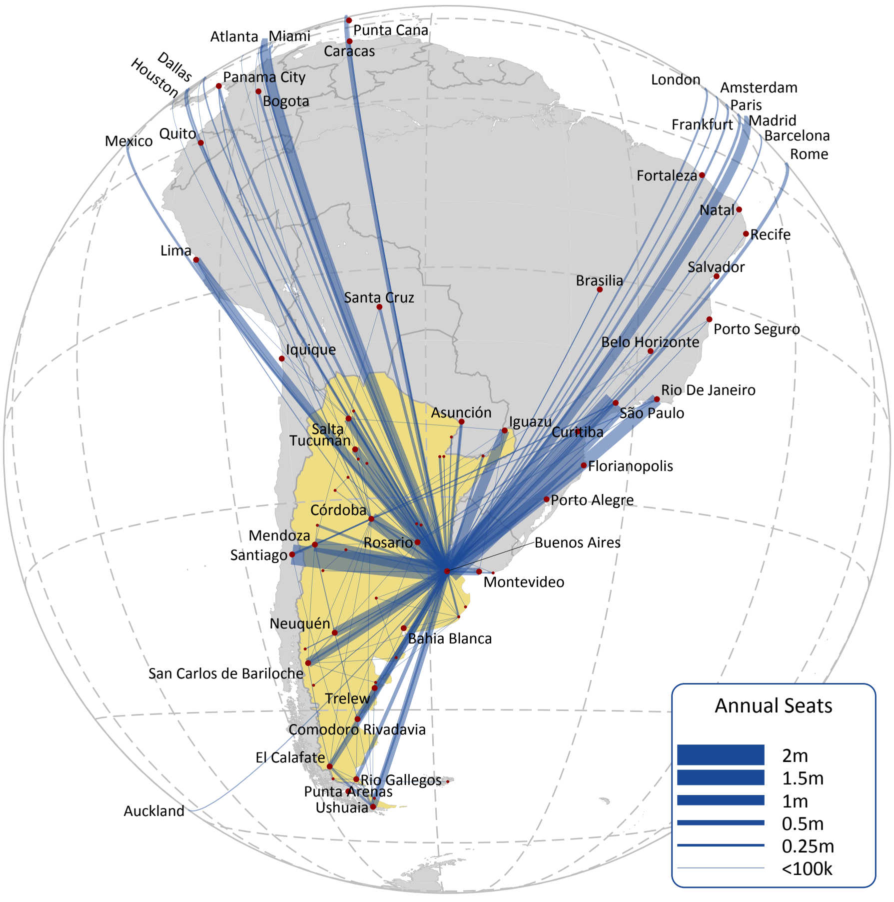
In the spring there was speculation that Irelandia might set up its third Viva brand airline in Argentina, possibly via buying an existing operator. But instead, a brand new airline with Ryanair involvement, Flybondi, was announced on September 30.

Flybondi hopes to take off next year as Argentina's first ULCC and expand rapidly in Latin America with A320s or 737-800s. The venture is backed by a group of prominent local and international investors, including Ryanair board director/ex-COO Michael Cawley, Air Canada ex-CEO Montie Brewer and BA CityFlyer Express founder Robert Wright.

Norwegian Air Shuttle is seriously interested in Argentina, too. It was reported in early October that CEO Bjørn Kjos had visited the country as Norwegian is evaluating plans for a base in Buenos Aires or Córdoba (the second largest city). Kjos was quoted calling Argentina a "hidden jewel" and saying that the country offered the largest potential for increasing visits he had ever seen. He was, of course, talking about potential transatlantic services, which would be years away. And Norwegian is also evaluating markets such as Chile.

In the meantime, there are major changes taking place at Aerolíneas Argentinas. After decades of losses, the state-owned flag carrier is making some progress towards a financial turnaround with the help of a new management team brought in from the private sector. Despite Ar-

ARGENTINA: MAJOR TRAFFIC FLOWS



Source: schedules data 2016. Thickness of the lines directly related to number of seats flown.

gentina's deep recession, Aerolíneas grew its passengers by 10% and revenues by 4% in the first quarter of 2016. The management expects this year's loss to be less than one third of the $1bn loss predicted in January.

Market-friendly policies

All of that is happening because of the changes that have taken place in Argentina since President Mauricio Macri took office in December 2015 after 12 years of left-wing, populist rule by Cristina Kirchner. *The Economist* noted at that time that Kirchner's reign had "distorted the economy, made enemies at home and abroad and undermined institutions" and that Macri was promising "a return to economic sanity, diplomatic prudence and a more accountable democracy".

Macri has moved fast to implement reforms and rebuild relationships with the rest of the world. He has restored Argentina's access to international credit markets (by settling a court case filed by hedge funds over unpaid debt), abolished capital controls and floated the exchange rate. The Macri administration is in the process of removing energy and transport subsidies and restoring the credibility of the country's institutions.

The crackdown on the institutions has already led to changes at the statistics agency INDEC, which in June released revised figures for GDP for the 12 years up to and including 2015. Differences between the two sets of data were startling; for example, the 2014 figure was revised from 0.5% growth to a 2.6% decline. Having macroeconomic data that can be trusted is crucial for restoring investor confidence.

In recent months, a series of business forums have been held in Argentina with participants from all around the world. As a result of that and the reforms, the country is again attracting foreign direct investment.

After a recent government-sponsored forum, German engineering group Siemens committed to funding $5.6bn in infrastructure projects in Argentina, while General Electric said that it would invest $10bn in the country over the next decade. GE has already invested $1.2bn there in the past four months, which has included a $280m loan to Aerolíneas Argentinas to buy aircraft.

On the aviation front, the Macri administration is moving to eliminate subsidies to Aerolíneas Argentinas, intending to transform the flag carrier into a viable commercial enterprise, invest in aviation infrastructure, relax controls on domestic fares and allow more competition in the domestic market.

In January the government ordered the removal of subsidies to privately owned regional carrier Sol Líneas Aéreas, which had been Aerolíneas' feeder partner. Sol subsequently filed for bankruptcy and ceased operations.

Invigorating the commercial aviation sector will be a key component for making the new economic policies a success. As a side note, Macri himself may be well tuned to the needs of airlines because his family was the owner of Macair Jet (which they sold to Synergy).

One of Macri's immediate actions was to appoint a new CEO from the private sector for Aerolíneas Argentinas. Isela Costantini had been president/CEO of the local arm of General Motors and in 2013 had been included in *Fortune* magazine's list of the 50 most powerful women in business. Since she took office in January, Aerolíneas has benefited from many new policies (discussed in the section below).

The Argentine domestic market is currently dominated by Aerolíneas and its sister company Austral (around 74% of the seats), with LATAM Argentina having a 24% share and Andes Líneas Aereas and Macair Jet accounting for the remaining 2%. The flag carrier has expanded aggressively in recent years while the previous government restricted LATAM Argentina's growth in the domestic market.

But LATAM Argentina is now believed to be free to grow in the domestic market (subject to route approvals). In June it signed a partnership agreement with Argentina's tourism ministry for the joint development of domestic tourism. And it was recently re-authorised to operate international services from a second Buenos Aires airport (more on LATAM's plans in the section below).

All of that bodes well for Flybondi, Macair Jet and other potential LCCs that hope to carve out stakes in the Argentine domestic market and later also move to the international arena. Importantly, in May the Argentine government set a goal of doubling domestic air traffic in the next four years.

Another positive sign is that the strict government regulation of domestic air fares is beginning to give way to a liberal pricing regime. In February the government abolished controls on maximum domestic air fares. Although minimum prices remain — which could be a problem for LCCs — those controls too are likely to go in the not-too-distant future.

Importantly, Argentina has announced plans to spend $24-26bn on infrastructure projects over four years. Although the bulk of that will be on roads and rail, $1.35bn has been earmarked for upgrading air transport infrastructure, including the refurbishment of 17 airports. Funding will come from multilateral development banks, the treasury and public-private partnerships.

Some government officials have cautioned that the infrastructure upgrades must come before a competitive aviation regime. But new LCCs would probably start relatively slowly anyway, and they would prefer more basic facilities. They don't need fancy business lounges or costly air bridges. Hopefully the new entrants will have a say in the types of facilities to be provided.

This year's big concern has been the deteriorating economy. The austerity measures in Argentina have caused short-term economic pain. GDP forecasts for 2016 have steadily come down as the year has progressed; the latest projections see the economy contracting by 1.5-1.7%. In recent months inflation has been running at close to 40%.

However, economic growth is expected to resume in the final months of 2016 and next year could see a strong rebound. Argentina's GDP is projected to expand by 3-3.5% in 2017. Inflation is also expected to fall; the central bank's (ambitious) target is 12-17% in 2017, reducing to 5% in 2019.

So this could be an opportune time to get LCC projects started in Argentina. But such ventures may only be for the most risk-tolerant investors, because Argentina poses special risks.

It was indicative that in recent weeks Moody's and Fitch merely affirmed Argentina's credit ratings, rather than raising them. The agencies felt that the big credit positives (reforms and imminent economic recovery) were offset by political and economic risks. While Macri enjoys strong approval ratings, who knows what the next election will bring? Moody's wrote in a September 29 report: "It will take time for the full effect of the new policymaking to materialize and there is still a high risk that a different government could reverse these policy changes."

Ripe for LCC stimulation?

Flybondi's founders noted in their presentation how LCCs have stimulated demand in other countries. Air traffic in markets such as Turkey, India, South Africa and Brazil multiplied after LCCs arrived and drastically lowered fares. Within Latin America, LCCs now dominate the Mexican and Brazilian domestic markets (63% and 57% of total seats, respectively) and are a growing force in Chile (30%) and Colombia (7.5%).

There is no reason why Argentina would be different. It has broadly the same demographic and socio-economic characteristics and trends as other Latin American countries, including a rising middle class made up of many people who have not flown before. The country is large with poor road and rail infrastructure. Buses have traditionally been the only low-cost option for long-distance travel, but that mode is extremely time-consuming.

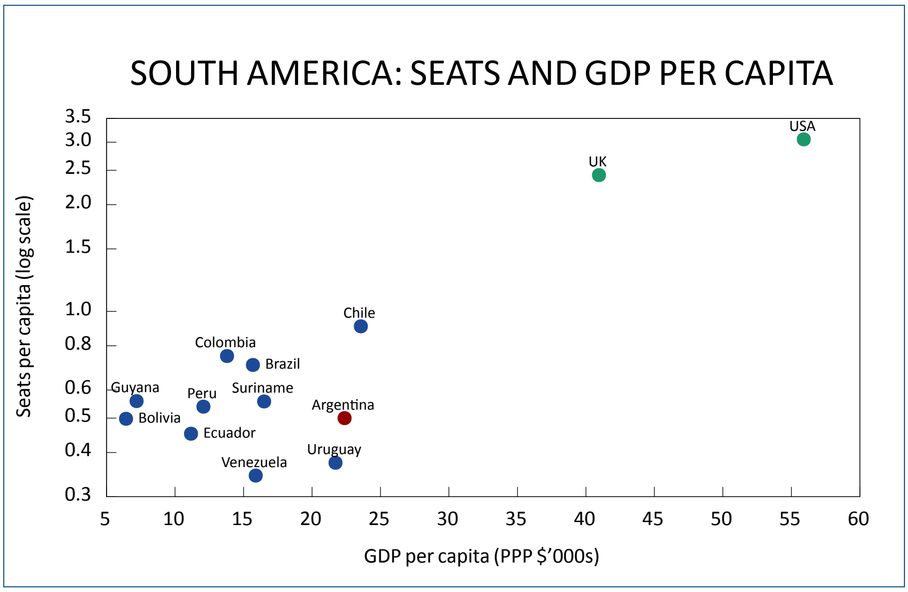
According to a recent LATAM presentation, Argentina and Ecuador had the lowest trips per capita among the top seven Latin American countries in 2014 — just 0.50, compared to Chile's 1.02 and the US's 2.68.

The Argentine domestic market would seem especially ripe for air travel stimulation because of the state-owned carrier's dominant position and because government controls have kept domestic air fares high.

In the following pages *Aviation Strategy* takes a look at each of the four existing or proposed airlines that look likely to be the main players in Argentina's future liberalised aviation regime.

The remaking of Aerolíneas Argentinas

Argentina's 66-year-old flag carrier has a colourful history. After its privatisation in 1990 managements from many different companies (including Iberia and American) tried to



make it work, but Aerolíneas ended up filing for bankruptcy in 2001.

It was subsequently acquired by Grupo Marsans, a former Spanish tour operator consortium, but its financial struggles continued. The Argentine government renationalised Aerolíneas at the end of 2008, alleging that the private owners had mismanaged it financially, which had included running up $890m in debt. (Grupo Marsans ceased to exist in 2010 after another airline investment, Air Comet, was declared insolvent.)

Aerolíneas has benefited from government ownership in one important respect: it got a new fleet (debt-funded or on operating leases). It has also built an extensive domestic network and recorded significant traffic growth. Since late 2011, when the government imposed an austerity plan, Aerolíneas has even been trying to cut costs. But heavy losses have continued, so the cost to the Argentine taxpayer has been substantial.

Also, under government ownership, Aerolíneas' debt has ballooned even more (figure not available). When the new management took over, the carrier was behind in payments to Boeing, Airbus and Embraer.

Aerolíneas does not publicly release its financial results; in 2013, the latest audited year, it reportedly lost $247m on revenues of $2bn. But according to local newspapers, the government has been subsidising Aerolíneas to the tune of $700m annually. Transport Minister Guillermo Dietrich has reportedly estimated the total subsidies paid to Aerolíneas through 2015 at $5bn.

The Macri government wants to eliminate the subsidies, so the number one task of the new CEO is to make Aerolíneas profitable. Importantly, Isela Costantini is supported by an entirely new senior management team — all from the private sector and some with extensive airline industry experience.

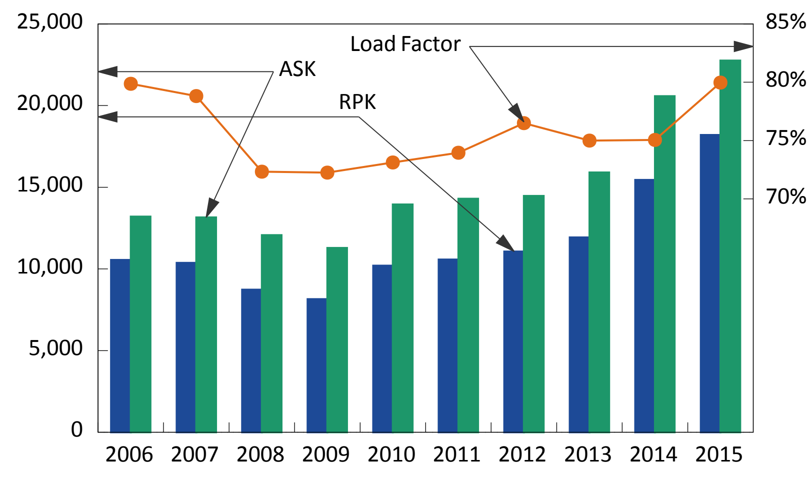
CFO Pablo Miedziak, who came from the global hotel chain Starwood Hotels & Resorts, spoke of some of the challenges at a recent *Airfinance* conference. The new management had to start from scratch because Aerolíneas even lacked basic controls such as budgets and sales and performance targets. Operational performance was dismal (an early area of success: after seven months, punctuality is at 85%).

While Aerolíneas is now allowed to shed unprofitable routes, the initial focus has been on reducing non-operating costs and boosting revenues, as well as improving productivity and better matching aircraft to markets. In August Aerolíneas completed a refinancing that halved the interest rate. The new deal was a $280m, 10.5-year loan from GECAS that is secured by four A330-200s and three 737-700s scheduled for delivery this year and in 2018. GECAS is a longtime business partner and all of the aircraft are powered by GE engines.

Fleet renewal offers important ongoing cost savings. At the end of September Aerolíneas' 53-strong fleet consisted of A330-200s, A340-300s, 737-700s and 737-800s, while Austral operated 26 E190s. Aerolíneas continues to take A330-200s for growth and plans to reduce the A340 numbers to three by 2018. On the regional front, Aerolíneas is taking more 737-800s to replace the smaller 737-700s, which will facilitate some ASM growth as well as cost savings. The airline recently modified an earlier order for 20 737-800s to include 11 of the even more cost-efficient 737 MAX 8s.

On the revenue side, Aerolíneas is benefiting from a codeshare relationship with Delta that began in November 2015, as well as cooperation with other SkyTeam members (it has been in SkyTeam since 2012). The Delta deal gives Aerolíneas access to 16 US destinations, while at the Argentina end the airlines codeshare on two domestic routes and to Montevideo (Uruguay) and Lima (Peru).

AEROLINEAS ARGENTINAS TRAFFIC



Source: Airline Monitor

AEROLINEAS ARGENTINAS FLEET

	2012	2013	2014	2015	*On Order*
737-700	22	22	22	18	
737-800	4	6	14	20	(22)
A-330-200		3	4	6	(2)
A-340-300	10	11	7	7	
Total	**36**	**42**	**47**	**51**	**(24)**

Source: Airline Monitor. Note: excludes Austral's fleet of 26 ERJ190 + 1 on order. In Sep 2016 Aerolineas converted 11 of the 737-800 orders to the 737 MAX 8

Aerolíneas' own international network, which once spanned the globe, has whittled down to a handful of Latin America routes and five destinations outside the region: Miami, New York, Madrid, Barcelona and Rome.

Since 2008 Aerolíneas has focused on growing its domestic network, which now covers 36 cities. On many city-pairs it is the only operator. The carrier has already closed its regional jet business (operated by Sol) and is expected to shed a few more unprofitable routes, while maintaining a strong market position as competition intensifies. Aerolíneas will have to get its costs down, because it will be undercut by more efficient airlines when the domestic fare controls are abolished.

But Aerolíneas is already under pressure because the Macri government moved immediately to reduce the subsidies. This year's deficit was initially projected to be around $1bn, but the government has capped the subsidy at a much lower level for 2016; figures in the $260-450m range have been reported. Based on comments made by the CEO and CFO in recent weeks, Aerolíneas has reduced its operating loss materially this year. The goal is to achieve break-even in three or four years.

That may not sound very ambitious, but Aerolíneas is digging itself out of a deep hole and continues to be constrained by what the new CEO described to *The Wall Street Journal* as "a deeply ingrained bureaucratic culture". State-carrier mentality remains strong among the carrier's six powerful unions. It has been hard to sell ideas such as productivity improvements or increased worker participation in decision making. The pilots have gone on strike at least twice in the past month to demand higher pay.

With 12,000 workers, Aerolíneas is overstaffed, but given the current union attitudes it is hard to see how it could reduce the numbers. And it may not be possible to attain profitability without labour cost reductions. Privatisation might help but is probably not possible in the foreseeable future. When campaigning for president Macri promised to keep Aerolíneas in government's hands.

LATAM Argentina: Now poised for growth?

LATAM Argentina is one of several domestic units that the Chile-based group operates in South America as joint ventures with local partners. It was established in 2005 and it benefits from aspects of an LCC-style business model that LATAM implemented at its domestic subsidiaries in 2007.

Making the Argentine venture profitable had initially been a struggle because of the domestic fare controls, a 737-200 fleet and other factors. But the new business model, re-fleeting and a series of authorised fare increases helped. LATAM Argentina grew quickly. By 2009 it operated a 12-point domestic network and had captured 26% and 17% of the Argentine domestic and international markets, respectively.

But since 2009 LATAM Argentina has added only two domestic points and its market share has fallen slightly. The pause in growth may have partly been due to the difficulties LATAM had with the previous government, but the reasons are probably mainly economic. The fare controls meant that the carrier was not able to deploy the pricing aspects of the LCC-style business model and stimulate demand. Back in 2009 LATAM executives noted that the airline was already present in the 12 markets that could be served profitably in Argentina.

Argentina's prolonged recession has also contributed to the delays. LATAM executives said in August that even though today the Argentine market was "relatively healthy", the economic situation there still made them cautious.

LATAM Argentina has grown internationally, though. It has connected LATAM's Lima hub to two secondary cities in Argentina, after long serving it from Buenos Aires. From the capital it also serves three points in Brazil and one each in Peru, the US and the Dominican Republic.

With passenger revenues of $979.3m in 2015 and a fleet of 13 aircraft, LATAM Argentina is already quite a sizable airline. Its well-established domestic network and facilities and 11-year operating experience in Argentina position it well to start growing again when Argentina's economy recovers and the fare controls are abolished.

Interestingly, LATAM is currently working on another "redesign" of its business model in Brazil and in its "Spanish speaking countries". The key objectives are to increase efficiency, reduce costs, develop ancillary revenues and facilitate sustainable growth in domestic operations. While details are yet to be announced, it does seem like LATAM is preparing the domestic units for a new era of competition with ULCCs.

Flybondi — First ULCC disruptor?

Flybondi is the brainchild of its CEO Julian Cook, a Swiss executive who created FlyBaboo and also worked at GECAS, and Argentine entrepreneur Gaston Parisier. The two men revived an unsuccessful earlier project from 2008, because they felt that conditions had changed and that now was a good time to start a low-cost carrier in Argentina.

Flybondi seems to have solid credentials and plans. It completed its first financing round in August and is looking to raise a total of $75m. The intention was to submit route applications to the Argentine authorities in October, followed by presentations to labour unions and the start of operations in next year's third quarter.

The airline will be Buenos Aires-based and will initially operate 12 domestic routes from the capital, beginning with Buenos Aires-Córdoba. By 2021 the network will include 40 cities in Argentina and 34 elsewhere in Latin America. An initial fleet of six will grow to 25 by 2021. The choice is between the 180-seat A320 and 189-seat 737-800 and discussions with manufacturers are reportedly under way.

Flybondi promises great benefits to local employment: 1,500 direct and 20,000 indirect jobs. That could go down well with the government. The toughest task may be to get Argentina's labour unions to agree to the types of pay rates, productivity and flexibility that an LCC needs.

Notably, Flybondi has the idea of using a secondary Buenos Aires airport, rather than either Aeroparque Jorge Newbery or Ministro Pistarini International Airport (the two existing gateways, both hubs for Aerolíneas). There may be alternatives, such as an Air Force base at El Palomar just 20km away or La Plata Airport (67km from Buenos Aires). Such airports could conceivably offer lower costs for LCCs. But that part of the plan is believed to be very uncertain.

Flybondi promises "a new way to travel" in Argentina, for which the key component will be low fares. But the carrier faces some unique challenges, including the high cost of facilities provided by state-owned ground handling company Intercargo and the government imposing minimum fares.

The government controls mean that Flybondi may not be able to offer the types of ultra-low fares that would stimulate traffic. However, according to reports, Flybondi believes that it could manage for a while pricing near the lows. As the fares are in pesos, inflation will lower the minimum levels in real terms. And the carrier's leadership predicts that the minimum caps will have been removed by mid-2017.

Macair Jet — Future Avianca Argentina?

Although Macair Jet is primarily a charter and business jet operator, it does have a scheduled licence and permissions to operate various routes and larger aircraft, so Synergy Group could in theory build the operations relatively rapidly.

Macair Jet is based at Buenos Aires' Aeroparque Jorge Newbery. Although it has been in existence since 1995, at the time of Synergy's acquisition it operated only two scheduled air taxi routes, to Reconquista and Sunchales. The fleet was made up of six executive jets and one Jetstream 32.

Earlier this year German Efromovich, Synergy's founder and chairman, talked about relaunching Macair Jet as a scheduled operator by the end of 2016, equipping it with 18 turboprops and moving the base to Córdoba. He has also mentioned rebranding, though it not known if Macair would use the Avianca brand.

It is not clear how those plans are progressing. Synergy has its own financial issues and hands full with its other investments. Among other things, it is trying to secure new equity investors and a strategic partner for Avianca Brasil.

Nevertheless, Macair Jet gives Synergy a useful foothold in Argentina to tap future growth in a new market and to provide feed to Avianca's international services.

By Heini Nuutinen
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