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European consolidation: another one bites the dust

IT ALWAYS amazes how long a loss making airline can survive before it goes bust. Air Berlin has been struggling as a going concern since it came to the markets with its IPO and dubious "hybrid" operating strategy in 2006. In the past ten years it has lost a total of €2.4bn at the operating level (a negative margin of 6%) and €2.7bn at the net. In the past few years it has been kept alive through constant cash support from major shareholder Etihad who took a 29% stake in 2011. Now, *that* shareholder has pulled the plug, and Air Berlin has filed for bankruptcy protection, gaining a €150m emergency cash loan from the Federal German Government to keep operations running to the end of the Summer season pending sale and reconstruction of its parts.

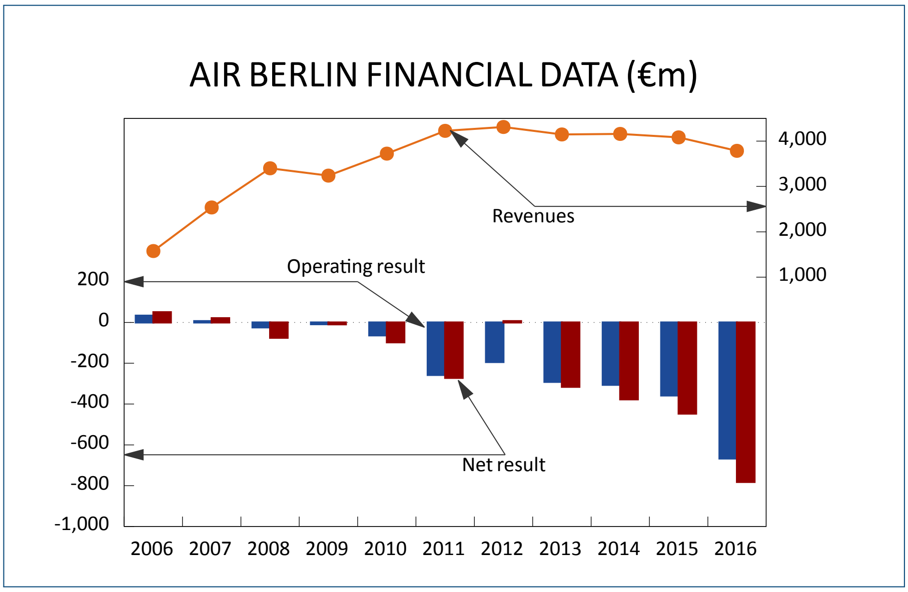
There is not much value in the company. The aircraft fleet is almost all leased. The net equity on the balance sheet at the end of March stood at a negative €(2.1)bn excluding a now unrealistic credit to Etihad for its "hybrid equity" funding of €358m. What had been promulgated as a rescue package, the divestment of the charter and tourist oriented business to a new "bad Air Berlin" structure involving TUI, Austrian subsidiary Niki and Etihad (see *Aviation Strategy* October 2016) has fallen apart, so the NAV represented at that time may represent a significant overstatement of the asset position.

Given that Etihad has washed its hands from its investment and reneged on a promise to keep the company afloat for at least 18 months, it may be that it will just write off its €358m perpetual convertible, a €350m loan granted in April this year repayable in 2021, its €100m investment in a new convertible loan issued in January and maturing in 2019; Abu Dhabi could also just write off its banks' €245m loans recently extended to April 2019. If so the company would still have a negative equity of €(1.4)bn.

The Air Berlin operation does have some assets. It holds some 30% of the slots at the heavily constrained Düsseldorf airport and 42% of the slots at Berlin Tegel. Whether these holdings can be monetised is debatable:

✈ Firstly Air Berlin has wet-leased 40 aircraft to Lufthansa/Eurowings (as part of the split between the "good" and "bad") and it is usually the case that the published operator will have possession of the slots.

✈ Secondly, the only active trading markets in slots in Europe involve either London Gatwick or London Heathrow; and at these airports,



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Publisher:

Keith McMullan
James Halstead

Editorial Team

Keith McMullan
kgm@aviationstrategy.aero

James Halstead
jch@aviationstrategy.aero

Tel: +44(0)207-490-4453

Subscriptions:

info@aviationstrategy.aero

Aviation Strategy Ltd
Registered No: 8511732 (England)
Registered Office:
137-149 Goswell Rd
London EC1V 7ET
VAT No: GB 162 7100 38
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ESTIMATED LESSOR EXPOSURE

	Air Berlin				Niki		
	737	**A320**	**A321**	**A330**	**A320**	**A321**	**Total**
GECAS		11		1	1	2	15
AerCap		3	1	9			13
BOC Aviation	3	3					6
Avolon		3	1			1	5
BBAM	2			1		2	5
ICBC		3				1	4
ALC		1	1			1	3
BoCom Leasing		1	2				3
AWAS	1	1					2
Castlelake		1				1	2
CDB Leasing		2					2
Deucalion				2			2
Hannover Leasing						2	2
ORIX						2	2
16 other lessors	4	8	1	2		1	16
Total	10	37	6	15	1	13	82

Note: excludes aircraft on wet-lease to Eurowings

from our experience in slot valuations, it is only long haul carriers who are willing to pay for access.

✈ Thirdly, when and if Berlin Brandenburg finally opens, Tegel is scheduled to close, giving a finite time to the net present cash flow a slot purchase may represent.

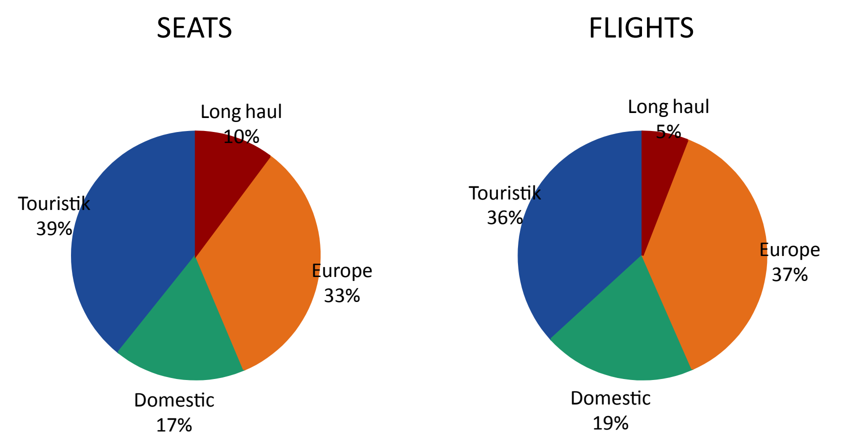
✈ And fourthly, should Air Berlin fail unsold, those slots will in any case become available to new entrants.

Having said this, Air Berlin has four distinct and disparate business segments which could appeal to some optimistic buyer:

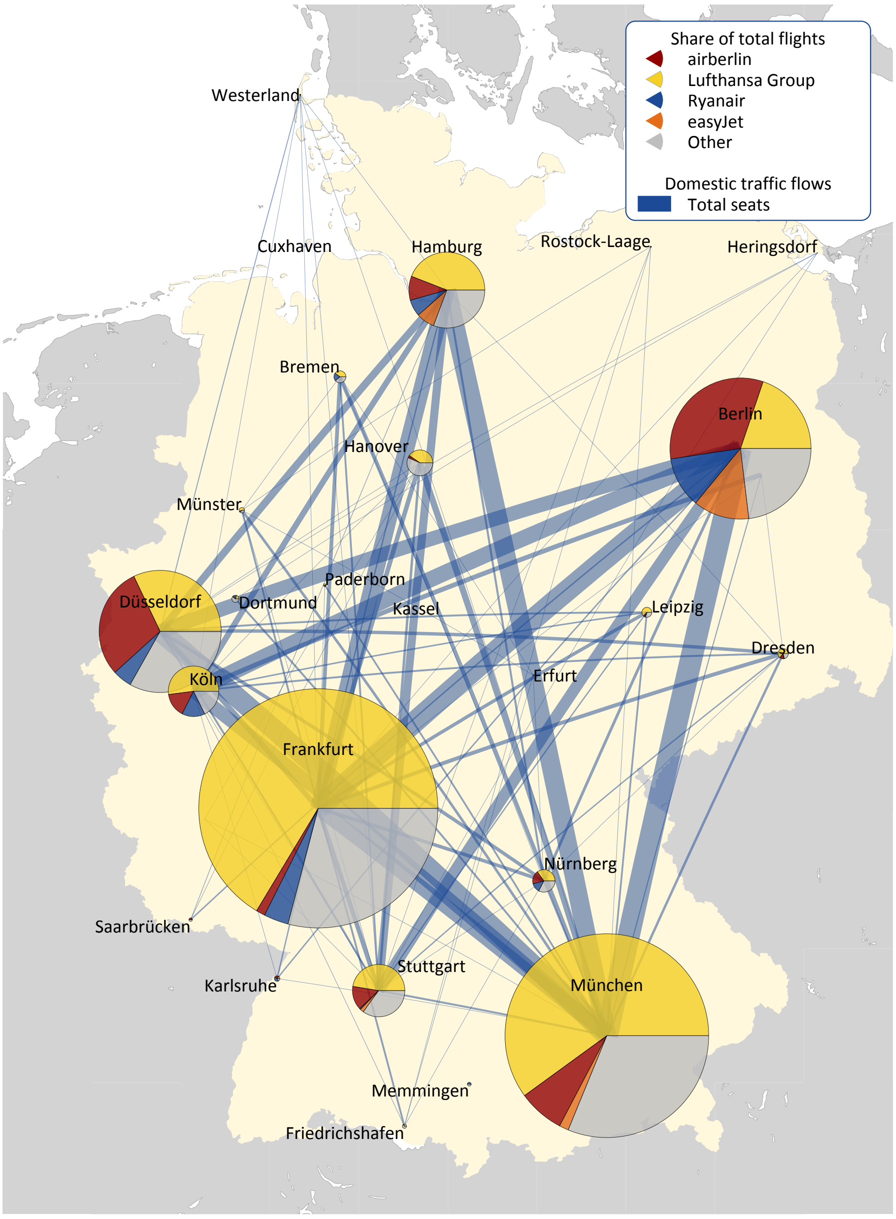
✈ The traditional sun, sea, sex and sand seasonal operations from Germany and Austria to what the Germans always refer to as "touristik" destinations. This is what they tried to offload to a new charter operation to be set up by TUI and Etihad as mentioned above.

✈ A significant domestic operation

AIR BERLIN: DISTINCT SEGMENTS



GERMAN DOMESTIC SEAT FLOWS



(the legacy of its acquisition of dba) in competition with Lufthansa and its subsidiaries.

✈ A European point-to-point network from German cities.

✈ A long haul A330 operation from Düsseldorf — the result of its acquisition of LTU.

The question is what if anything would a potential purchaser be buying? There may be some value in the Niki brand — the Austrian leisure operation — and in Austria Niki Lauda's legacy may retain some local kudos. The Air Berlin brand however is tainted by the decade of losses.

However, it appears from press comments that Air Berlin is in talks with a handful of players — including perhaps Lufthansa, Condor, TUI and easyJet — vying to take on Air Berlin's fleet, pilots and cabin crew.

The government has put its oar in and has suggested that the only solution is a break up, helpfully waking up to the fact that "the Air Berlin model has failed", with some politicians suggesting that a large portion of the operation should go to Lufthansa to "foster a national aviation champion" (as if they didn't have one already).

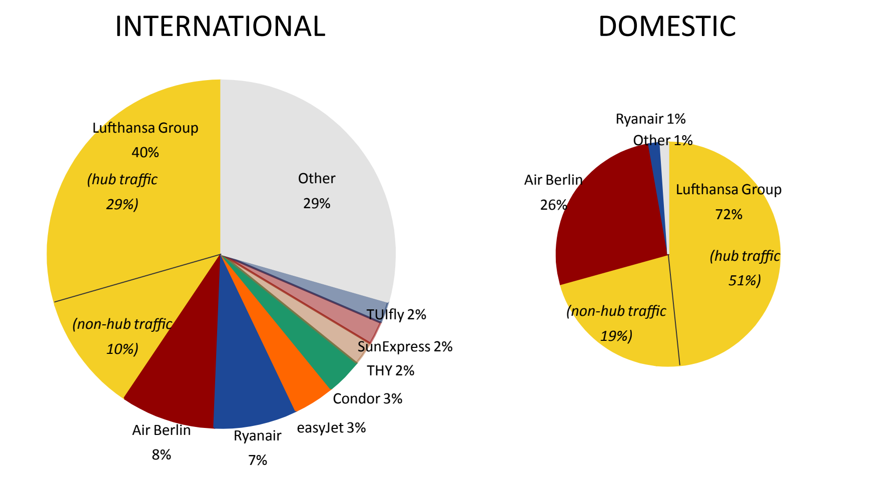
At the same time the transport minister Alexander Dobrindt dismissed competition concerns saying "there is no transfer of Air Berlin as a whole to Lufthansa, there are parts of the business that will go to Lufthansa and there are interested parties for other bits of the business so we do not expect cartel difficulties".

Meanwhile, aviation veteran Hans Rudolf Wöhrl — the architect behind the sale of dba and LTU to Air Berlin in the first place — has entered the fray suggesting that he would consider acquiring the whole business if only someone would let him look at the books. This comment has been mirrored by Ryanair's Michael O'Leary who also stated that the bankruptcy process was a "stitch up" to help strengthen Lufthansa, indicating perhaps that Ryanair would only be interested in Air Berlin if it were allowed to acquire the entirety of the bankrupt carrier and not just what might be left after Lufthansa has taken its pick of the assets.

Failure brings opportunities

Air Berlin will disappear and its demise will change the German market, and possibly in a dramatic way. For the past decade it has seemed that Lufthansa has been happy to co-exist in the domestic market with a financially weak competitor, to curtail the incursion of easyJet and Ryanair.

GERMAN MARKET CAPACITY SHARES



And the domestic market is pretty vibrant, reflecting the country's federal nature and historically independent states. Unlike some other European countries Germany is relatively decentralised and there are significant flows of domestic air traffic between industrial centres and state capitals (see map on the preceding page), with the federal capital distanced from the financial centre (Lufthansa's hub in Frankfurt), the industrial Nord-Rhein Westfalia (the most populous state in the Federation), Hanseatic Hamburg, and Bavaria.

Furthermore nine of the top 12 city-pairs by annual seat capacity on routes involving Germany are domestic (see chart on the current page).

Lufthansa as a group has a 71% share of all domestic German capacity (see chart on this page). Three quarters of this is essential to its network business — providing feed to its two hubs at Frankfurt and Munich. The other quarter is perhaps maintained to continue to provide its corporate contracts with services as an encouragement to use its long haul services. With its high cost base, it has struggled to make profits; and

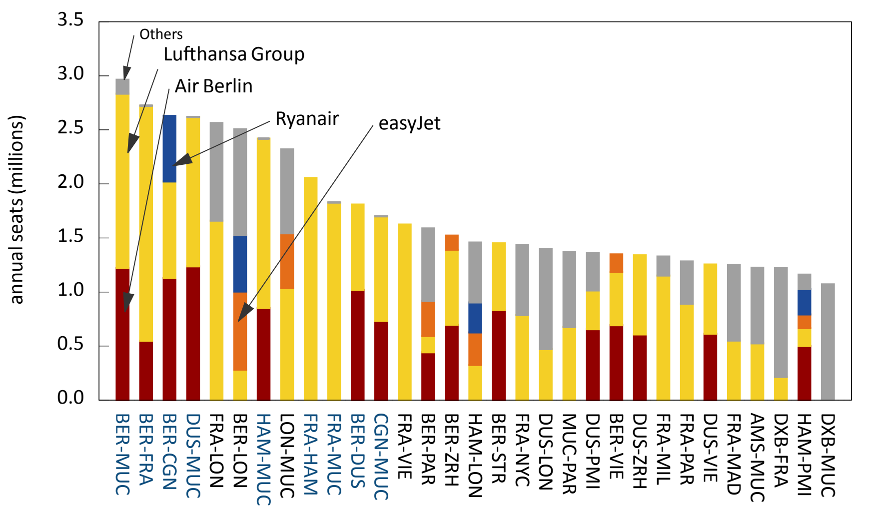
the transfer of these routes to its lower cost subsidiary germanwings has been a focus of its strategy in the past few years. Air Berlin has been the next largest operator with 26% of capacity. Even Transport Minister Dobrindt might accept that should Lufthansa take on Air Berlin's domestic services it would be a somewhat anticompetitive move.

Why haven't Ryanair and easyJet made greater inroads into the German market? One of the main reasons must be that it has been easier to develop services elsewhere in Europe.

Having said that, Ryanair has an 8% share of capacity out of Germany, and easyJet 3% — albeit less than half their respective market shares in Europe as a whole. Both have a strong presence at Berlin Schönefeld, but of the two only Ryanair operates domestic services. It made a major push into Cologne/Bonn and Frankfurt this year and has ended up with a 20% share of capacity on Cologne to Berlin route, a noticeable presence in Frankfurt and 2% share of domestic capacity.

Whatever the Air Berlin bankruptcy solution, the competitive landscape in Germany is likely to change dramatically. Could it be that the German domestic market could mirror the development in the UK — with the LCCs dominating the non-hub routes? Is this an incentive for the LCCs to adjust their product to make it more attractive to the conservative German consumer and, more importantly, change the local market perception of LCCs?

TOP 30 GERMAN CITY-PAIRS BY CARRIER



Note: Seats arriving and departing German airports 2017. Domestic routes in blue

Garuda Indonesia: Financial troubles follow quantum leap

WITH A significant fall in profits in 2016 and a drop into the red for the first-half of 2017, Garuda Indonesia is facing troubled times. A new CEO has just 12 months to turn around Indonesia's flag carrier; what are the chances of succeeding?

Founded back in 1947, today Garuda Indonesia offers services to 61 domestic and 73 international destinations around the globe and is one of the Asia/Pacific region's major airlines. In 2016 the Garuda group saw revenue rise 1.3% to US$3.9bn (the company reports its results in US dollars), based on a 6.2% rise in group passengers carried, to 35m. However, operating profits fell 41.3% to $99.1m, and the net profit was down 88% compared with 2015, to just $9.4m.

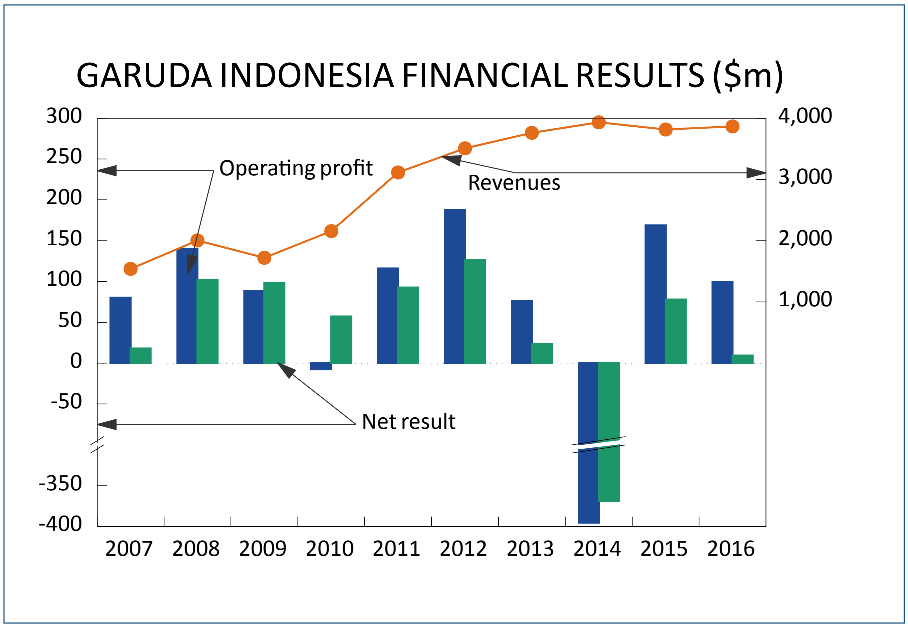
The trend continued into this year. In the first half of 2017 the Garuda group saw revenue rise by 7%, to $1,886.5m, of which $1,636m came from scheduled passenger revenue (up 4.6% year-on-year), with passengers carried up 3.9% to 17.2m. But an operating loss of $37.8m in H1 2016 increased to a $214.5m operating loss in January-June 2017, and a net loss of $63.2m in the first half of 2016 grew to become a $283.8m net loss in H1 2017.

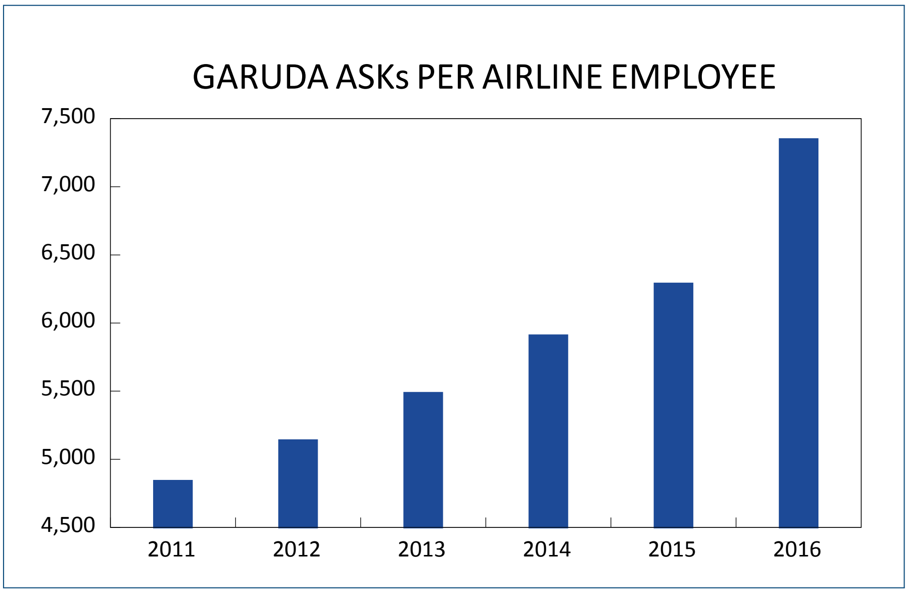
The first half figures for the full-service Garuda Indonesia mainline are discouraging — the majority of passengers (5.0m out of the total mainline total of 6.1m) were carried on domestic Garuda services, where passenger yield dropped 3.8% year-on-year, to 7.9US¢ — whereas costs/ASK rose 3.8% in the half, to 7.1¢. The data show the same adverse trends for international services at the mainline (1.1 m passengers in H1 2017), where passenger yield fell 5.5% to 6.0¢, and CASK rose 3.1% to 5.4¢.

Other than the mainline, the Garuda group has six major business units/subsidiaries, the most important of which is Citilink, the group's LCC. Launched in 2001 and based in Jakarta (as is the mainline), it operates a fleet of 57 aircraft to more than 30 destinations domestically and across the Asia/Pacific region. Citilink carried 5.6m passengers in H1 2017 (up 7.8% year-on-year), but costs per ASK rose even faster here than at the mainline — up 10.5% to 4.8¢. Even after stripping out fuel, CASK rose 6.5% in January-June 2017, to 3.1¢. The only bright news in a sea of red KPIs for the group was a 5.8% rise in yield for Citilink in H1 2017, to 5.1¢. Overall though, despite Citilink reporting a 19.6% rise in revenue in H1 2017, to $264.8m, its net loss worsened by a huge 139.5%, to $51m.

Pahala Nugraha Mansury, a former banker, became president & CEO of Garuda Indonesia in April this year (replacing Arif Wibowo, who lasted just over two years), with a warning/mandate from Rini Soemarno, Indonesia's state-owned enterprises minister, that the airline needs "a thorough restructuring in both operations and finances".

The new leadership can't blame the rise in costs so far this year purely on fuel — though it accounts for just over 27% of all operating costs, and fuel costs rose by 36.5% in H1 2017 compared with the first half of 2016. That's because every other category of major costs rose at the group, with — for example — "general administration" costs rising by a massive 60%





to $183m in H1 2017.

Expansion mania

It's difficult to unpick the limited amount of data available in Garuda's public accounts, but the underlying driver of rising costs is a combination of poor management control and the group's unrelenting focus on expansion. Passengers carried have risen from just 6m in 2006 to 35m in 2016 (a compound growth rate of 14.5% pa), with the fleet quadrupling over the same period and fuelled by its so-called "Quantum Leap" strategy that was launched in 2009 with the aim of transforming Garuda from an essentially moribund airline into a modern-day carrier.

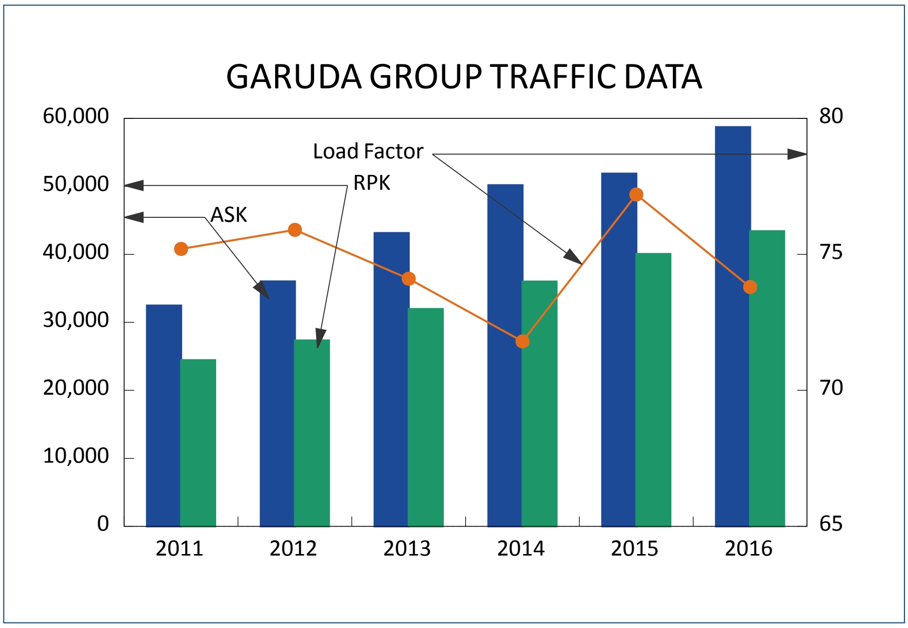
The problem that Garuda made for itself after this initial phase, was that it continued to believe that growth was the panacea for all its problems. Under the previous chief executive, Wibowo (who started in December 2014), the group's "Sky Beyond" strategy targeted a domestic market share of 50%, an international share of 50% and achievement of more than $10bn in turnover annually by the early 2020s. To do that a fleet of well over 300 aircraft was envisaged; in short, the mantra for Garuda — yet again — was expansion.

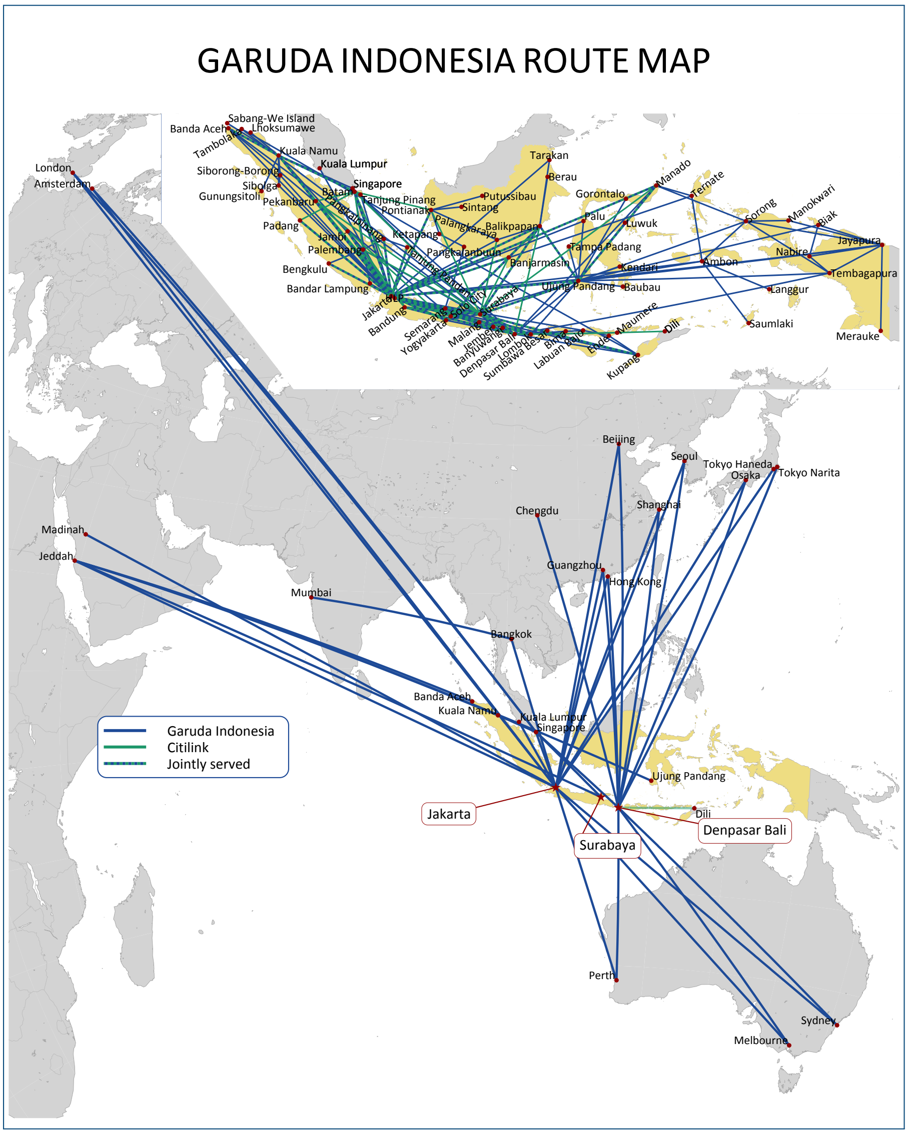
However, that ambition was severely dented by the reduced profitability through 2016, leading to furious attempts to cut costs as Wibowo tried to avoid the group posting losses — which ultimately was to no avail.

Mansury now has the task to halt and reverse the group's downturn, but that will be hard to do given that the airline still seems intent on aggressive growth in order to keep expanding its market share. Many of the group's international routes are believed to be unprofitable (particularly to Europe), yet the company keeps expanding internationally (no doubt encouraged by its majority shareholder — the government) in an attempt to develop Jakarta as a major transit hub against multiple local rivals.

Jakarta's Soekarno–Hatta International airport — 20km north-east of the capital — is relatively young (opening domestically in 1985 and internationally in 1991), but is now operating at full capacity, with its three terminals and two runways carrying some 59m passengers in 2016. A third runway is under construction, although it won't be completed until 2018, and while a fourth terminal is unlikely before 2022, an upgraded Terminal 3 will be completed this year.

In the meantime, Garuda's expansion continues apace. In January-May 2017 Garuda's international passengers carried rose by 24.1% — way ahead of almost all other legacy competitors in the





Asia/Pacific market (passengers carried in the total Asia/Pacific market rose 5.8% in the same period).

Garuda's international network now covers Asia (36 destinations), Africa (two), the US (Chicago, Los Angeles, New York, San Francisco and Seattle), Middle East (seven) and Europe (23). Most of these are code shares, and it only actually operates to 17 Asia/Pacific destinations outside Indonesia, London and Amsterdam in Europe, and two in the Middle East (see map on the current page). Services from Bali to Chengdu — the group's fourth Chinese destination — started in June this year while a Jakarta-Moscow service using A330-200s was announced to launch in August and a Jakarta to Los Angeles via Tokyo route is scheduled to start in November with 777-300ERs.

Garuda Indonesia joined SkyTeam in March 2014 and has a total of 27 codeshare partners (the latest of which is Saudia, which started in August), though interestingly throughout its expansion strategy, while capacity has risen steadily (see chart on the facing page), the airline has struggled to lift passenger load factor above the mid-70s.

To be fair to management, the expansion focus is partly being driven by the relentless wave of competition from LCCs. AirAsia Indonesia (see *Aviation Strategy,* June 2017) operates out of three hubs in Indonesia — Jakarta, Surabaya and Medan. The biggest challenge, however, comes from Lion Air, which launched in 1999 and today operates out of the same three hub airports as AirAsia with a fleet of 109 737s and three A330s.

Lion Air's services connect more than 100 destinations domestically (where it has the largest market share, ahead of Garuda) and throughout Asia, and scarily (from Garuda's point of view) it has an outstanding order book for 203 737 MAXs and 737-900ERs.

By its own estimate Garuda had a 39.5% share of the domestic market in the first half of 2017 (down from 40.6% in H1 2016) and a 28.0% share of the international market (compared with 27.1% in January-June 2016), and the airline seems to be obsessed with increasing those percentages.

Variable cost efforts

Garuda has been and is carrying out cost-cutting exercises, which in 2016 concentrated on items such as fleet optimisation, reduced insurance costs and optimised maintenance programmes, aimed at on saving US$250m on an annual basis.

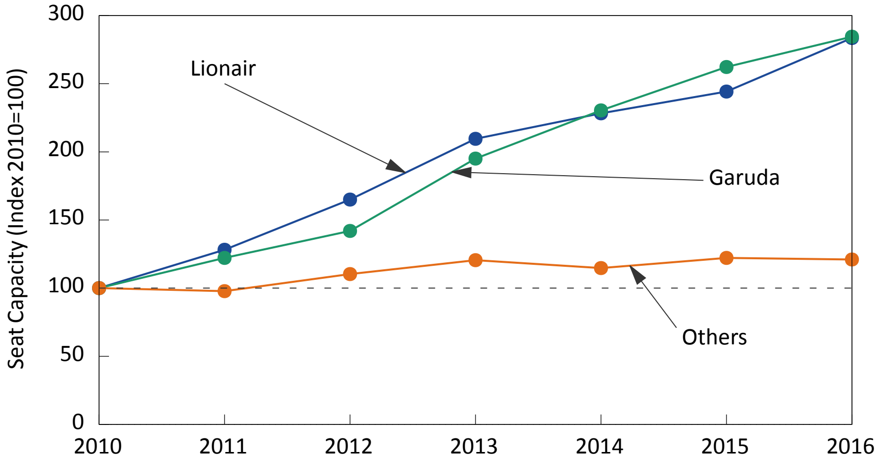
However, progress has been mixed; for example, productivity in terms of ASKs per airline employee has improved steadily over the last few years (see chart on the preceding page). On the other hand, fleet rationalisation is painfully slow. The Garuda groups currently operates a fleet of 200, but this is split between 11 different types.

The mainline operates 73 737-800s, 18 CRJ-1000s, 16 ATR 7-600s, two 747-400s, 10 777-300ERS, seven A330-200s and 17 A330-300s. To make matters worse even the LCC — Citilink — operates four types: five 737-300s, three 737-500s, 45 A320-200s and four A320-200neos. In short, the fleet strategy is a mess.

By the end of this year the total fleet will increase to 202 aircraft but the mix will change only slightly, with the two 747-400s exiting at the mainline. However, by the end of 2017 the total number of models won't reduce as one new type will be added, with mainline receiving the first of an outstanding order for 50 737MAX-8s (placed in 2014), which will all be delivered by 2023.

Citilink also has an outstanding order for 25 A320neos and the mainline for six more of the model. Additionally, Garuda has an order for 14 A330-900s, placed last year, which will start arriving in 2019.

GARUDA MATCHES LIONAIR GROWTH RATE



Notes: Garuda includes Citilink, Lionair includes Batiq and Wings, Others = All other carriers operating domestically or to/from Indonesia

Other measures that are being implemented include adding an extra 79 seats for each 777-300ER aircraft, and a renegotiation of all contracts with manufacturers and lessors. Of the total fleet of 200, all but 22 are leased, though so far Garuda has only managed to renegotiate existing contracts with a single lessor.

In terms of revenue generation, although ancillary revenue is rising there are other areas where Garuda is significantly behind its rivals (whether legacy or LCCs); for example, 51% of all its ticket sales originate from travel agencies, with the Garuda's ticket offices accounting for another 23% and just 24% coming from e-commerce sources.

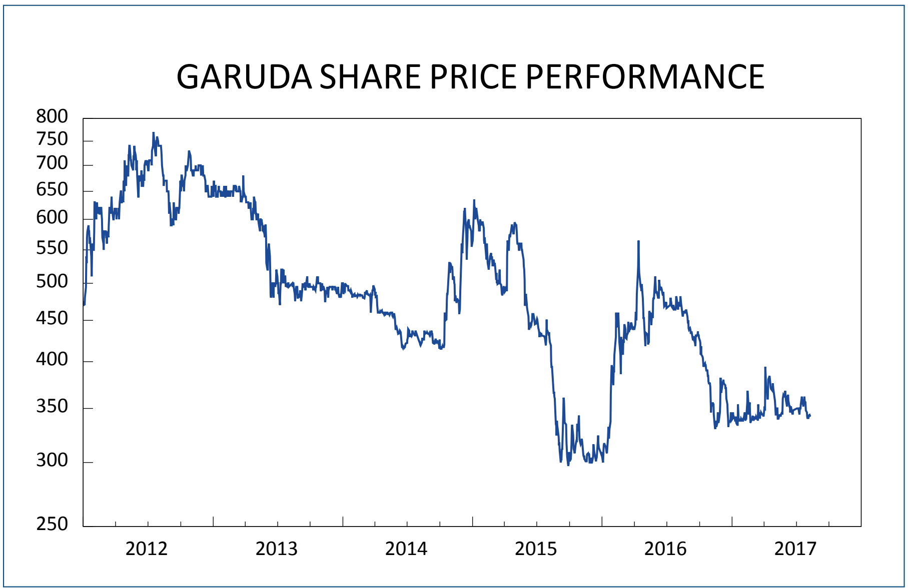
GARUDA FLEET PROFILE

		In service			
		2015	2016	2017e	(On order)
Garuda	747-400	2	2		
	777-300	9	10	10	(1)
	A330-200	9	7	7	
	A330-300	13	17	17	
	A330-900				(14)
	Widebody	*33*	*36*	*34*	*(15)*
	737-800	81	75	73	
	737MAX-8			1	(49)
	CRJ 1000	18	18	18	(2)
	ATR72	11	15	18	
	Narrowbody	*110*	*108*	*110*	*(51)*
	Total	**143**	**144**	**144**	**(64)**
Citilink	737-300	5	5	5	
	737-500	3	3	3	
	A320ceo	36	44	50	
	A320neo			4	(31)
	Total	**44**	**52**	**58**	**(31)**
	Group Total	**187**	**196**	**202**	**(95)**

Mansury's challenge

Mansury says that "the phase of business cycle that Garuda Indonesia is going through is only temporary" — which may be wishful thinking given that upon his appointment Soemarno warned that "we give him 12 months" to turn the airline around,

The airline is "taking action" to improve revenue, with a better balance of ASK versus RPK growth, and improving passenger yield — although at the same time is says it wants to continue to increase market share both domestically



and internationally. That seems an impossible mix, not least because Mansury will be spending a lot of his time trying to keep shareholders on board, negotiating with more than 25 lessors to reduce leasing costs, and smoothing concern among creditors and the stock market in general.

The Indonesian state still owns 60.5% of the airline, with 24.6% owned by PT Trans Airways (an executive charter airline owned by Indonesian businessman Chairul Tanjung), with the group listing on the Jakarta stock exchange in February 2011. Since then, however, the share price has fluctuated wildly (see chart on this page) — rising well above the Rp700 level in 2013 before plunging to almost touch Rp300 in 2015. After a recovery in early 2016 the price has fallen sharply over the last 12 months, and the stock has underperformed around 85% of Indonesia-listed stocks over the period. Today the price is hovering just under the Rp350 level, and it will have to rise significantly over the next few quarters if Mansury wants to retain his job.

Shareholders will be nervous by the 9.3% rise in financial debt at Garuda in just six months — total debt stood at $1.9bn as at the end of June 2017, and net gearing rose from 1.1x as at December 31st 2016 to 2.1x on June 30th 2017. More worryingly perhaps, cash fell by 29.2% year-on-year, to $381m at the end of June 2017, which management blames largely on “the significant growth of operating expenses”.

Whichever way you look at it, Mansury has a very tough job ahead, and unless he can effectively reign back expansion in order to give the airline breathing space to cut costs, the group is more than likely to have yet another CEO in place sometime in 2018.

Icelandic hubbing: Can Icelandair live with Wow?

ICELAND, population 334,000, plays an increasingly important, if widely unrecognised, role in the North Atlantic market, with two competing hub systems funnelling traffic from Europe to America via Keflavik Airport (KEF). But can Icelandair and Wow continue to co-exist with their rapid expansion strategies?

In the mid-2000s Iceland submitted to a bout of financial madness, turning from fishing to speculative trading as its main industry. Iceland's banks, recently deregulated, accumulated foreign debt, invested ludicrously in subprime mortgages, complex financial instruments and global property markets. And when the financial crisis struck, and Lehmans collapsed, the three main Icelandic banks went spectacularly bankrupt, GDP plunged by over 10% in 2009 and 2010, and the country had to partly default on its foreign debt, which peaked at ISK15.7tr ($190bn).

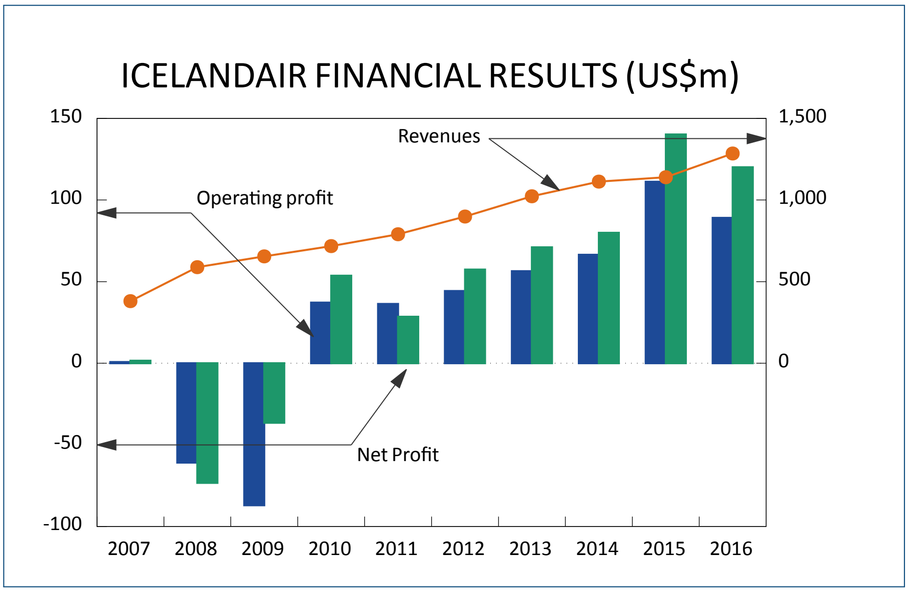
The recovery has been as remarkable as the collapse. The government nationalised the banks (and sent dozens of bankers to jail, a stark contrast with the US fall-out), a support package from the IMF was agreed, debt was restructured and repaid — foreign debt today is down to ISK 280bn ($2.6bn). The Icelandic economy has rebounded, this time based on sustainable tourism, with GDP in 2016 growing by 7.2% (again a highly favourable contrast with some the EU states' economic performance post the financial crisis).

Icelandair was in the centre of the financial crisis. The airline became a subsidiary of an investment/leasing company called Flugleiðir, owned largely by the leading banks; although Icelandair accounted for just over half of revenues, growth and profits were seen to come from the exciting world of financial and corporate investments (at one point it owned over 10% of easyJet).

Flugleiðir promised its shareholders an annual return of 20% pa, which of course did not materialise. In 2009 as the investments turned toxic, Icelandair had to announce a net loss of ISK10.8bn, a loss margin on revenues of 13.3%, and it teetered on the edge of bankruptcy. This was, however, a major turning point for the company as it reverted to concentrating on its aviation operations, specifically building its hub operation at KEF, as well as promoting inbound tourism to the island.

Coincidentally, this was the time when the North Atlantic market was rapidly consolidating with virtual mergers among the Lufthansa Group/United-Continental, Air France-KLM/Delta-Northwest and IAG/American-USAirways creating the conditions for oligopolistic profits in this region, and opening up opportunities for lower cost new entrants.

The KEF network is the only 24-hour hub system in Europe or North America, taking advantage of time differences between Iceland and Europe (minus 2-3hours) and N. America (plus 3-4 hours). Icelandair's first wave departs from KEF in the morning, arriving in Europe around midday with the return flight scheduled for early afternoon, arriving back at KEF at midday. The eastbound wave then leaves in the early afternoon arriving at American cities in the early afternoon, departing in the late afternoon and arrive back at KEF in next morning to connect with the westbound wave. In the five peak months, May-September, a second eastbound



ICELANDAIR ROUTE MAP

Note: Equidistant map projection based on Reykjavik (great circle routes appear as straight lines). Thickness of lines directly related to seat capacity.

wave starts up in the mid-morning.

The 28 European points and 18 North American points produce, according to Icelandair, a remarkable 496 connection options. How convenient many of these connection options are is, however, questionable: daily year-round flights are offered to only 11 European cities.

The hub system has been the main driver behind Icelandair's rapid traffic growth — from 2.0m international passengers in 2012 to 3.7m in 2016 (plus 0.3m passengers on domestic and regional services to Greenland, the Faroes and northern Scotland operated by Air Iceland). Connecting Passengers, the "via" market in Icelandair's terminology, now account for 54% or 2.2m of the projected 2017 total of 4m. The "to" market, mostly inbound tourism, accounts for about 34%, and is a target for expansion through the promotion of year-round holiday packages, with the aim of smoothing the high seasonality of the market. The "from" market, Icelandic outbound travel, accounts for the remaining 12%.

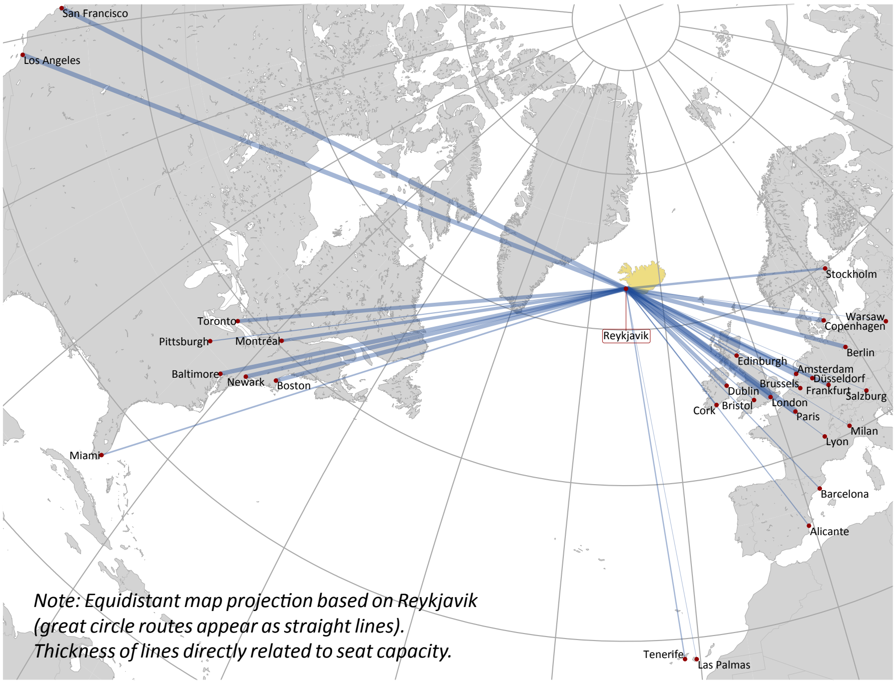
It is interesting to note that Aer Lingus, which carries about 1.6m passengers across the Atlantic, has identified Icelandair (and by implication, Wow) as one of its biggest threats. CEO Stephen Kavanagh earlier this year urged Dublin airport to improve its connectivity or lose business to Reykjavik. Passenger throughput at KEF has soared from 1.8m in 2009 to

ICELANDAIR AND WOW SEAT CAPACITY BY TOP TEN CITY PAIRS (000 Seats to/from Reykjavik, 2016 est)

North America					Europe				
	Icelandair	WOW	Total	Icelandair share		Icelandair	WOW	Total	Icelandair share
New York/Newark	348	143	491	71%	London (LGW & LHR)	456	260	717	64%
Boston	250	145	395	63%	Copenhagen	409	153	562	73%
Toronto	180	125	305	59%	Paris	287	209	496	58%
Washington	199		199	100%	Amsterdam	232	209	441	53%
Seattle	180		180	100%	Stockholm	227	79	306	74%
San Francisco		157	157		Frankfurt	165	129	295	56%
Los Angeles		155	155		Oslo	207		207	100%
Baltimore		145	145		Helsinki	194		194	100%
Montréal	26	106	132	19%	Munich	156		156	100%
Denver	130		130	100%	Berlin		143	143	
Others (11 cities)	544	93	636	85%	Others (26 cities)	707	482	1,189	59%
TOTAL	1,855	1,069	2,924	63%	TOTAL	3,039	1,666	4,704	65%

Note: Destinations in blue served by both carriers. Also service by both carriers on Brussels and Milan

WOW AIR ROUTE MAP



6.8m last year.

KEF can offer very fast on the ground transfers for passengers simply because there is only one terminal with all the gates compacted into a small area. The downside is that at peak times it is uncomfortably overcrowded, stretched to the limit it appears, which must present a barrier, albeit a solvable one, to Icelandair's and Wow's expansion.

On the major transatlantic routes Icelandair has to sell flights which are apparently significantly less attractive than direct services — for example, London to New York via Reykjavik adds 500-600km to the aircraft routing and at least two and half hours to the passenger journey compared the LON-NYC direct. But for passengers from Scandinavia, or those originating or destined to smaller cities, whose alternative is a connection at a European global hub at LHR, CDG, AMS or FRA, the disadvantage reduces, disappears in many cases.

The range of secondary cities current served by Icelandair and Wow includes on the American side: Edmonton, Portland, Orlando, Pittsburgh, Halifax and Tampa; and on the European side: Hamburg, Edinburgh, Birmingham. Billund, Cork, Bristol, Gothenberg, Bergen and Lyon. This must raise a serious question about the long-haul low cost models that anticipate business from linking secondary points in Europe and America with direct service. The Icelandic carriers offer the alternative of consolidating thin traffic flows through their mid-Atlantic hub in a medium to low cost operation.

Just how far the mid-Atlantic hub concept can be taken is illustrated by the recent start-up of a three-times a week Q400 service from Belfast City (the downtown airport) by Air Iceland, the turboprop subsidiary, to KEF, providing multiple onward connections from Northern Ireland to North America, as an alternative to getting to, then connecting at, LHR or DUB.

Icelandair has remained profitable since the recovery from the financial melt-down, but pressure is mounting on both revenues and costs. In 2016 passenger volume grew by 20% but passenger revenues rose only 12%, from $849m to $947m. Total revenue increased by 13% from $1.14bn to $1.28 with an increased contribution from the hotel/tourism/airport division (which accounts for about 20% of the total).

Operating costs, however, shot up by 17% from $0.91bn to $1.06bn despite a decline in fuel costs of 5%. Costs that should be controllable looked as if they were out of control — personnel up 27% and ground handling, largely provided through the fully owned subsidiary IGS, also up 27%. Icelandair management attributed much of the inflation to the strengthening of the krona against the US dollar. (The Group reports in US dollars, which represent the largest proportion of its revenues, 37%; only 25% of revenues are generated from Icelandic residents; revenues in euros and Danish/Norwegian crowns account for 22%, and sterling 7%, with 9% others.) But a more fundamental reason was a 15% surge in employee numbers — 3,384 average FTEs in 2015, 3,900 in 2016 — a response to what Icelandair describe as the stresses of rapid expansion.

Consequently, EBIT fell to $120m in 2016, 12% down on 2015. Net income was down 20% to $89m.

The adverse trend has continued into this year, with Icelandair facing the twin problems of yield pressure due to increased competition and capacity, and an escalation in its operating expenses in what is a high cost country.

ICELANDAIR GROUP FLEET

	ICELANDAIR Fleet	ICELANDAIR *Orders*	ICELANDAIR CARGO	LOFTLEIÐIR	AIR ICELAND
757-200/300	26		2	2	
767-300	4			2	
737-700/800				3	
737-MAX 8/9		*16*			
Q200/400					5
F50					4
TOTAL	**30**	***16***	**2**	**7**	**9**

Note: MAX 8 deliveries, 2018-2021, MAX 9 deliveries 2019-2021

Figures for the first half of 2017 show passenger numbers up 14% to 1.76m, but passenger revenue only increased by 7% to $393m. Total revenues, including cargo and the hotel/tourism division, were $422m, up 9%. But operating costs grew by 16%; fuel was up slightly but again there was a huge increase in personnel costs, up by 40%.

There was a loss at EBIT level, $(31)m, in contrast to a $11m profit in the first half of 2016. The net loss was $(24)m, against a profit of $9m in the same period last year.

These trends should be worrisome for Björgólfur Jóhannsson, CEO since 2008 (though Icelanders are phlegmatic — one of the 757s is named Eyjafjallajökull, after the volcano which brought airline chaos when it erupted in 2010). His strategic response lies in a $30m profit improvement programme, focusing on network expansion, better connectivity with domestic flights, efficiencies in ground handling and rebranding of classes. This may seem a little low-key given the ever-growing threat posed by Wow Air.

Wow Air was founded as a A320-operating LCC in 2011 by IT and telecoms entrepreneur Skúli Mogensen. It took over Iceland Express in the following year. Morgensen retains tight control of the airline through an investment company called Titan, which has not as yet revealed any financial details, but it is clear that the airline is aiming at even faster growth than Icelandair's. Estimated passenger volume was 1.6m in 2016, and 3.0m is the target for 2017.

Whereas Icelandair offers a medium service product — three classes, Economy, Economy Comfort (the main difference being that that food and alcohol are charged in the former, included in the latter) and Saga (40" pitch) — Wow is a ULCC model. The aircraft are densely configured with one class only, 220 seats on the A321, up to 350 on the A330. Passengers are encouraged to bring their own food and make their own entertainment. Fares on Wow are consistently the lowest across the Atlantic, undercutting Icelandair on Economy, and Icelandair's fares are in turn very competitive especially on thinner routes where the only competition is a Legacy carrier.

Although a ULCC in product terms, Wow operates a very similar hub system to Icelandair, with waves of flights connecting up traffic flows between Europe and North America — Wow's waves arrive about an hour before Icelandair's .

In fact, there is a substantial overlap between the two systems: both carriers concentrate capacity on major cities — London (both Heathrow and Gatwick), Paris Amsterdam, Frankfurt Copenhagen and Stockholm, New York (JFK and Newark), Boston and Toronto. The cities where both carriers compete account for 48% of joint seat capacity on the European side and 27% on the American side. On the smaller routes there is generally no competition between the two airlines, either Icelandair or Wow operates. That is until this summer, when

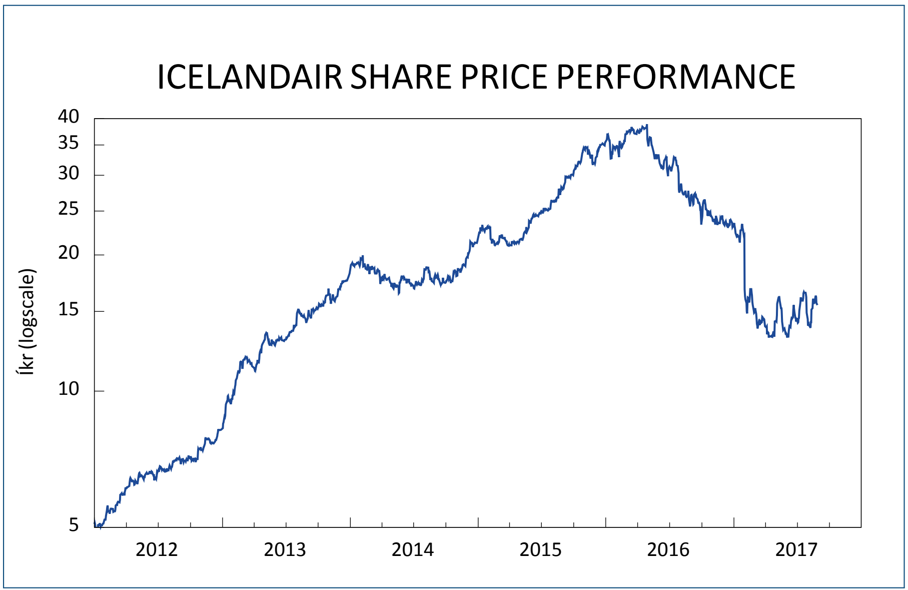
ICELANDAIR GROUP BALANCE SHEET

June 30, 2017	US$ millions
Fixed Assets (Fleet)	642.8
Intangibles & Investments	208.6
Deposits	67.4
Non-Current Assets	***918.8***
Cash and equiv.	360.1
Receivables	211.6
Inventories	30.8
Current Assets	***602.5***
Total Assets	**1,521.3**
Payables	335.7
Prepayments	372.3
Current Liabilities	***708***
Long-term Loans	249.7
Deferred Tax	46.9
Non-Current Liabilities	296.6
Total Liabilities	**1,004.6**
Shareholders' Equity	**516.7**

WOW AIR FLEET

	Fleet	*Orders*
A320-200/neo	3	
A321-200/neo	11	*6*
A330-300	3	
A330-900neo		*4*
TOTAL	**17**	***10***

Note: 7 deliveries scheduled for 2018



Icelandair announced the start-up of operations to Cleveland, Ohio, a city that has not registered on the radar of transatlantic airlines, and then Wow has committed to the same route. Perhaps an indication of an intensification of intra-Icelandic rivalry.

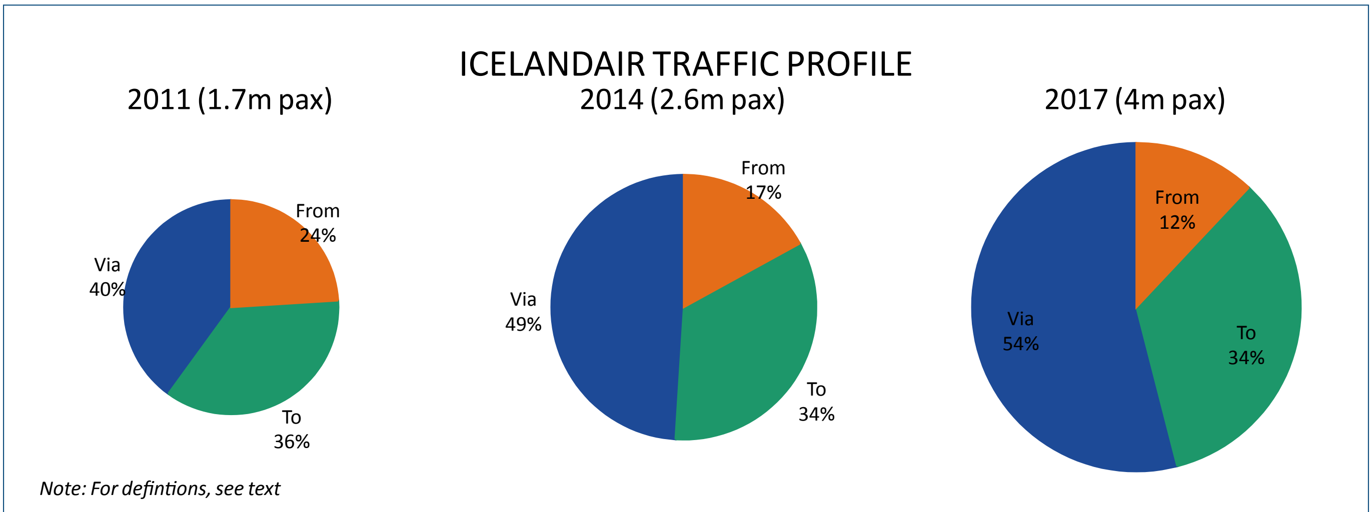
Up to now Icelandair has mostly utilised 757s and 767s but from next year will be introducing the 737MAX — three 154-seat MAX-8s, followed by another six plus seven 174-seat MAX-9s during 2019-2021. According to Icelandair, the MAXs will be an addition to the 757 fleet rather than a replacement. Meanwhile, Wow is planning for the delivery of 11 aircraft in the next couple of years, seven of which will arrive in 2018 — 220-seat A321neos and 350-seat A330-900neos — a doubling in seat capacity.

Can the KEF infrastructure absorb such an expansion in capacity? Can the two airlines continue to steal away traffic from the network carriers (and maybe thwart the expansion plans of the point-to-point long haul LCCs)?

Different airline models of course co-exist — point-to-point LCCs and networking global carriers — throughout the world, but they rarely have their bases of operations at the same airport. Nor do LCCs have the same base airport (Ryanair at Stansted and Dublin, easyJet at Luton and Gatwick). Nor are network carrier hubs based at the same airport in Europe, nor in the US (with the exception of United and American at ORD).

So Icelandair and Wow are a unique combination — long haul hubbing airlines, one medium service, the other very low cost, based at the same small airport and competing mostly for the same traffic. Could a take-over or merger be a possibility?

Icelandair's balance sheet is fairly solid at the moment — a debt/equity ratio of 2/1 and $360m in cash. The Icelandair Group is listed on the Nasdaq Iceland exchange, and 76% of the shares are controlled by 20 local investment funds and financial institutions. Having been worth close to zero in 2010 the market capitalisation rose to ISK177bn in 2015 but has fallen back to ISK70bn ($672m) as at August 2017. Wow's financial resources are not revealed but it is likely that the company is well capitalised as a result of the funds received from Morgenson's sale of his telecom company, OX Communications, to Nokia in 2010.



Copa: MAX Returns

AFTER two tough years, Panama's Copa is seeing its profit margins bounce back as Latin America's economies and air travel demand gradually recover. As a result, Copa is now cautiously returning to the growth mode; its ASMs are projected to increase by 8% in 2017 and in the "high single digits" range in 2018, after only 1.5% and 4.4% growth in 2016 and 2015, respectively.

But Copa will not be returning to the heady growth rates of the past. Its CEO Pedro Heilbron has talked about the long-term growth rate averaging around 6% annually. In the next couple of years at least the growth will mainly come from higher aircraft utilisation and upgauging.

This new expansion phase is seeing several new strategies, which Copa's management discussed in more depth in recent earnings calls and at the company's annual investor day, held on June 1 in New York.

First, there is Wingo — Copa's first foray into LCC operations. The Bogotá-based venture began operations in December 2016 with an initial focus on the Central American market.

Second, the 737 MAX will play a key role in facilitating Copa's growth and keeping its unit costs in check. The airline has 71 MAXs on firm order, with the MAX 9 deliveries starting in August 2018 and the MAX 10 deliveries in 2021. (Copa became one of the latter's launch customers at the Paris Air Show.)

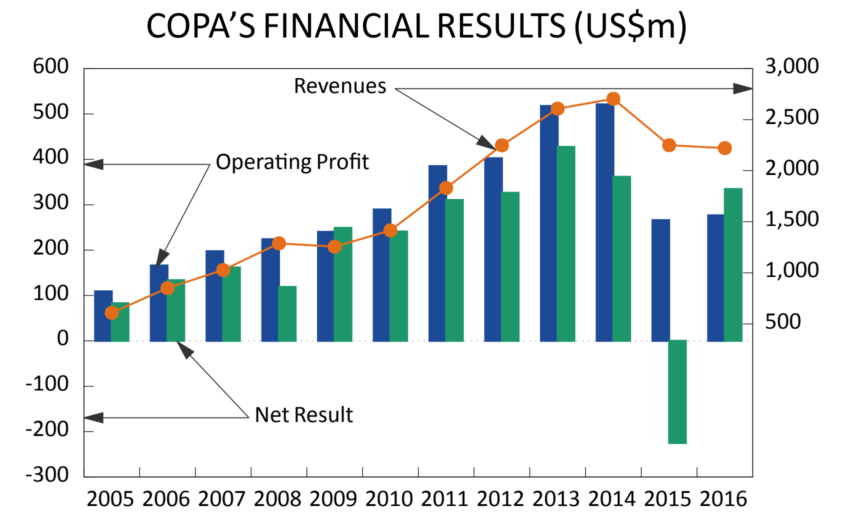
Third, there are attractive opportunities to grow ancillary revenues. Copa has a brand new FFP that can be further developed, while upgrades to its reservations system and IT capabilities will allow it to sell more ancillary products and benefit more from airline partnerships.

The management believes that these new strategies, coupled with cost and efficiency initiatives, will enable Copa to return to its historical high (17-21%) operating margins over the next several years.

Copa used to consistently achieve industry-leading operating margins because of its hugely successful "Hub of the Americas" strategy, which channels traffic between North, South and Central America via the Panama City hub. The business model is very "defensible" because it focuses on underserved thin markets where point-to-point service is generally not an option.

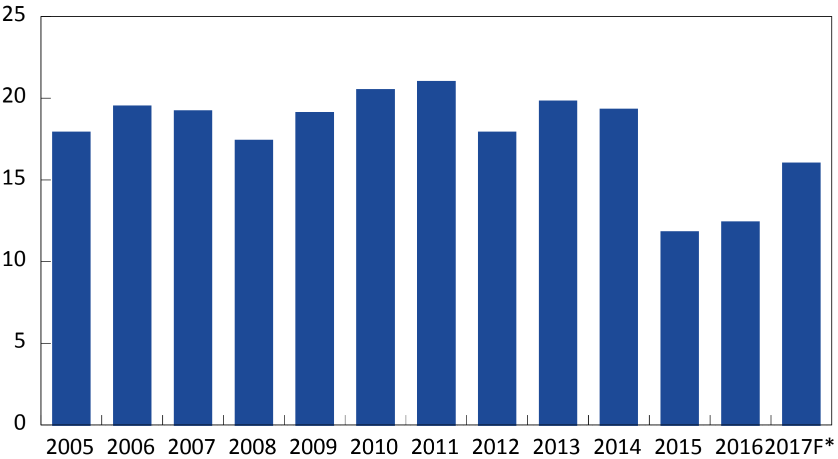
Copa's success is due to many factors, which mostly remain intact or are being reinforced. Panama City's Tocumen International Airport will see a significant increase in capacity in 2018, which will strengthen its role as the region's largest and most efficient hub. Copa has retained its relatively low unit costs and high service quality.

But investor opinion is divided on whether Copa will recapture its former position as an industry high-flyer with 20%-level margins. There are some concerns that the hub strategy is under threat from LCCs coming in and introducing point-to-point services that bypass Panama City. Such incursions have increased in Copa's markets in the past 12 months. Mexican ULCC Volaris has launched a Costa Rica-based unit that competes directly with Copa on some Central



Note: Excluding significant special items in the past three years, Copa would have reported the following net profits: $201.4m in 2016, $226m in 2015 and $486.2m in 2014.
Source: Company reports

COPA'S OPERATING MARGINS



*Notes: Excluding large fuel hedge losses, Copa would have reported operating margins of 16.7% and 16.1% in 2016 and 2015, respectively. * Mid-point of Copa's 15-17% forecast. Source: Company reports*

American routes and is awaiting authorisation for US-Central America operations. LCCs such as Interjet and VivaColombia are also growing in the region.

Improving results

Copa weathered Latin America's economic and currency woes well, at least compared to its peers in the region. Its operating margin dipped for two years but still remained in double-digits — 11.8% in 2015 and 12.4% in 2016. Furthermore, if fuel hedge losses were excluded, Copa would have reported 16%-plus operating margins for both of those years.

But the net results have seen wild swings in the past three years because of losses or gains associated with currency devaluations and the mark-to-market of fuel hedge contracts. Copa had a heavy exposure to the Venezuelan market (9% of its revenues in 2014), so it was hit hard by the currency remittance issues. A massive $433m currency translation loss related to the Venezuelan bolívar led to Copa reporting a $225m net loss for 2015.

Those headwinds are now behind the airline. Copa has significantly reduced operations to Venezuela and no longer sells in bolívars nor has bolívars on its balance sheet. The out-of-money fuel hedges have rolled off and there are currently no hedges.

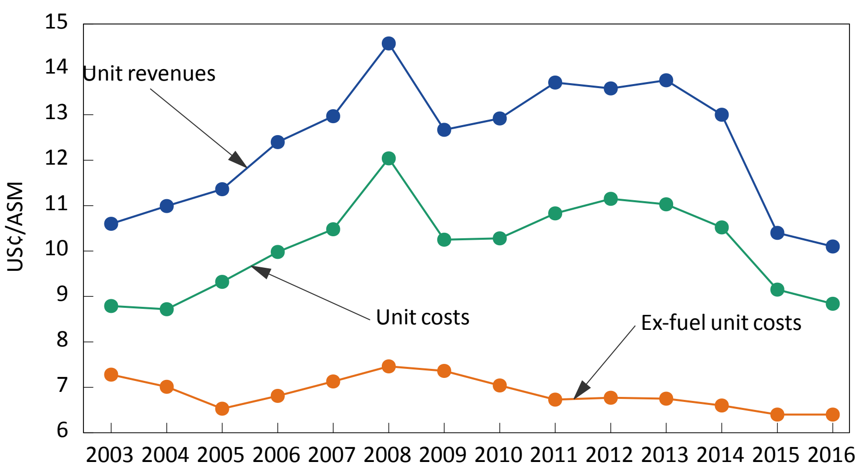
So Copa is benefiting fully from the improving demand and yield environment in most Latin American markets. Currencies have strengthened from their worst points in 2015 and, importantly, stabilised. IMF forecasts Latin America's GDP to grow by 1.1% in 2017 and 2% in 2018, following a 1% decline in 2016 and 0.5% growth in 2015.

Although the airline benefits from Panama's use of the US dollar as its currency (which enables Copa to earn significant dollar revenues), about half of its total traffic is connecting, which means that its results also benefit from the positive trends in other Latin American countries.

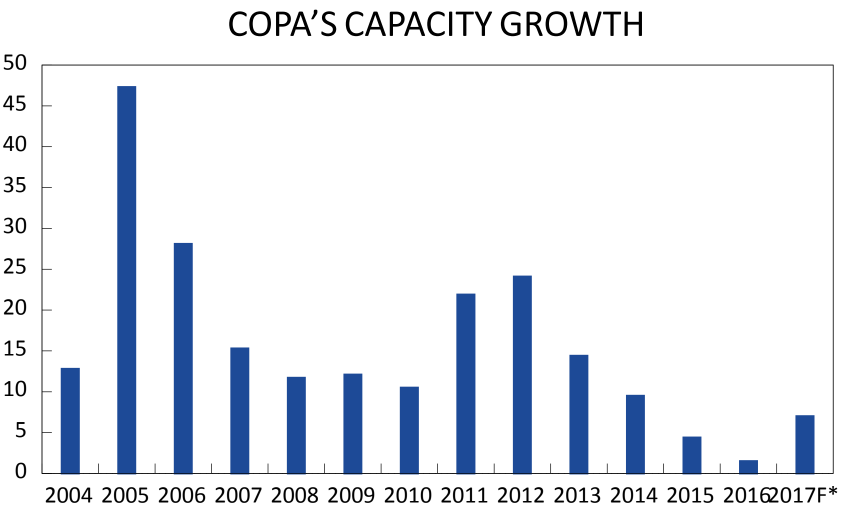
Copa's unit revenues are now improving — up 6% and 7.5% in Q1 and Q2, respectively. In January-June, traffic (RPKs) surged by 12% and the load factor by 4.1 points to 81.9%. In the second quarter, Copa's revenues grew by 17%, operating margin more than doubled to 14.4% and adjusted net income almost tripled to $63m. The management subsequently raised its 2017 operating margin guidance from 15-17% to 16-18%.

Copa has a history of managing recessions well. This time around, the smartest action was to slow growth. The benefit is clearly visible in the

COPA's UNIT REVENUES AND COSTS



Source: Company reports



Note: Copa's projection (June 2017) Source: Company reports

load factor trends: up to and including 2015, Copa's passenger load factor was in the mid-70s, but in 2016 it rose to the 80% level for the first time.

The management noted at the investor day that Copa also benefited from "proactive and dynamic capacity deployment", which meant exiting five markets but adding eight new ones in 2015-2016. When demand collapsed in markets such as Brazil, Copa found good uses for the aircraft in new higher-demand markets (especially to the US).

Another accomplishment was to maintain competitive unit costs in a low-growth environment. Copa's ex-fuel CASM, which had been on a steady downward trend since 2008, fell by another 3% in 2015 to 6.4¢ and remained at that level in 2016.

And Copa has continued to reward shareholders. In addition to paying regular dividends, it has completed more than half of the $250m inaugural share repurchase programme that the board authorised in late 2014. Given the strong cash position and vastly improved earnings this year, the board recently approved an increase in the quarterly dividend from $0.51 to $0.75 per share for the second half of 2017.

This year's ASM growth will come entirely from increased aircraft utilisation. Copa is simply reducing capacity less in the low season (Q4) now that demand patterns are stronger.

In Copa's second-quarter earnings call in early August, the management reassured investors that they had so far seen only rational behaviour from other Latin American airlines in response to the demand recovery in the region. Brazil-US routes have certainly seen airlines bring back capacity, but Copa is not a major player in those markets.

Nor is Copa a major player in the Central America-US East Coast market that Volaris Costa Rica hopes to serve. Those routes account for a relatively small portion of Copa's revenues or network and already have a large number of operators, so the impact may not be material. While Copa is facing some pricing pressure in Central America, the management generally played down the effect of Volaris Costa Rica.

But some analysts disagree, arguing that the ULCC's Costa Rica hub could compete with Copa's Panama hub. In an August 9 report, Bradesco BBI analysts cited increasing competition from ULCCs in Central America as one of two reasons they had an "underperform" rating on Copa's NYSE-listed shares. The other reason was unattractive valuation.

Copa's share price has recovered well from the depths that it plummeted to in 2015-2016, which has reflected Latin America's improved fundamentals and Copa's better profit outlook. Most analysts currently have a "hold" recommendation on the stock, mainly because of the valuation. The sentiment is not helped by the fact that Copa's unit revenue recovery is flattening out in the second half of 2017 due to tougher comparisons (its RASM recovery began in H2 2016).

The Panama hub advantage

One of Copa's greatest strengths is being based in Panama — a stable dollar-based economy with a free-trade zone, low taxes, low labour costs and growing tourism. It is home to many regional offices of multinational corporations and benefits from strong public and private sector investment.

The expansion of the Panama Canal, completed in 2016, has provided an enormous economic boost. Panama continues to be the fastest-growing economy in Latin America, with 5.8% and 6% GDP growth projected for 2017 and 2018, respectively (IMF, April 2017).

Panama's population is only 4.2m, but its steady growth and emerging middle classes have contributed to the growth of O&D traffic, which accounts for half of Copa's total traffic and makes Copa's business model more sustainable in the longer term.

COPA ROUTE MAP

Copa's strategy works because the Panama hub is highly efficient and because Copa offers convenient schedules, high-quality service and excellent on-time performance.

Tocumen is geographically well located, allowing 737NGs to fly nonstop practically anywhere in the Americas. The airport benefits from two sea-level runways and offers easy transfers and short connecting times. Copa accounts for more than 80% of the daily flights there.

Tocumen is one of the few major airports in the region where infrastructure provision has kept pace with airlines' needs. Two expansion phases since 2004 have increased total gates from 14 to 34 and have provided new taxiways and ramp and support areas. The current Phase 2 expansion will add a new south terminal (T2), with 20 additional gates and new areas for customs, immigration, security and baggage handling.

One point of concern, though, is that Phase 2 is running behind schedule. It is currently expected to be completed towards the end of 2018. However, eight remote positions from T2 were activated in 2016 and a "soft opening" of 3-4 gates is expected in Q2 2018.

Copa has been short of gates at peak times already for some years, so the new capacity will come none too soon. However, Copa executives noted in early August that the further delay with T2's full opening may not matter because most of the MAX 9 deliveries, and especially the net increase in aircraft, will not happen until late 2018.

Premium RASM, low CASM

Copa enjoys the very unusual combination of premium unit revenues and low unit costs. The strong RASM reflects a high business traffic content, lack of competition, a high-quality product and a strong brand.

While increasing competition with LCCs may pressure RASM in the future, Copa's management is focused on maintaining what they call a "world class product offering". Operational excellence is a key part of that and Copa has maintained it. This year FlightStats named it "most on-time airline in Latin America" for the fourth consecutive year, while OAG recognised it as "second most on-time airline in the world" for the second consecutive year — amazing achievements for a hub-and-spoke carrier.

Copa's low unit costs reflect a modern streamlined fleet, efficient operations and Panama's low labour costs. The ex-fuel CASM of 6.4¢ is among the lowest in the world for a full-service carrier.

The management is focused on achieving further cost savings. Copa is about half way through a company-wide $50m cost-cutting programme. There are cost reduction opportunities in distribution, maintenance and supplies. The 737 MAX will of course be very helpful in keeping unit costs in check.

Copa's efficiency projects include migrating to a new unified

MRO programme, which will allow it to manage maintenance more efficiently for both Boeing and Embraer aircraft and integrate the MAX more easily. Copa also continues to insource more heavy maintenance and is undertaking a $14m hangar expansion due to be completed next year.

Diversifying with Wingo

The new lower-cost unit Wingo, which is part of Copa Colombia, is aimed at reversing losses in Colombia, competing with LCCs more effectively and tapping growth opportunities in Central American leisure markets.

Copa has operated an airline in Colombia since 2005, when it acquired an initial 85.6% stake (now 99.9%) in AeroRepública, now Copa Colombia. Colombia is Latin America's third largest market in terms of population (48.8m in 2016), shares a border with Panama and represents a significant market for many Panamanian companies (for historic, cultural and business reasons).

But Copa has not succeeded in making Copa Colombia profitable, despite replacing the unit's old fleet and later slashing its domestic operations and refocusing it on the international market. The unit's non-Panama international routes had predominantly leisure traffic and low yields, while competition domestically had escalated after VivaColombia entered the scene.

So, most of Copa Colombia's network has been converted to the lower-cost business model. Copa Colombia continues to operate the more business-oriented Colombia-Panama routes, which it took over from Copa years ago.

An added benefit is that it is a lower-risk approach to setting up an LCC. Wingo operates "administratively and functionally" under Copa Colombia (which includes using the latter's operating certificate) but has separate commercial structures, distribution systems, customer service, management, fleet and brand.

By keeping Wingo commercially separate from Copa Airlines and Copa Colombia, which are full-service airlines, the group should avoid brand confusion. But Wingo will benefit from the economies of scale, business culture and support offered by the Copa family, which should facilitate better cost controls and "reliable service and operations".

Wingo's initial fleet consists of four Copa Colombia 737-700s, which it operates in single-class configuration with 142 seats (of which 28 have extra pitch). Copa Colombia operates its 737-700s with 124 seats.

Wingo's current route network (most of which it took over from Copa Colombia), covers 15 cities in nine countries. It includes six points in Colombia and nine elsewhere in South and Central America, Mexico and the Caribbean. The operations are mainly point-to-point and out of Bogotá. In Panama it operates to the city's secondary airport (Pacifico) while Copa Colombia operates to Tocumen.

Wingo offers low basic fares (though not ULCC-level) and charges extra fees for everything except carry-on bags and water. Numerous ancillary offerings make it possible to "fly well" (part of the airline's slogan) if one so chooses. The options include checked bags, express check in, seat selection, seat with more legroom and, of course, food and drinks. Wingo says that it offers its passengers a "cool, friendly and low-cost experience that makes them feel good".

Cost savings will mainly come from a higher seating density on the 737-700s, direct distribution, lower on-board service costs and less complexity generally.

According to Copa executives, Wingo is performing better than expected. It will lose money this year but the losses will be lower than Copa Colombia's in those markets. Back in May CEO Pedro Heilbron said that he expected it would take a few years for Wingo to become profitable.

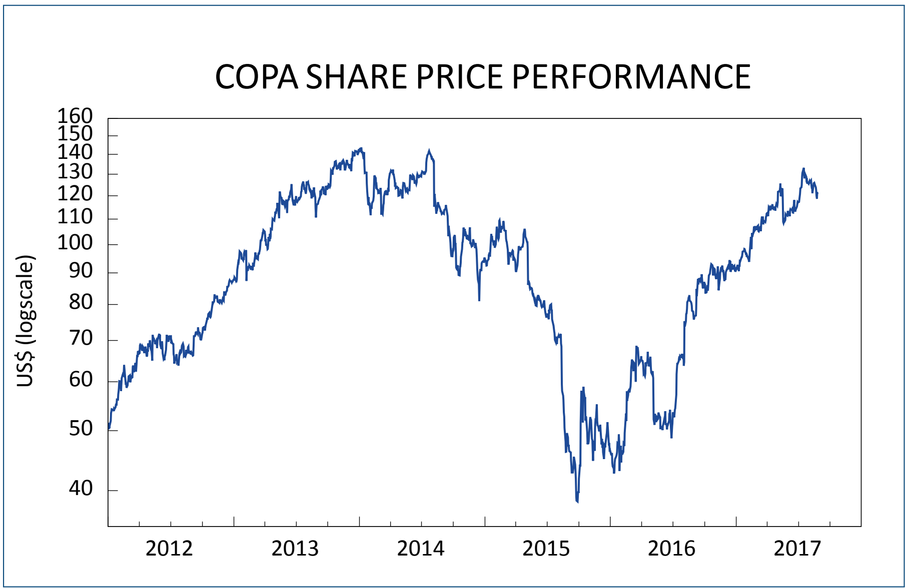
Wingo accounts for only 2-3% of the group's revenues, so the losses are not material to Copa. The group clearly views the venture as strategically important for the long term, now that LCC growth in Copa's markets is accelerating. According to CAPA, LCCs currently account for only 8% of the weekly airline seats in Central America, which is among the lowest penetration rates for any world region or sub-region.

Growth plans

Copa's network (including the Colombian units) currently includes 75 destinations in 31 countries in North, Central and South America and the Caribbean. Codeshares with Star and other partners extend the coverage to another 146 destinations.

Copa also benefits from an unusually deep strategic relationship with United, which dates back to the late 1990s when the US and Panama signed an open skies agreement and Continental acquired a 49% stake in Copa. The stake was sold a decade ago but the partnership is going strong and last year the agreement was extended through to 2021.

After adding numerous new destinations (especially in North America) over several years, in 2016 Copa added only three new cities. This year will see just two: Denver (its 13th



US destination) and Mendoza (Argentina), both in Q4. However, Copa will continue to add frequencies in existing markets.

The strategy is to continue to strengthen the intra-Latin America operations and the Panama hub with more destinations and frequencies. According to the June investor day presentation, Copa has identified 20-plus potentially attractive underserved destinations. There are no plans to operate to other world regions.

Notably, Copa has continued to serve Venezuela even as many other airlines have pulled out due to tough conditions and safety fears as the country's crisis has deepened. Venezuela-Panama demand has held up and the routes remain profitable.

Copa and its Colombian units currently operate a 101-strong fleet, consisting of 66 737-800s, 14 737-700s and 21 E190s. There are firm orders for two more 737NGs for delivery in 2018 and 71 737 MAXs (2018-2024 delivery).

However, significant lease expirations (31 up to 2024) and some 15 owned older aircraft give Copa flexibility to grow its fleet at a fast pace or not at all in the next seven years. "Conservative" fleet growth (at 2% CAGR) would result in only 115 aircraft by year-end 2024, while "aggressive" growth (at 7% CAGR) would give Copa 170-plus aircraft.

In any case, ASM growth will continue because the MAXs will replace many smaller-gauge 737NGs. They will also enable Copa to operate longer routes, potentially opening up the Pacific Northwest/Western Canada and the far south of South America. Of the 71 MAX orders, Copa has so far specified that 15 of the aircraft will be MAX 9s (deliveries in 2H 2018 and 2019) and 15 will be MAX 10s (deliveries in 2021-2022). The fleet is also likely to eventually include some MAX 8s.

Copa expects to operate the E190 at least for the next 4-5 years. By 2018 the E190 fleet will have been brought down to 19 (from 27 at one point), which are all owned and which the airline feels is the ideal number of 100-seaters.

Copa is a good candidate for growth because it has one of the strongest balance sheets in the industry. At the end of June, it had \$924.6m in cash or 39% of LTM revenues. Long-term debt was \$1.17bn, all of which was aircraft related. Adjusted net debt/EBITDA ratio was only 1.7 times — by far the lowest in its Latin America peer group.

But Copa has also other important projects in the works, notably further developing its new ConnectMiles loyalty programme, upgrading its reservations system and pursuing ancillary revenue opportunities.

Copa only launched its own FFP in July 2015, because it previously participated in partner United's MileagePlus plan. Having its own plan allows it to build a more direct relationship with its customers and develop new revenue streams. The programme has been well received and Copa expects it to boost its operating margin by around one percentage point in 2018.

Having postponed a planned migration to Sabre late last year, Copa has for now instead chosen to upgrade its HP Shares reservations system. That work is expected to be completed in the first half of 2018. The upgrades will allow Copa to do a lot more in terms of selling ancillary products.

The airline is working on a number of ancillary initiatives and considering others that are "consistent with the Copa brand". While most of the benefits will come after 2018, Copa is anticipating \$10m additional revenue this year from selling a second checked bag, upgrades and premium seats. Those revenues are projected to grow to \$20-40m in 2018 and \$40-60m in 2019. New ancillary revenue streams could be instrumental in helping Copa get back to the 20%-level operating margins.

By Heini Nuutinen
heini@theaviationeconomist.com

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