Issue no. 262

Jul/Aug 2021

Atlantic Recovery Redux

WHILE domestic markets have largely re-opened in the US and, to a lesser extent, Europe, the North Atlantic market remains very restricted. Occasionally It appears that progress towards normalisation is being made, then there are set-backs, the latest being the removal of the US from the EU's "whitelist" meaning new quarantine rules. The Atlantic re-opening is going to be more complex for airlines than the domestic market restarts; some of the key issues are condensed in some comments on three key graphs.

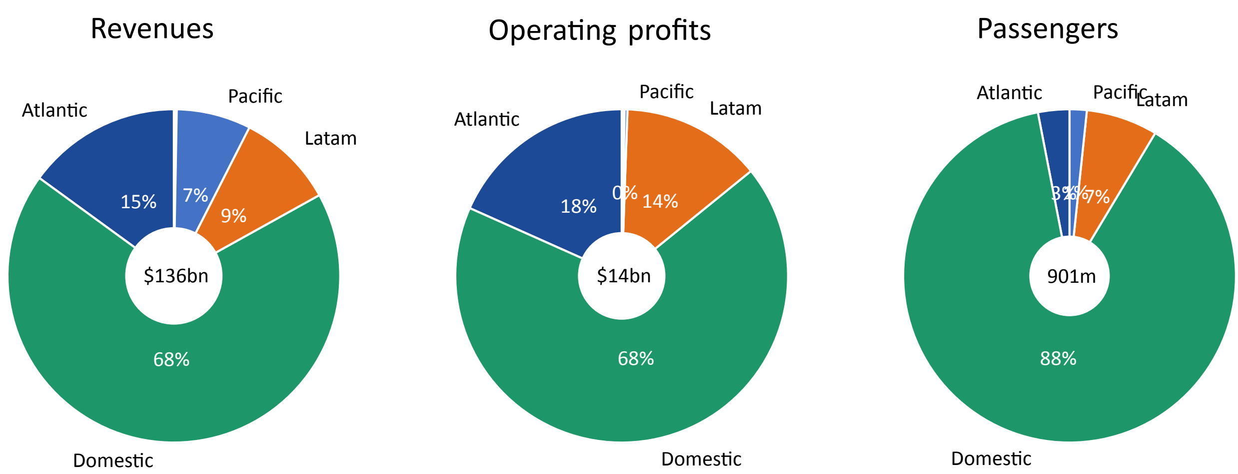
Firstly, it is worth reemphasising the fact that long-haul, especially the North Atlantic, is much more important financially for network carriers than the passenger volumes might suggest. The US Legacies — United, Delta and American — are usually regarded as being primarily domestic operators, particularly by US-based analysts, 88% of their passenger volume is domestic but this segment represents only 68% of their revenues and profits. The North Atlantic accounted pre-pandemic for 18% of operating profits. The reliance on the North Atlantic is even greater for the European carriers who, unfortunately, are not required to reveal the regional breakdown of revenue or profits.

Overall, the cost structure of European network carriers and to a lesser extent the US majors is based the complex hub systems that feed short-haul traffic to/from the long-haul services where the profits are made (or not).

The second graph on the following page underlines the importance of the UK, specifically London, in the North Atlantic market. The top 15 city-pairs account for 30% of the market: seven of these (the red bars) are to/from London. London-New

This issue includes

US NETWORK CARRIERS RESULTS BY REGION 2019



Source: DoT Form 41. Note: Financial data for American, Delta and United. Traffic includes their regional affiliates.

Aviation Strategy

ISSN 2041-4021 (Online)

This newsletter is published ten times a year by Aviation Strategy Limited Jan/Feb and Jul/Aug usually appear as combined issues. Our editorial policy is to analyse and cover contemporary aviation issues and airline strategies in a clear, original and objective manner. Aviation Strategy does not shy away from critical analysis, and takes a global perspective — with balanced coverage of the European, American and Asian markets.

Publisher:

Keith McMullan
James Halstead

Editorial Team

Keith McMullan
kgm@aviationstrategy.aero

James Halstead
jch@aviationstrategy.aero

Subscriptions:

info@aviationstrategy.aero

Aviation Strategy Ltd
Registered No: 8511732 (England)
Registered Office:
6 Langside Avenue
London SW15 5QT
VAT No: GB 162 7100 38
ISSN 2041-4021 (Online)

Typeset in Calibri and Rockwell using XƎLATEX

York had, pre-pandemic, over twice the passenger volume of the nearest rival, Paris-New York. Clearly, until Covid-19 restrictions are lifted for UK travel, there is no prospect of a real reopening of the North Atlantic. And any sign of a viral resurgence in New York would be a disaster for the industry.

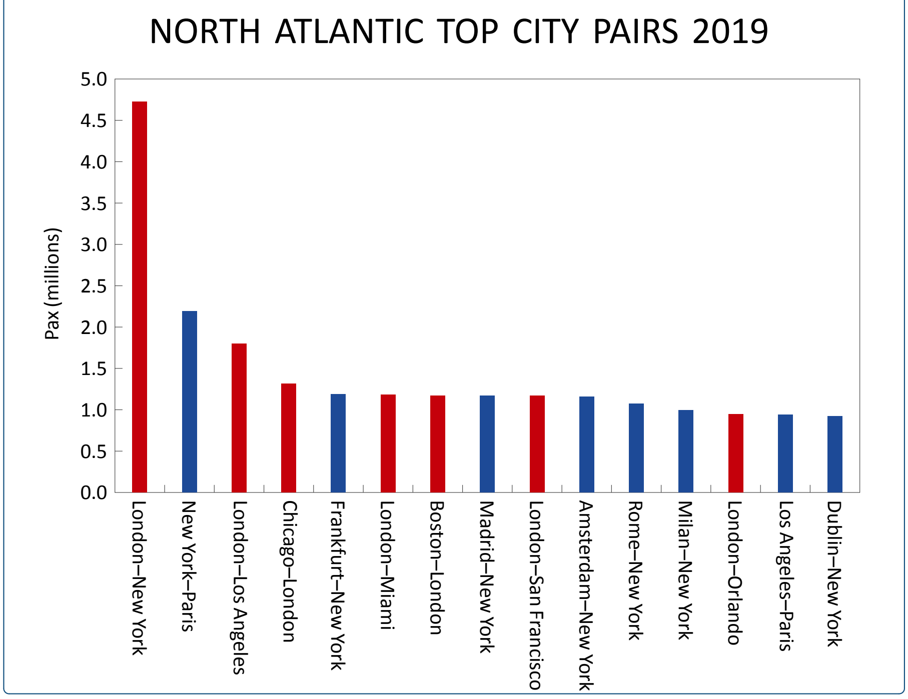
London-New York is also the dominant business travel route, largely because the two cities are the global financial centres. Airline planners have agonised over the impact of Covid-19 on business travel but the only conclusion is that at some point business travel may recover to pre-Covid levels but it is not going to be soon. Video technology is now universal; corporations will continue to cut travel budgets, and they have realised that they can use air travel to meet their carbon reduction obligations; and super-elite passengers are choosing private jets.

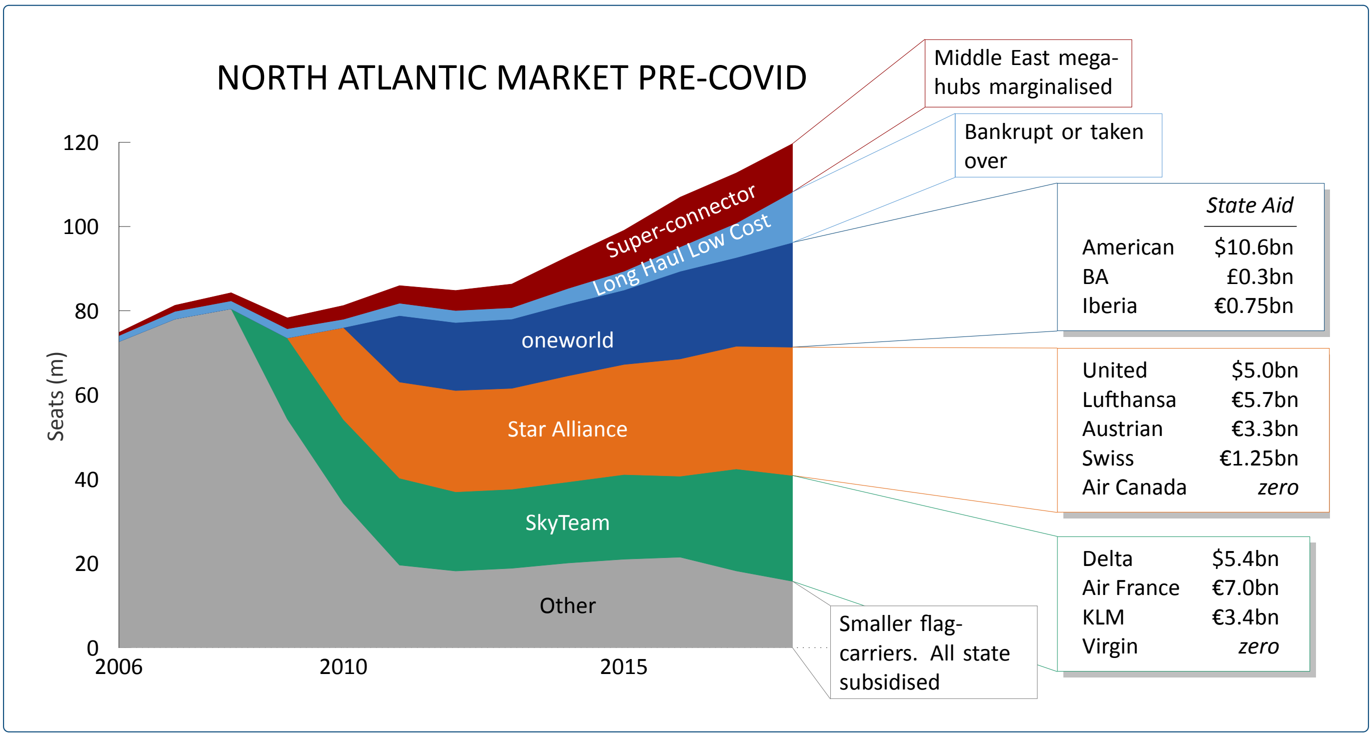
This will be a big problem for the network carriers whose premium passengers have accounted for 30-40% of their revenues. Pre-Covid the ratio of premium to economy fares was about 5:1 as a global average, higher on the Atlantic. That type of ratio will not be achieved in the foreseeable future because to fill Business class cabins premium fares will have to be significantly reduced from pre-Covid levels. Premium leisure is being promoted but is only a partial solution.

For the revenue part of the profitability equation — average RASK — to get close to balancing the cost part — average CASK — economy class fares will have to be raised. In turn, a rise in economy fares might put off a substantial recovery in traffic volumes.

The pre-pandemic structure of the Atlantic market is encapsulated in the third graph.

The North Atlantic market had become increasingly consolidated by multinational groups that together controlled about 68% of capacity: the antitrust immunised joint ventures of Air-France-KLM with Delta; Lufthansa





Group with United; British Airways, Iberia and Aer Lingus with American. These groups became virtually merged entities, with the US and European partners making joint decisions on fares, schedules and capacity, sharing revenues and costs on a "metal-neutral" basis so that in theory there was no difference as to whose aircraft were operated — a legal oligopoly among privately owned, competitive airlines.

But, with the notable exception of IAG and Virgin Atlantic, these network carriers have absorbed at least $45bn in state aid in grants and loans during the pandemic. And after decades of extricating themselves from their national carriers, the German, French and Dutch governments now find themselves as significant shareholders; under the CARES Act, the US government will have the right to participate in "the gains of the eligible business" — a sort of national control.

The challenges of restoring long-haul services to anything like pre-Covid operations are such that governments may find themselves enmeshed for the long term, in which case it is possible to envisage long-haul international airlines once again assuming the role of national champions or chosen instruments, a transatlantic airline industry a bit like the pre-deregulation world — dominated by a few large airlines, owned or controlled by their governments, subsidised by their states, with little sign as yet of disruptive competitors.

Long-haul low-cost capacity, in various forms, had peaked at about 12% of the North Atlantic total, but Covid-19 killed off these delicate airlines. Norse Atlantic is aiming to replace Norwegian's 787 operation, and Play is planning a Wow-type low cost hubbing operation at Reykjavik using A321neos. Both presumably will have learnt from the mistakes of the predecessors, but they seem to be niche outfits rather than market disruptors.

The super-connectors — Emirates, Etihad and Qatar Airways — had built up their share of Atlantic to about 9% pre-pandemic but their finances have been damaged, and funnelling passengers to/from 200-plus countries through a few terminals to the US may not be an attractive proposition when the market finally re-opens.

The model offered by JetBlue — operating A321LRneos featuring the MINT premium product — may be the optimal solution, if it is allowed to take over suitable (and currently unused slots). It is based In New York, the prime US gateway on the Atlantic. It has a strong network of routes domestically in the North East of the country to be able to feed routes out of both its home city and Boston. It has the experience of successfully (and profitably) disrupting the erstwhile cosy transcontinental markets between west and east coast (while halving fares on the routes). It will be operating with efficient, new, and relatively small aircraft. And it may be able to afford to treat the Atlantic as an experiment.

THY: Opportunity emerges from the pandemic

THY MIGHT just emerge from the pandemic as a stronger player, a super-connector in the cargo business as well as the passenger sector. Its recent financial results show it to be one of the first airlines to achieve a genuine turn-around, but can the recovery be sustained?

Covid-19 vaccination rates in Turkey has progressed fairly well (75% single jab) and the summer months saw an unexpected surge in tourist demand. The Turkish economy appears to be rebounding — the OECD forecasts 5.7% growth in real GDP this year compared to 1.7% in 2020.

On the downside, the traffic recovery depends on Covid infection trends and travel rules imposed by northern European countries, and THY in the second quarter of 2021 was flying just 56% of its 2019 capacity. The country's economic performance is uneven, heavily reliant on large-scale spending by the state on infrastructure projects, and inflation is threatening to get out of control. The political situation on Turkey's borders remains volatile (as an aside, THY was the number one commercial airline flying to/from Afghanistan in the first half of this year)

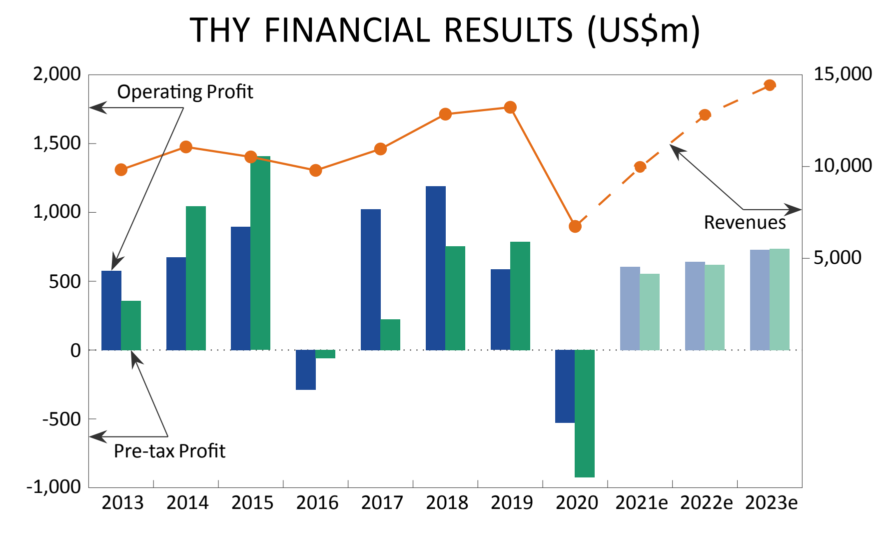
How THY achieved break-even

THY broke even at the net level in the first half of this year, a sharp contrast with the rest of the European industry. THY has not received direct financial support from the Turkish state (although it is 49% owned by the Turkey Wealth Fund, the national investment vehicle, and this link has facilitated access to bank funding and kept down its cost of capital). Remarkably, the 2021 operating profit, $24m, was a much better result than in the equivalent pre-pandemic period of 2019 when it reported a loss of $193m. The turnaround was achieved despite a collapse in RPKs of 59%, a reduction in ASKs of 48% and a decline in average load factor of 11 points to 62.4%. So how did THY do it?

Passenger revenue fell more or less directly in line with the collapse in traffic by $2.9bn (see summary P&Ls on the next page), but cargo revenue more than doubled to nearly $1bn, which meant that total revenue fell by a mere $2bn or 33%.

In the first half of 2021 THY owned a fleet of 18 widebody freighters, wet leased in a further seven units, and also used up to ten passenger widebodies in cargo roles, but the increase in FTKS was fairly modest, up about 18% between the two periods. The real boost to revenues came from an increase of 87% in unit prices, reflecting the global shortage of belly-hold capacity on grounded passenger widebodies and the unprecedented boom in maritime freight rates, in turn caused by a surge in demand for JIT-delivered products combined with logistical disruptions throughout the containership transport system.

Then THY succeeded in cutting operating expenses by $2.2bn or 36% — hence the turnaround to an operating profit of $24m in the first half of this year, $217m better than in 2019. Net financial costs, mostly forex related, of $83m produced a pre-tax loss of -$59m which was a $257m improvement on 2019. Adding in a tax credit of $58m, much less than the 2019 refund, produced the net result



Note: Estimates HSBC

of -$1m, $202m better than 2019.

Looking at the operating costs in more detail, fuel was the biggest cost item, falling by 47% mostly reflecting the reduction in flight hours but also a 10% decline in price per gallon.

Aircraft ownership costs were marginally up. Nearly 80% of THY's fleet is owned or on financial leases (for which for which the average interest rate is 2% pa) and 90% of this cost element was non-cash depreciation. THY has not had to enter into renegotiations with operating lessors, but the overall fleet plan has been cut back.

In 2019 THY moved its entire passenger operations from the old İstanbul Atatürk airport to the new İstanbul Grand Airport (İGA) which meant that it was based at the most modern, high-tech, unconstrained hub in Europe but it also meant that it was facing some of the highest airport charges in Europe as the pandemic struck. The airport owners, a private Turkish consortium, having paid €22.1bn for the 25-year concession was reluctant to cut charges but did agree a 10% discount on landing fees. The state airport authority, DHMI has cut charges at its airports by 50%, the discounts continuing into 2022, while the other İstanbul airport used by THY, Sabiha Gökçen, made similar concessions. As a result, airport and navigation charges for THY fell by $164m or 30% between 2019 and 2021.

The most dramatic saving came from personnel — expenses were down by $443m or 43% — the result of an agreement reached in September 2020 with the unions which implemented across-the-board salary cuts of 40% in return for no lay-offs. With consumer price inflation in Turkey edging towards 20%, this salary reduction has had to be modified, and 15% salary restorations are being phased in throughout 2021. The agreement is for full salary restoration to take place when, in the words of chairman Mehmet İlker Aycı there is "a reasonable recovery in the profit of THY and recovery in the sector".

THY: 2019 AND 2021 COMPARISON (Jan-June periods)

US$ Millions	2019	2021	Change	%
Pax Revenue	4,971	2,060	(2,911)	-59%
Cargo Revenue	799	1,765	966	121%
Other	179	147	(32)	-18%
Total Revenue	**5,949**	**3,972**	**(1,977)**	**-33%**
Fuel	1,836	981	(855)	-47%
Personnel	1,041	598	(443)	-43%
Aircraft Ownership	895	944	49	5%
Airports and Navigation	548	384	(164)	-30%
Sales and Marketing	575	258	(317)	-55%
Ground Handling	391	284	(107)	-27%
Passenger Services	298	97	(201)	-67%
Maintenance	384	238	(146)	-38%
Others	174	164	(10)	-6%
Total Operating Costs	**6,142**	**3,948**	**(2,194)**	**-36%**
Operating Result	**(193)**	**24**	**217**	
Net Finance Costs	(123)	(83)	10	
Pretax profit	**(316)**	**(59)**	**207**	
Tax	113	58	(55)	
Net Result	**(203)**	**(1)**	**202**	

Other significant cost savings were made in sales and marketing, down $317m or 55% and in passenger services, down $201m or 67%. Some of these savings will be permanent; reliance on e-marketing has been accelerated, the airline is downgrading its catering offering, and operations have been transferred to the lower cost brand, Anadolujet.

In the short term the outlook is favourable; THY will still have a strong cargo performance throughout the rest of this year at least while the passenger business continues to recover. HSBC is forecasting a net profit of $484m for 2021, a 4.9% margin in contrast to an -$836m, -12.4%, loss in 2020.

Longer term, there is the possibly that THY's upturn will be endangered by the normalisation of the air cargo market — with falling cargo revenues negating the recovery in passenger revenues at the same time as cost pressures, especially from labour, are escalating,

Spinning off TC and Anadolujet?

However, THY intends to consolidate recent gains in the cargo sector — it has stated its explicit target of establishing itself as one of the top three cargo airlines in the world, which is ambitious as in 2019 THY was the ninth largest cargo airline, well below FedEx, UPS and Emirates. The implication is that THY will be capable of win-

THY FINANCIALS: REVENUE, PROFIT AND CASHFLOW

	FY (Jan-Dec)						Jan-Jun	
US$m	2016	2017	2018	2019	2020	Total 5 years	2020	2021
Revenues	9,792	10,958	12,855	13,229	6,734	53,568	3,434	3,972
Net result	7	223	753	788	(836)	935	(654)	(1)
Operating Cashflow	613	2,368	1,457	2,111	389	6,938	100	1,516
Capex	(878)	(848)	(1,242)	(1,068)	(1,153)	(5,189)	(625)	(380)
Other Income (Expenditure)	622	1,664	(1,161)	52	784	1,961	441	229
Free Cashflow	357	3,184	(946)	1,095	20	3,710	(84)	1,365
Increase (Decrease) in debt	209	(2,759)	691	(656)	(284)	(2,799)	(230)	(922)
Total Cashflow	566	425	(255)	439	(264)	911	(314)	443

ning business from Emirates, Qatar Airways and the European network carriers.

The cargo operations are branded separately as Turkish Cargo (TC), and the plan is to spin TC off as a separate identity with its own AOC and to form a joint venture with a major player in the cargo sector. Currently, the company is in the process of setting up IT systems, negotiating legislative issues and planning for some type of capital raise, with a competition date of the end of this year. As for the partner, THY says that there are interested parties but has revealed nothing definitive. Qatar Airways might be a possibility or Lufthansa with whom THY has had a long-standing 50/50 joint venture — the charter airline Sun Express (last year Lufthansa wound up its own subsidiary Sun Express Deutschland and transferred residual operations to Sun Express and Eurowings). A joint venture with one of the internet giants would be an imaginative move — Amazon, perhaps.

TOP TEN CARGO AIRLINES 2019 (FTKs bn)

1	FedEx	17.5
2	Qatar	13.0
3	UPS	12.8
4	Emirates	12.1
5	Cathay Pacific	10.9
6	Korean	7.4
7	Lufthansa	7.2
8	Cargolux	7.2
9	**THY**	**7.1**
10	China Southern	6.8

Source: IATA

THY is in the process of moving the entire cargo operation to İGA in the course of this year (the freighter fleet remained temporarily at the old Atatürk airport after passenger operations moved to İGA in 2019). Like the passenger side, the cargo facilities at İGA — called Smart East — are high-tech featuring robotic process automation and augmented reality technology; specialist facilities for the shipment of temperature-sensitive cargo and livestock; and direct connections between the terminal and the freighters. Initial capacity will be 2.8m, rising to 4m tonnes by 2024, by which time İGA expects to be ranked as the fourth biggest cargo hub in the world and the biggest in Europe.

THY has indicated that it may consider spinning off Anadolujet in a similar manner to Turkish Cargo, though details are sparse.

By mid-2021 64 737-800s were operating under the Anadolujet brand on 97 international routes compared to just 30 in 2020, with ASK capacity up 129%. Anadolujet is a classic LCC model: the aircraft are configured to 189 seats and the network is pure point-to-point, separate from the THY hub network. The main bases are Sabiha Gökçen and Ankara Esenboğa, much less expensive airports than İGA, even before the pandemic discounts. The focus is on price-sensitive passengers in Europe and the Middle East

The risk with such LCC subsidiaries is cannibalisation of the mainline traffic and undermining of THY's hub economics. Although the two markets appear distinct, Anadolujet's network from İstanbul will increasingly overlap with THY hub operation. New destinations started this year by Anadolujet include Lyons, Milan, Moscow, Zürich, Baku, Dubai, Baghdad and Tehran.

Anadolujet also has the classic LCC-subsidiary role of trying to protect the parent from aggressive competition, in this case from Pegasus, also based at Sabiha Gökçen. Pegasus has proved to be resilient throughout the crisis; according to HSBC's Turkish analysts, passenger volume will be

20.5m this year, 67% of the 2019 volume, and operating losses will be reduced to -€27m from -€179m in 2020.

THY and ME3

Although THY has in the past used Lufthansa as its benchmark (its longstanding target of bypassing the German carrier in terms of total passengers by 2023 now seems irrelevant given Lufthansa's post-Covid downsizing), the most important competitors for THY have been the three Middle East super-connectors (ME3).

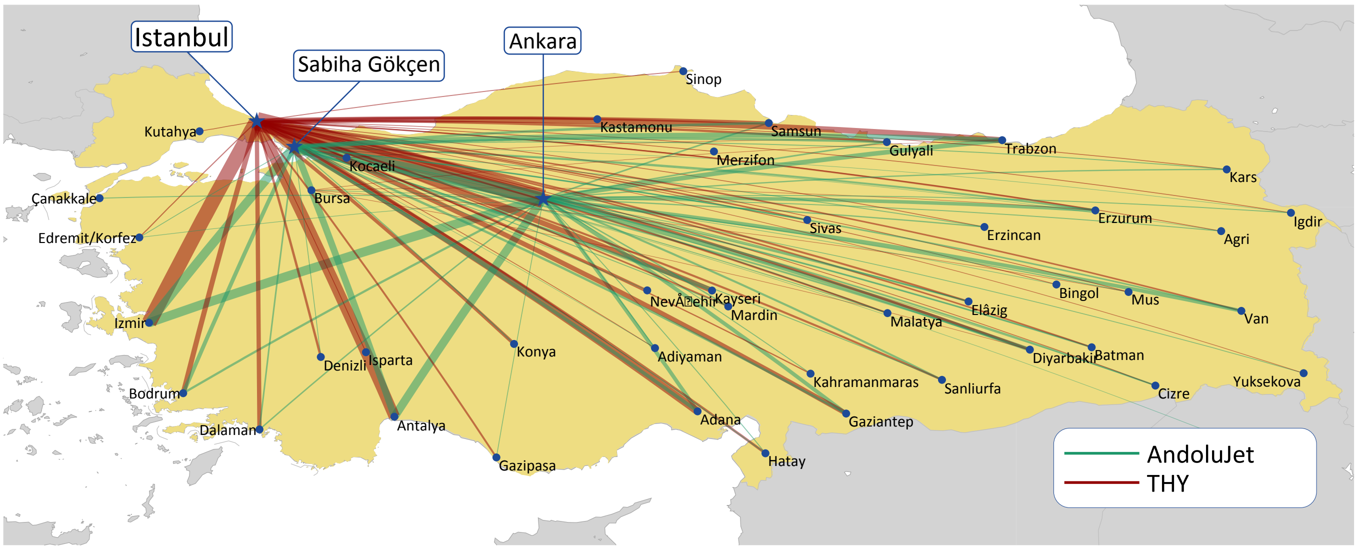
The pandemic has had the effect of highlighting the importance of having a significant domestic market (or not having any domestic market in the case of the ME3). In 2020 THY carried 13.6m passengers domestically, and 27.7m in total — 37% of the 2019 volume. By contrast, in FY1020/21 Emirates managed only 6.6m passengers, 11% of its 2019/20 volume.

THY's international network with its focus on secondary as well as primary cities in Europe and its strong presence in Africa is relatively less exposed to competition for connecting traffic. Our pre-pandemic analysis (see *Aviation Strategy* April 2019) of the overlap among the four super-connector networks revealed that

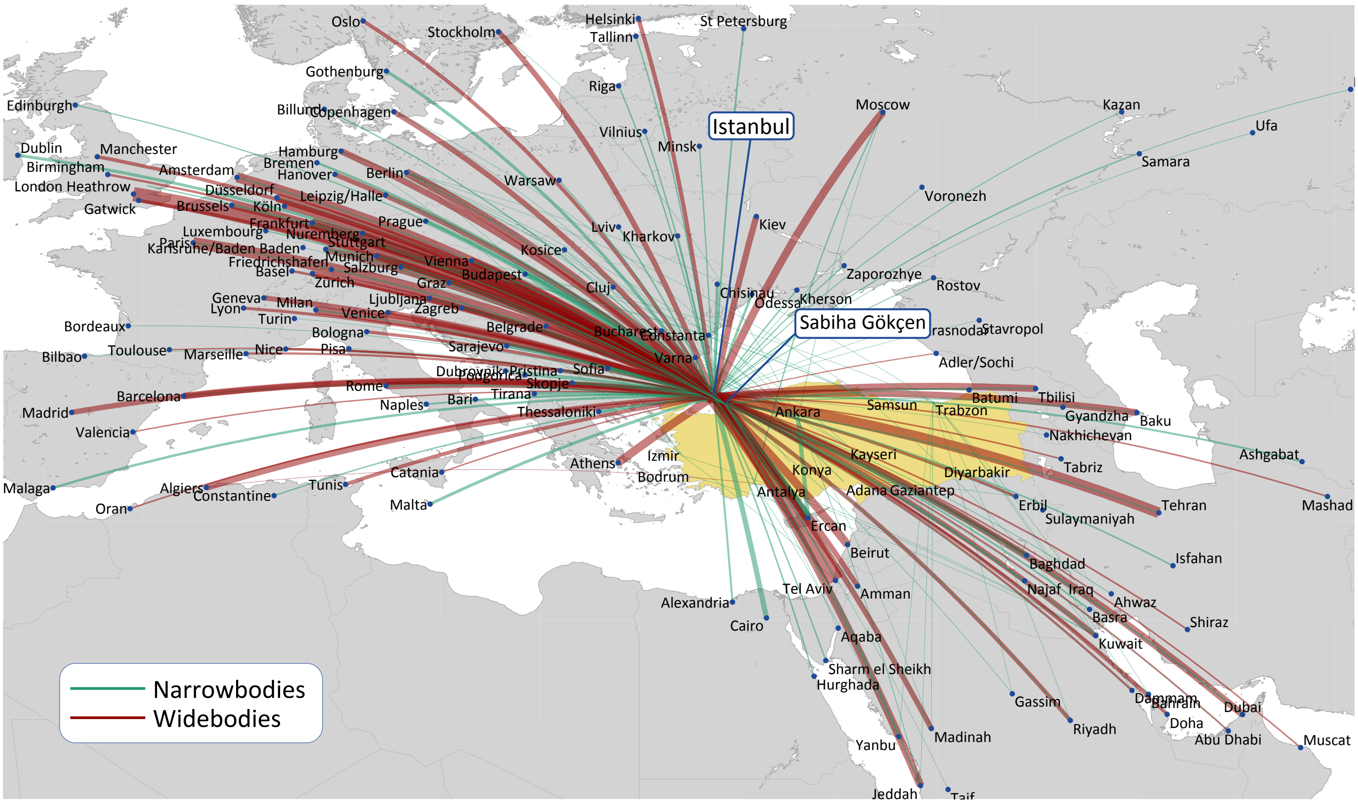
THY LONG HAUL ROUTE NETWORK

Notes: Equidistant azimuthal projection based on Istanbul: great circle routes appear as straight lines; thickness of lines directly related to annual seat capacity.

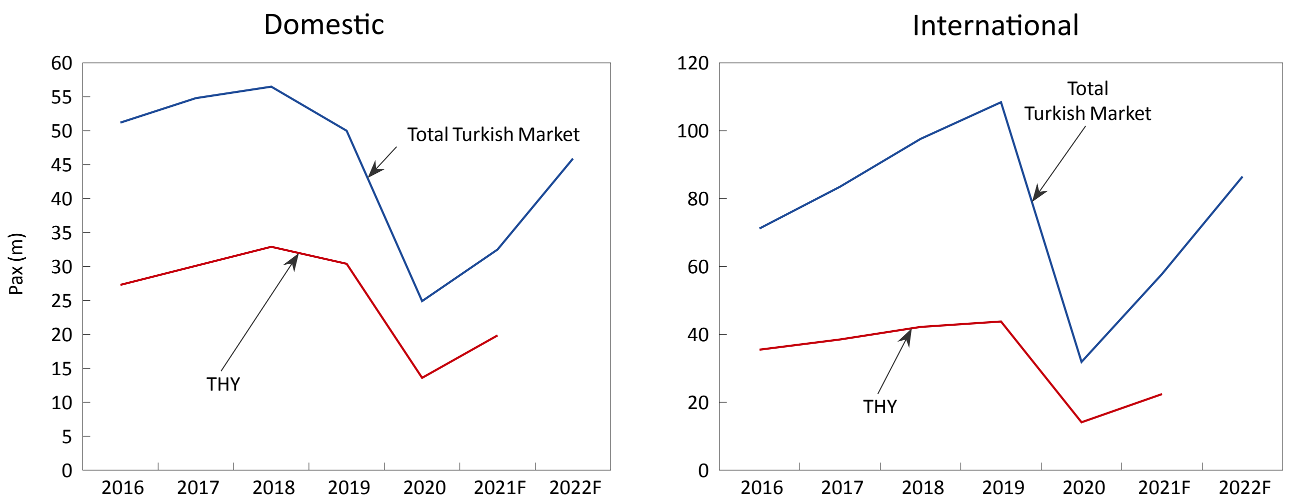
THY DOMESTIC ROUTE NETWORK



THY SHORT HAUL ROUTE NETWORK



TURKISH TRAFFIC RECOVERY



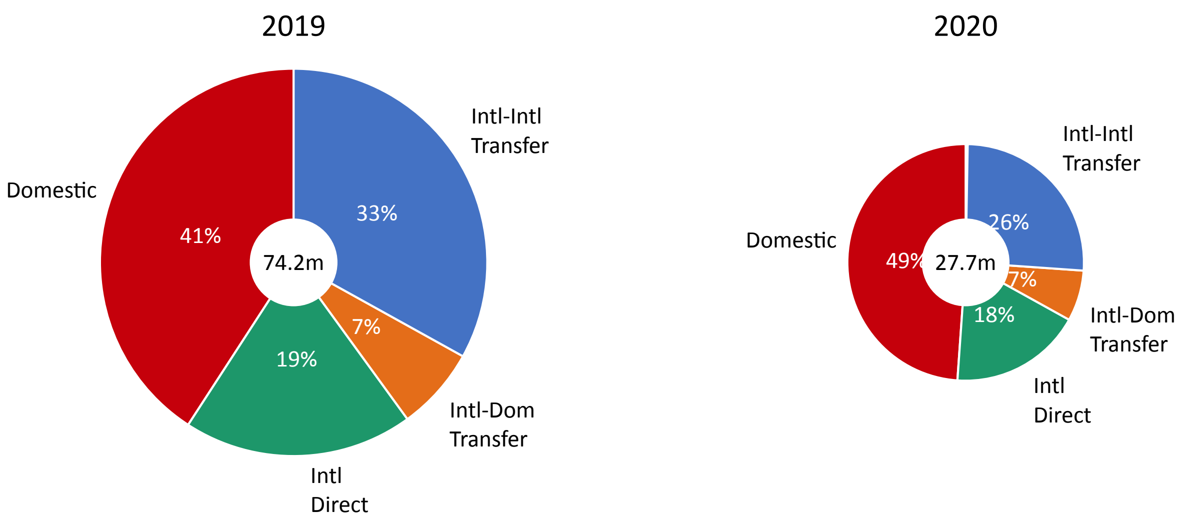
Sources: DHMI Airports Authority and THY

24% of THY's international capacity was deployed on routes where there was no direct competition from the other super-connectors whereas the comparable percentages for Qatar Airways was 6%, Emirates 5% and Etihad 1%.

Nevertheless, the overlap between the networks was still substantial. Again based on pre-pandemic numbers, 62% of THY's capacity operated to the same destinations as Emirates, 65% to the same destinations as Qatar; only 45%s of capacity competed directly with Etihad, a figure that will be significantly reduced following Etihad's forced downsizing.

Pre-pandemic the super-connector sector was characterised by persistent over-capacity, with each of the carriers having expansionist over-ambitions. All that has changed, each of the ME3 super-connectors has downsized their fleets, attempting to shift to smaller-size equipment, Etihad in particular has had to face

THY PASSENGER STRUCTURE



THY BALANCE SHEET (US$m)

	End June 2021
Fleet assets	4,347
Right of Use assets	15,065
Cash	*2,254*
Other assets	4,664
Total Assets	**26,330**
Long term debt	12,072
Short term debt	4,291
Other liabilities	4,282
Total Liabilities	**20,645**
Shareholders' Equity	**5,685**

up to the consequences of its rapid expansion and absurd airline investment strategy. Although the ME3 can continue to rely on support from their very wealthy owners, even they will be unwilling to add to the billions of dollars that have been pumped into their flag-carriers over the past 18 months.

In this new environment THY, with its non-reliance on direct state funding and its rational turnaround strategy, should be able to enhance its competitive position. It may be significant that THY recovery is being led by the Americas region with business captured from both the ME3 and the European network carriers — ASKs in June this year were 112% of the June 2019 level and load factors had moved back up to near normal levels, 77%.

Resetting growth

Indeed, the pandemic may just have afforded THY the opportunity of resetting the growth strategy. THY used to confidently present detailed long term, 6-year, fleet plans — for instance, back in 2018 it projected a 435 aircraft fleet for the end of 2021, 112 widebodies, 305 narrowbodies and 18 freighters. Today it no longer publishes its firm orderbook and limits itself to a 6-month projection — by the end of 2021 the fleet will be 371 units consisting of 106 widebodies, 245 narrowbodies and 20 freighters.

In late 2020 THY renegotiated with Airbus the delivery schedule for 71 A321 NEOs and 25 A350-900s, moving from a final delivery date of 2023 to 2028. Then in early 2021 THY reached an agreement with Boeing to cancel ten 737 MAXes from its orderbook of 75 units, and to reduce deliveries to an undisclosed lower annual rate (previously THY was to have taken all the ordered MAXes by 2023). This has allowed the airline to postpone the raising of some $5bn in aircraft debt until after 2024,

Even before the pandemic financiers were getting a little concerned by THY's capex commitments and balance sheet. The airline has cut back sharply on capex (although it still has over $1.3bn of commitments this year) and has managed to reduce net debt, but the balance sheet as at mid-2021 was still highly leveraged — a debt/equity ratio of 3.6/1. Fitch's rating for THY debt is only B (which means that "while financial commitments are currently being met; capacity for continued payment is vulnerable to deterioration in the business and economic environment"). However, cash has been built up to a very respectable $2.2bn.

THY's growth strategy has been essentially to add more cities, add more aircraft so that traffic grew exponentially through the multiplication of city-pairs connected through the İstanbul hub. İstanbul's geography meant that about 40% of global air traffic was within narrowbody range and by using 737s THY could open up markets that were never going to be served by direct widebody flights. But well before the pandemic it had become clear that growth was not necessarily translating into profits and acceptable ROCEs. For instance, between 2016 and 2019 revenues grew by over 10% pa but net profit margins were in the zero to 6% range.

THY FLEET (mid 2021)

Widebody	A330-200/300	54
	777-300ER	33
	A350-900	5
	787-9	15
		107
Narrowbody	737-800/900	109
	737-8/9MAX	16
	A320 Family	84
	A321 NEO	30
		239
Freight	A330F	10
	777F	8
	Wet Lease	8
		26
	TOTAL	**372**

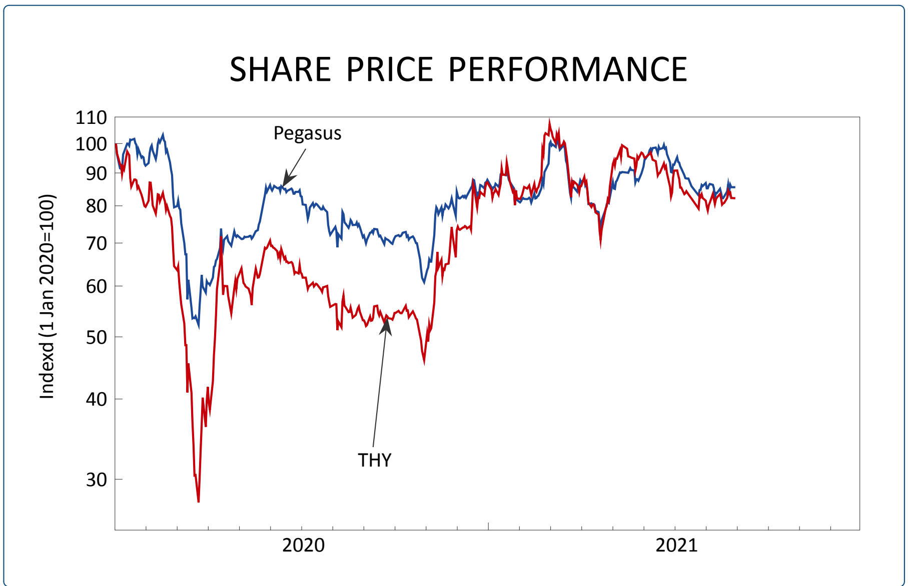
With the orderbook rescheduling comes the opportunity for THY to adjust its network for profit maximisation rather than market maximisation. The network covers 331 destinations, both domestic and international, of which 249 were being flown as at June 2021. The airline in its latest presentation identified 14 future destinations, including Nantes, La Coruña, Palermo, Abha (Saudi Arabia), Juba (South Sudan), Port Sudan, Atyrau (Kazakhstan) and Sialkot (Pakistan). Even with narrowbody hubbing operations, can such points be commercially viable?

The mega-airport question

Potentially, İGA, İstanbul's new airport, is THY's greatest asset. But it is also a a symbol of the extravagant nationalist policies of President Erdoğan.

İGA is located 50km north-west of the city centre on the European side of the Bosphorus. It has a capacity of 90m passengers a year with a single terminal and two sets of parallel runways. Planned expansion will take it to 150m passengers by 2027 with eight runways and a second terminal. Whether this will take place in the post-pandemic world is uncertain, but it is clear that İGA will be Europe's, and maybe the world's, biggest airport. Moreover, user reaction to the new airport has generally been very favourable and it has received various awards. For example, it was deemed to be "Europe's most efficient airport" by the Air Transport Research Association while Skytrax appointed it as a "5-Star Airport" and a "5-Star COVID-19 Airport".

İGA itself is part of a mega-project promoted by President Erdoğan, which includes Kanal İstanbul, a planned $30bn shipping canal designed to bypass the Bosphorus Strait, plans to build a new city for 2-3 million inhabitants, the North İstanbul Highway, and the proposed third bridge on the Bosphorus.



Critics of the mega-project and President Erdoğan's other policies, especially the repression of democratic and social rights, and the replacement of Turkey's secularism with a fundamentalist Islamic ideology, warn that Turkey will suffer both economically and politically. The grandiose spending sprees will provide a temporary boost to the economy but the fall-out will be inflation and recession and political unrest (it was only five years ago that there was an attempted coup in Turkey).

THY as an international hubbing airline is somewhat protected from these developments, but not completely.

Virgin Atlantic: Desperately Seeking Capital

FEW CITIES in the world can support two directly competing home airlines. American plays second fiddle to United at Chicago; JAL and ANA enjoy a comfortable duopoly in Tokyo; and Virgin Atlantic competes aggressively against IAG's British Airways in London. But Virgin only flies long haul, with a heavy focus on the Atlantic, and had a relatively small overall footprint in London — with 3% of the slots at Heathrow in 2019 and 1.5% of those at Gatwick. Long haul operations have been badly hit by the coronavirus crisis, and are expected to take a long time to recover to pre-pandemic levels.

Recent press reports suggest that Virgin Atlantic may be contemplating an IPO on the London Stock Exchange as early as autumn this year. This is likely to see the flamboyant Richard Branson relinquish majority control (51% owned by Virgin Group, 49% by Delta Airlines) for the first time since the airline was founded nearly forty years ago. It will also open the carrier to greater financial scrutiny than that to which the unconventional entrepreneur has been accustomed. But it may go some way to restore a balance sheet almost fatally harmed by the effects of the Covid pandemic.

And 2020 was disastrous for Virgin Atlantic. It saw an 80% decline in passenger numbers (from 6m in 2019 to 1.2m) and passenger revenues (down to £446m from £2bn) — although cargo revenues were up by 50% to £319m. Operating losses before exceptional items amounted to £514m (down from a restated £72.5m profit) and total net losses reached £864m compared with losses of £55m in the prior year period.

On top of all this it had to write off its 30% stake in FlyBe, strategically acquired in 2019 presumably in an attempt to generate much-needed feed to it long haul operations, when that regional UK airline fell into bankruptcy in March 2020.

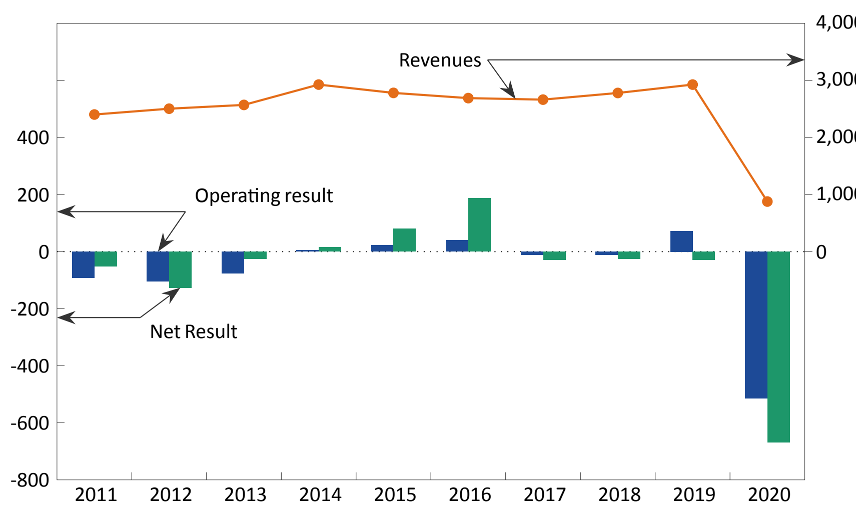
Virgin Atlantic reacted as best it could to mitigate the crisis. It got rid of its four-engined widebody aircraft — sending its eight 747s and three A340s into early retirement — sacked 3,100 staff (a third of its workforce) and closed operations at London Gatwick to concentrate on services out of Heathrow and Manchester (aiming to return to Gatwick when demand returns). The company also announced plans to consolidate all operations under a single brand — with Virgin Holidays becoming Virgin Atlantic holidays — in order "to drive a 10x growth mindset when recovery begins".

Despite pleas for help, the UK government did not go out of its way to help the aviation sector through the crisis, and Virgin's balance sheet was too weak to allow it to take advantage of the Government-backed Coronavirus Loan Scheme.

With the prospect of running out of cash at the end of September, Virgin Atlantic was the first UK company to use the process of a court sanctioned solvent Restructuring Plan (in a procedure hastily appended to the UK Companies Act 2006 at the start of the pandemic), coinciding with a filing for Chapter 15 court protection to allow the plan to be recognised in the US.

The headline to the announcement mentioned a refinancing pack-

VIRGIN ATLANTIC: FINANCIAL DATA (£m)



age worth £1.2bn over the following 18 months "with the unanimous support of our shareholders and creditors".

Not that much hard cash was involved. Hedge fund Davidson Kempner Capital provided £170m of secured financing and the airline's largest creditors and suppliers contributed an additional £450m by way of payment deferrals. Shareholders Delta Airlines and Virgin Group provided £600m — a £200m cash injection from Virgin and £400m in deferral of brand fees (to Virgin) and JV fees (to Delta). (Delta is constrained by the terms of the CARES Act from on the forms of investment it can make). It also got rid of another 1,500 staff.

The balance sheet (see table left) seems to show this as a £100m introduction of capital (in accounting terms equivalent to a gift from the majority shareholder) and a £375m issue of preference shares.

Even after the restructuring plan, the balance sheet is sickly. Assets of £2bn do not quite support loans and other long term liabilities of £2.6bn. Net unrestricted cash stood at £4m at the end of December — although liquidity has since been boosted by an additional £160m support "from our shareholders and creditors" in March, and a $260m sale and leaseback of two 787s to repay a (presumably expensive) loan taken out during the crisis.

But those assets also include intangibles of another £460m — in the 2020 accounts the company decided to capitalise its extended joint venture agreement with Delta and Air France-KLM, which came into force (with meticulous timing) in February 2020. The shareholders' deficit is realistically probably somewhere between the published £576m and a cynical analysts approximation of £1bn.

CFO Oliver Byers is keen to point out that the balance sheet does not include an estimated £423m value of slots the group has not officially capitalised (surprisingly up from £350m at the end of 2019). noting that its total UK slot portfolio had a year-end market value of over £500m (although its Heathrow slots, representing by far the majority, had already been put up as security to a £220m bond issued in 2016). It is probably just as well for Virgin that Heathrow's proposed third runway looks now as least likely as ever to be built any time soon.

Finding an investment story

In its report of a potential IPO, Sky News mentioned that "City sources" had said that institutions' response to management presentations led by the airline's executives had been positive. Virgin Atlantic declined to comment; it would be nice to know what positive spin it could present to suggest that an investment would be attractive. The airline's stated core values — Think Red, Make Friends, and Be Amazing — are not enough.

The airline industry is one that re-

VIRGIN ATLANTIC: BALANCE SHEET DATA

£m	2020	2019
Fixed Assets	1,952	2,228
Defd tax & other	19	31
Intangibles	460	183
Cash	115	353
Restricted cash	77	97
Stock	30	39
Drs	162	288
Derivatives	2	20
Current Assets	386	796
ST debt	(111)	(248)
Crs	(346)	(516)
Defd revenue	(263)	(523)
Provisions	(40)	(30)
Derivatives	(13)	(34)
Current Liabilities	(773)	(1,352)
Net Current Liabilities	(388)	(555)
Assets	2,043	1,886
LT Debt	(2,369)	(1,967)
Crs	(192)	(4)
Defd revenue	(3)	(2)
Provisions	(55)	(100)
Derivatives		(5)
Liabilities	(2,619)	(2,077)
Net Assets	(576)	(190)
Represented by		
Equity capital	100	100
Preference capital	426	50
Reserves	(187)	(290)
Retained earnings	(915)	(51)
Shareholders funds	(576)	(190)

VIRGIN ATLANTIC: FLEET

		Current			
	End 2019	In Service	Parked	Total	On Order
747	8				
787	16	16	1	**17**	
A330	14	5	8	**13**	14
A340	3				
A350	4	7		**7**	6
Total	**45**	**28**	**9**	**37**	**20**

quires profitable growth to be able to stand still. In the decade leading up to 2020's pandemic Virgin Atlantic has neither grown nor been profitable. In 2019, its capacity in ASK terms was 10% lower than in the peak of the previous cycle, while the total number of passengers carried has fluctuated around 5.5-6m. In the decade leading up to 2019 it raked up total operating losses of £132m, generating an operating profit in only five of the ten years, and effectively breaking even at the net level only after exceptional items and tax. A peak operating margin of 2.5% was achieved in 2019 on revenues of £2.9bn.

It has advantages. It is based in London. And Heathrow in particular has the strongest natural long haul O&D demand worldwide, and stands as the prime gateway to Europe. The UK itself, in normal times, is one of the largest generators of international air travel, and has strong historical and cultural links with English speaking nations, former colonies and protectorates.

The strongest routes in its portfolio, and those that in normal times

VIRGIN ATLANTIC: (PRE-COVID) ROUTE MAP

Note: Equidistant map projection based on London – great circle routes appear as stright lines. Thickness of lines directly related to total seat capacity.

would be profitable, we estimate to be the business oriented routes from London to New York, Boston, Los Angeles and San Francisco; leisure-oriented routes to Orlando, Miami and Las Vegas and the leisure and VFR oriented routes to the Caribbean; its routes to Lagos and South Africa where it enjoyed a virtual duopoly with British Airways in the face of relatively high yields and weak or non-existent competition. Hong Kong may have had a positive contribution in the past, but the attractions of routes into the UK's former colony are likely to have waned following the introduction of the new national security laws.

Virgin Atlantic is also now part of the extended immunised joint venture with Delta and Air France-KLM — which covers routes on the Atlantic and through on to the Indian subcontinent. This may be enough to enable it to make sense of its routes to Delhi, Bombay and Tel Aviv, while connections into Delta's hubs in Atlanta and Boston may give it sufficient US originating traffic.

Virgin Atlantic also has disadvantages. It has had difficulty diversifying: three quarters of its operations were on the Atlantic and three quarters of its sales originates in the UK. (For those who like to reference Freddy Laker in reference to Virgin Atlantic, it was that dependence on Sterling income that sent Laker into administration when the pound fell from $2.40 to $1.80).

It lacks domestic and regional feed: although a handful of long haul routes out of London can be supported by point-to-point demand — the ones it originally cherry-picked from British Airways — many only work with transfer traffic. It is dependent to an extent on high yield traffic: and long haul business traffic will take a very long time to recover.

Secondly its prime routes are subject to the very same cherry-picking by new entrants. Although Norwegian's attempts to create a long haul low cost operation has failed, its presence was highly disruptive. Norwegian's successor Norse, with much cheaper equipment, is in the process of applying for a UK AoC to take Norwegian's place in Gatwick.

JetBlue, which had successfully disrupted the US transcontinental market and engineered a permanent reduction in average fares there, is starting operations from New York and Boston into the London airports with its small capacity but highly efficient long range A321neos.

Aer Lingus similarly will be spearheading an attack on the Atlantic with its A321s out of Manchester, in direct competition with Virgin, under its own new UK AoC.

In 2017, Richard Branson had announced a deal to sell a 31% stake in Virgin Atlantic (out of Virgin Group's 51% majority holding) to Air France-KLM for £220m (in which Delta and China Eastern had recently injected funds). The was undoubtedly linked with Delta's plan to include Virgin Atlantic in the Skyteam immunised joint venture on the Atlantic — which came into effect at the beginning of 2020.

That deal never took place but perhaps indicated Branson's willingness to reduce his stake and give up on his once-held ambition to build up a network of Virgin-branded airlines around the world — see *Aviation Strategy,* August 2009 — and concentrate on space adventures.

Virgin America, which started operations in 2007, was acquired by the Alaska Air Group in 2016, with the Virgin brand phased out by 2019. The Virgin Group lost its remaining 10% stake in Virgin Australia (formerly Virgin Blue, launched in 2000) when that carrier, in poor financial health, succumbed to Covid-19 last year (see *Aviation Strategy* December 2019). Elsewhere Lagos-based Virgin Nigeria (which started operations in 2005) was always sub-scale and loss-making, despite (or because of) being the Nigerian flag-carrier, and the Virgin Group escaped its investment in 2010. Brussels-based (and loss-making) low cost carrier Virgin Express merged with SN, the successor to the rump of Belgian flag carrier Sabena (which had died in 2001), to form SN Brussels in 2007. It is possibly also worth mentioning that Delta acquired its 49% stake in Virgin Atlantic from Singapore Airlines in 2012 for £224m — half the price that SIA paid in 2000.

But potential investors should perhaps ignore the history of the returns generated by Virgin Atlantic under Virgin Group's control. Richard Branson is an unconventional entrepreneur and views total returns somewhat differently from the run-of-the-mill equity market investor. Apart from anything else there are brand license agreements which guarantee a return on revenue (Virgin Group presumably still receives a fee from the re-incarnated Virgin Australia).

If there were to be an IPO, Delta would presumably remain a major (and may end up the largest) shareholder — although because of the CARES Act provisions it is unlikely to be able to partake. It should be able to persuade potential investors that it knows how to run an airline profitably. But, in the meantime, the hole in the balance sheet is very deep and very red.

Air France-KLM: The transformational journey continues

IN THE aftermath of the 2008 Global Financial Crisis, Air France-KLM had been lumbered with an almost insurmountable €6.8bn mountain of debt and searing operational losses. It embarked on a process to restore profitability and financial health, and has spent the past decade deleveraging the balance sheet mostly from internally generated cashflow. By 2019 it had reduced its net debt/EBITDA ratio to an almost investment grade level of 1.5x (see chart right), but over the decade had underperformed its European peers in terms of profits and returns on equity.

A new management team in late 2018, led by the group's first non-French (and non-énarque) CEO, Ben Smith, was all set to take the group on a transformational journey: seriously trying to turn Air France round, narrowing the gap between the French airline (on a sub-2% operating margin at the peak of the cycle) and the well-run KLM (on a respectable 10%); and targeting group "mid-cycle" operating margins of 7-8%.

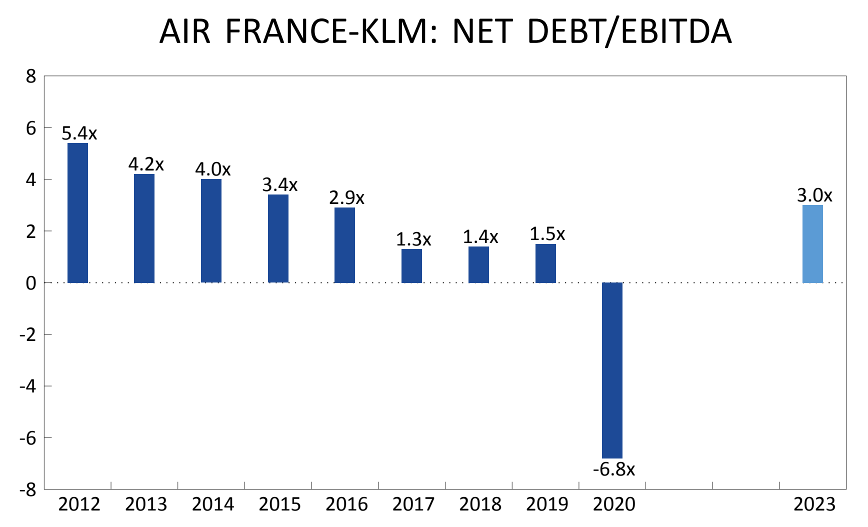
And then the pandemic struck.

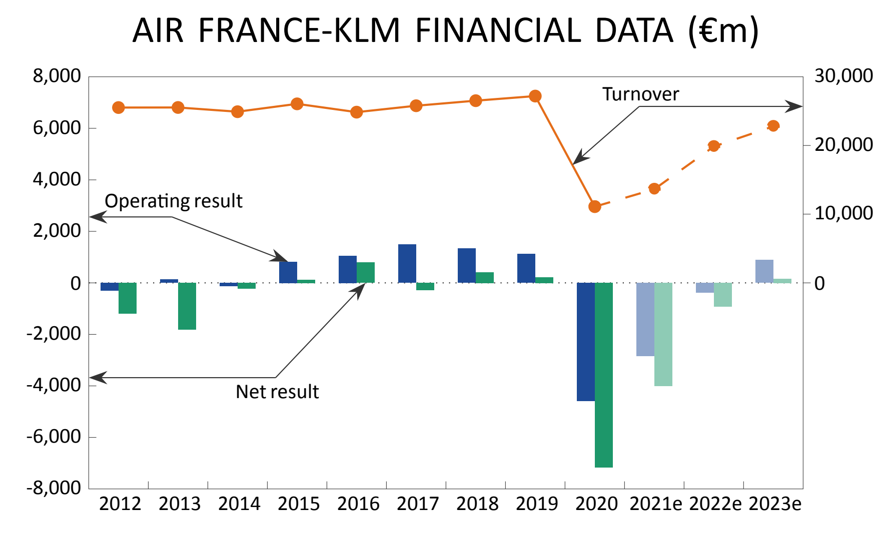
A hunt for liquidity

In comparison to the other two major European network carriers, IAG and Lufthansa, Air France-KLM still had a relatively weak balance sheet at the end of 2019. Its net debt of €6.7bn (albeit including €3.1bn lease debt) was three times shareholders' funds of €2.4bn (before considering €1.5bn in goodwill and intangibles). It had cash in hand of €4.5bn (16% of annual revenues) but short term debt liabilities of €1.8bn and advance ticket sales of €4.1bn.

As the crisis took hold it tried to react quickly, and by the end of the first quarter had available liquidity of €6.7bn and had announced cuts to its capex budget of €700m. But with an estimated monthly €400m cash outflow this was not going to be enough to survive the crisis and went cap-in-hand to its governments for help.

The group's position was complicated by having two governments to call — both of which view "their" re-





Note: Forecasts Bernstein.

spective national airline as an essential part of national infrastructure.

Accessing the payroll support programmes was the easy bit. Air France and its French subsidiaries implemented short time working under the French *Activité Partielle* rules while KLM was able to access a similar NOW programme in the Netherlands (the acronym from the Dutch *Tijdelijke Noodmaatregel Overbrugging voor Werkbehoud).* These programmes provided 70%-85% of furloughed employee costs and saved the group €2.1bn in 2020 (the total wage bill was down by 35% at €5.3bn for 2020).

Although Air France and KLM were the pioneers in cross-border flag-carrier mergers in Europe when they teamed up in 2004, the Internal relationships between the French and Dutch parts of the resulting group have on many occasions been strained.

This tension spread to the Governmental level when The Hague in February 2019 surprised the Elysée by announcing that it had acquired a 12% stake in the Air France-KLM Group with plans to build this to match the then French national holding of 14%. (France may aim to be egalitarian, but under its *Loi Florange* some shareholders are more equal than others: the French state had 21% of the theoretical voting rights, and the Dutch would have had to wait another two years to achieve parity).

Negotiations for the division of government aid between the two governments in the Covid crisis were not easy but in total the group received financial packages totalling €10.4bn (equivalent to just around a third of 2019 group revenues).

The French Government provided €7bn:

- a €4bn loan, 90% state-guaranteed, with an extendable initial 12-month maturity and a coupon rising from EURIBOR+75bp to EURIBOR+275bp in year three; and
- a €3bn four-year extendable subordinated shareholder loan at a rate of 7% over the base rate (rising to +7.75% in year six). The coupon would increase further by an additional 5.5% (to EURIBOR+12.5-13.25% — what a hefty stick!) if Air France-KLM did not get the loan incorporated into the Group's shareholder equity, raised new equity without state approval, or if anyone other than the French State acquired a 20% stake.

The group agreed not to pay any dividends (it last did so in 2008) until the loans were repaid in full. There were other soft "conditions", not necessarily worded in the agreement. According to the *Financial*

AIR FRANCE-KLM: BALANCE SHEET ITEMS

€m	Dec 2019	Dec 2020	Jun 2021
Flight equipment	11,334	11,031	10,645
Other P&E	1,580	1,548	1,453
Right-of-use assets	5,173	4,678	5,033
intangibles	1,522	1,445	1,464
Other assets	2,587	1,614	1,336
	22,196	20,316	19,931
Cash &c	4,515	7,030	6,575
Stock	737	543	519
Drs	2,164	1,248	1,530
Other	1,123	1,074	1,455
	8,539	9,895	10,079
ST debt	(1,817)	(2,159)	(1,652)
Advance sales	(4,137)	(3,310)	(3,793)
Crs	(2,379)	(1,435)	(1,604)
other	(4,316)	(4,874)	(3,969)
	(12,649)	(11,778)	(11,018)
Net current assets	(4,110)	(1,883)	(939)
Assets	18,086	18,433	18,992
Debt	(6,271)	(14,171)	(11,240)
Lease liabilities	(3,149)	(2,425)	(2,697)
Pensions	(2,253)	(2,147)	(2,119)
Other provisions	(3,750)	(3,670)	(3,977)
Other liabilities	(364)	(1,438)	(2,563)
	(15,787)	(23,851)	(22,596)
Net Assets	**2,299**	**(5,418)**	**(3,604)**
Represented by			
Equity	4,501	4,543	5,567
Perpetual	403		3,042
Retained earnings	(2,620)	(9,970)	(12,221)
Minority	15	9	8
Shareholders' funds	**2,299**	**(5,418)**	**(3,604)**

AIR FRANCE-KLM: SHAREHOLDER STRUCTURE

	% of capital		% of theoretical
	Dec 2020	Jun 2021	voting rights
French State	14.3%	28.6%	28.5%
China Eastern	8.8%	9.6%	11.5%
Dutch State	14.0%	9.3%	13.9%
Delta Airlines	8.8%	5.8%	8.7%
Employees	3.7%	2.5%	3.7%
Treasury stock	0.3%	0.2%	0.3%
Others	50.1%	44.0%	33.4%

Times, the French Finance ministry stated that the loans were "intended solely for the needs of the subsidiary Air France", while Bruno Le Maire, French finance minister, is quoted as saying that the loans came with conditions including that "Air France must become the most environmentally friendly airline on the planet". In the wake of the *Flygskam* movement in 2019, France had been considering banning domestic flights where there was a train alternative of less than 2½ hours duration.

The Dutch put up €3.4bn:

- a revolving credit facility of €2.4bn, 90% guaranteed by the state at a rate of EURIBOR+1.35%
- a direct loan of €1bn with a maturity of 5½ years and a coupon of EURIBOR+6.25% rising to +7.75% by the fourth year. Both the revolving credit facility and the direct loan are drawn simultaneously on a pro rata basis.

These too came with conditions. KLM agreed not to make dividend payments to its shareholders (ie the Air France-KLM Group) until the loans had been repaid. In addition the direct state loan is linked to "manageable cost improvements, the airline becoming more sustainable, and the restored performance and competitiveness of KLM including a comprehensive restructuring plan and contributions made by employees".

At the time of the agreement Dutch Finance minister, Wopke Hoekstra, seemed to show that tensions continued between the two governments saying: "Air France is not the same size or the same level of profitability as KLM. The Dutch government will therefore support the group and KLM at a level proportionally equivalent to that of the French government for Air France."

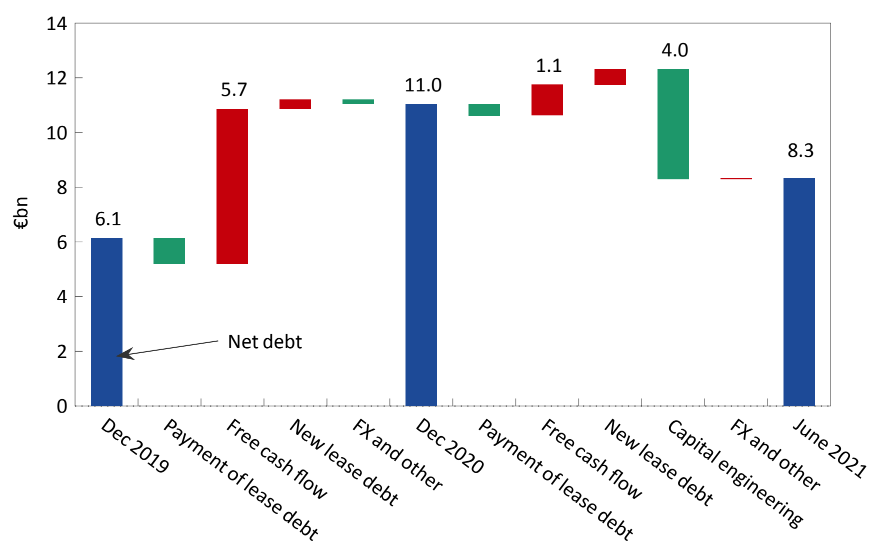
By the end of 2020 Air France-KLM had drawn the full €7bn made available by France, and KLM just €942m of the €3.4bn offered by The Netherlands.

Full year 2020 results from operations were disastrous. Traffic for the group was down by 70% on a 55% reduction in capacity, operating losses exceeded €4.5bn, net losses topped €7bn, and the group suffered a net cash outflow of €5.7bn pushing net debt up to €11bn by the end of December.

The first half of 2021 has seen some faint signs of recovery. Air France in the current environment has some network strengths in comparison with its peers: it has a relatively low exposure to the Atlantic, Asia and the Far East, relatively low dependence on high yield corporate business traffic, a moderately large domestic market boosted by its quasi-domestic routes to the DomTom (*Dominions et Territoires Outre-mer*) destinations in the Caribbean and Indian Ocean, and strong essential links to francophone Africa. Overall capacity is running at around half the "normal" level of 2019 and was building further into the third quarter.

Cash outflow in the first half was

AIR FRANCE-KLM: NET DEBT DEVELOPMENT 2019-21



reduced to €1.1bn, and was positive in the second quarter helped by a €1.2bn increase in working capital from advanced ticket sales.

In April, Air France-KLM, avoiding the threat of punitive interest rates on its shareholder's loans, raised €1bn from a sale of new shares (had it been a rights issue it would have been on the basis of 1 for 2) and transferred the bailout loan into "equity" as "super-subordinated notes". This had to go through approval from the EU Commission as permissible state aid: the price was to relinquish 18 slots at the congested Orly airport, agree not to pay dividends and limit executive pay.

The French State took over half of the new equity issued, pushing its stake up to 28% of the total. China Eastern subscribed for a further 11%. Delta could not partake, under the rules of the CARES Act, and the Dutch Government forebore. As a result of the issue the group ended June with net debt of a mere €8.3bn strengthening (still negative) shareholders' funds by €4bn to €(3.6)bn. The group has extended the €4bn government guaranteed debt into 2023 and is renegotiating the repayment schedules. It also successfully launched an €800m corporate bond in June — its first foray into the capital markets since January 2020. It had €9.4bn available liquidity at the end of the quarter.

The Dutch Government meanwhile wants to be able to do something similar to support the financial structure at KLM. To that end it has been in discussions with the European Commission. But it may be a bit more awkward to talk about converting government debt into the equity of a subsidiary of a French registered group. The EC will probably also want to impose slot disposals by KLM at the (normally) overfull airport in Amsterdam. Air France *in extremis* was willing to give away valuable slots at Paris's second airport Orly (which perhaps it was only holding

AIR FRANCE-KLM FLEET

		Dec 2019				Jun 2021					
		Air France	KLM	Transavia	Group	Air France	KLM	Transavia	Group	*Avg Age*	On Order
Widebody	747		8		8						
	777	68	29		97	64	31		95	*14.5*	
	787	9	17		26	10	19		29	*3.7*	8
	A380†	10			10						
	A350	3			3	10			10	*1.1*	28
	A340	4			4						
	A330	15	13		28	15	13		28	*16.1*	
		109	**67**		**176**	**99**	**63**		**162**	***12.0***	**36**
Narrowbody	737NG		52	80	132		49	89	138	*11.6*	
	A220										60
	A318	18			18	18			18	*16.3*	
	A319	33			33	31			31	*20.0*	
	A320	44			44	44			44	*12.0*	
	A321	20			20	19			19	*19.0*	
		115	**52**	**80**	**247**	**112**	**49**	**89**	**250**	***13.6***	**60**
Regional	ATR42/72	4			4						
	CRJ700/1000	25			25	20			20	*12.0*	
	E195E2						4		4	*0.5*	21
	E190	15	32		47	17	32		49	*9.4*	
	E170/175	15	17		32	15	17		32	*8.9*	
	E145†	17			17					*8.3*	
		76	**49**		**125**	**52**	**53**		**105**	***9.4***	**21**
Freight	747-F		4				4		4	*21.4*	
	777-F	2				2			2	*12.8*	
		2	**4**			**2**	**4**		**6**	***18.5***	
	Total	**302**	**172**	**80**	**554**	**265**	**169**	**89**	**523**	***12.3***	**117**

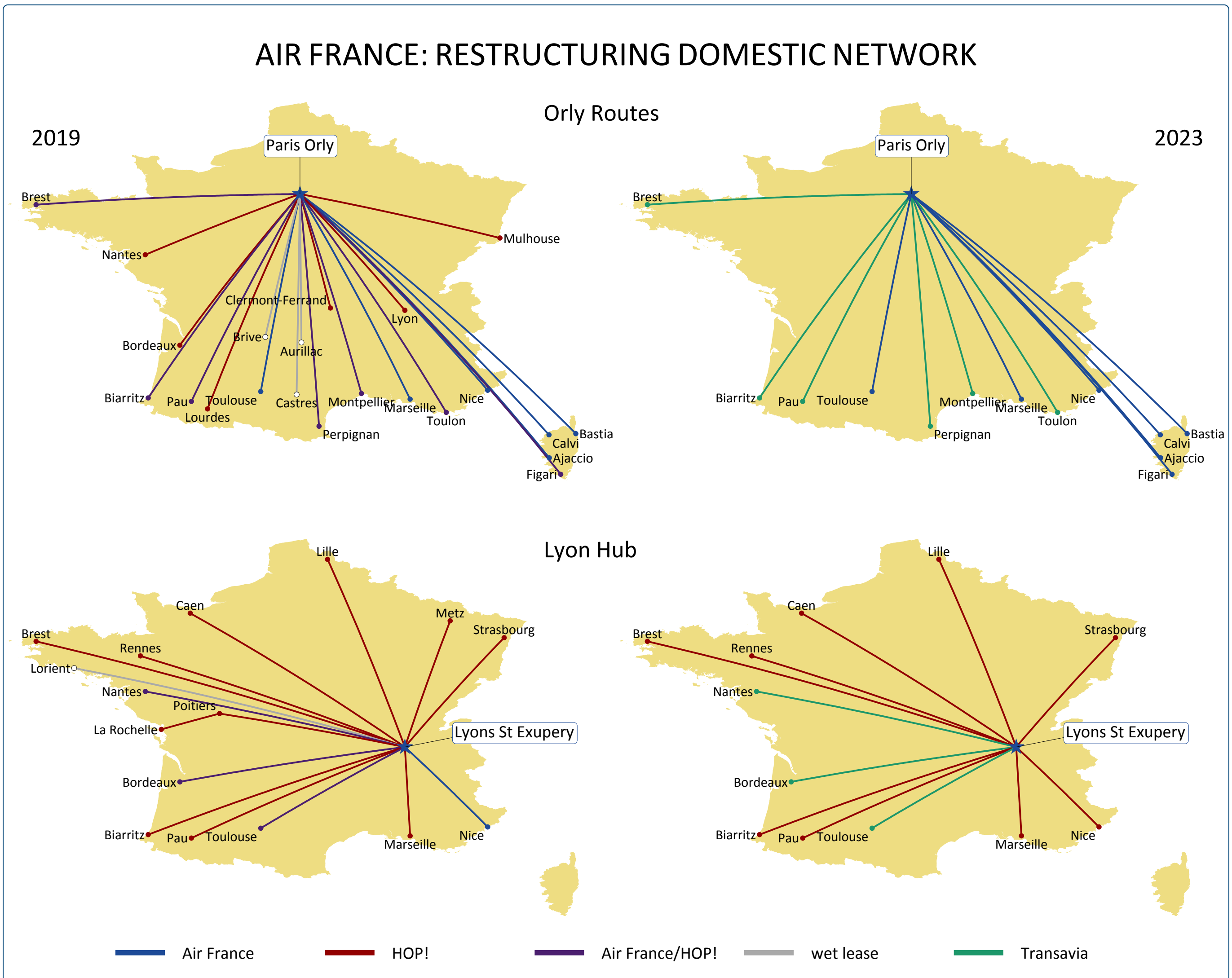
Note: † eight A380s and 11 E145 on books but in storage and effectively decommissioned onto to keep other competitors out, and was possibly going to relinquish anyway as it downsized its loss-making domestic network). For The Netherlands and KLM, Schiphol is of ultimate strategic importance and slot disposals threaten the network economics of the sixth-freedom hub.

The group's capital engineering is not sufficient. Under current projections it sees the likelihood of net debt standing at three times EBITDA by 2023; management would prefer something nearer 2x. The board gained authority at the annual general meeting to increase the current share capital by up to 300% and issuance for up to €3.5bn equity linked instruments, and at the Q2 results meeting the management gave a clear indication that they would return to the capital markets once they have a convincing recovery story. However, the French State has a dilemma in again providing more than its fair share of new equity: under French Bourse rules once a single holder has more than 30% of the shares in a quoted stock, it has to make an open bid for the entire company.

Restructuring under way

The transformational restructuring plan (see *Aviation Strategy* November 2019) put forward by Ben Smith had been to improve industrial relations at Air France, modernise the fleet, optimise the operating model, grow profitable passenger revenues, maximise group synergies and "lead the way in sustainable aviation". If anything the Covid crisis has accelerated the process and made the painful bits of the plan easier to impose.

Before March 2020 management had already achieved major milestones. It had signed over 40 agreements with personnel groups at Air France — and notably an agreement with the pilots that removed the constraints on the size and operational perimeter for Transavia



France. Air France had ordered 10 A350s and announced plans to decommission its A380s; it had ordered 60 A220s to replace its old A318s and A319s. KLM had ordered two 777s and 21 Embraer E195-E2s. The two airlines had started a programme of cabin harmonisation and brand simplification (the troublesome Hop! regional brand reincorporated under Air France) and a fleet swap (of 787s from Air France to KLM in return for A350s).

Since the pandemic the group has implemented voluntary severance plans to remove 8,700 full time equivalent jobs by the end of 2020, with the aim of cutting an additional 5,000 positions by the end of 2021. The management points to structural benefits from the lower level of employment of around €800m for KLM by the end of 2022 compared with 2019, and €1.3bn for Air France. (Meanwhile the Dutch NOW mechanism remains in place until the end of Q3 2021 and Air France has negotiated a long term "partial activity" agreement until the end of 2022).

As for the fleet, the group has accelerated the removal of the A380s and phased out all the four-engined A340s and B747s, and the smaller French regional E145s and ATR72s; and announced plans to get rid of the CRJs and KLM's A330s. It expects to be operating 7% fewer aircraft in 2022 than it had in 2019.

Network improvements

The Air France regional and domestic operations have been a perennial problem ever since they were amalgamated in the early noughties with the divergent aims of keeping out low cost (and non-French) competition, feeding traffic into CDG, and maintaining connectivity under political pressure from the regions.

In each of the last ten years the then management has stated that "in the next year or two they will break even". But even at the top of the last cycle they were losing around €200m a year.

The intense political scrutiny of Air France's operations during the negotiations for state aid last year gave rise to a "condition" that the company should not operate domestic flights on routes that could be completed using train services within 2½ hours.

Ben Smith meanwhile has committed, as part of the drive to fill the role as the "most environmentally friendly airline", to cut domestic flight CO_2 emissions by 50% in absolute terms by 2024. A perfect opportunity to do exactly what he planned to do but with full political approval.

The maps on the facing page show the extent of the changes that Air France is planning by 2023 (these exclude some 175 small transversal regional routes, of which 70% have already been cut).

Hop! will stop operating from Orly entirely. Air France will continue to operate the shuttle (Navette) services to Nice, Marseilles and France's second largest city Toulouse; and routes to Corsica. Transavia, newly liberated to operate domestically, will assume a handful of routes to Brest, Biarritz, Pau, Perpignan, Montpelier and Toulon. Other routes to the hinterland — not all conveniently on the TGV network — will be axed. By 2023 the company expects that Transavia will have nearly 30% of the Group's domestic capacity out of Orly. The company says it has already achieved 60% of the changes

Hop! will continue to operate out of Lyons, but with much reduced flying. Here also Transavia is seen to take on a handful of higher density routes to end up with just over 30% of seat capacity. The future for Hop! is very uncertain (indeed the scurrilous story circulating in Paris is that it is now mainly a depository for Air France executives who do not share the new vision for the airline).

On short-medium haul, there is an opportunity to revisit its operational strategy through the acquisition of 60 A220s. Historically the company has focused on maximising feed from medium and short haul services on to long haul operations. However, one of its strengths is to be based in a highly populated city with a large catchment area and good natural point-to-point O&D traffic — second to London in Western Europe and way ahead of Frankfurt. The new management team seems to recognise (as British Airways worked out twenty years ago) that the pursuit of transfer traffic for its own sake can generate too a high proportion of very low yield leisure-oriented transfer traffic (the deepest discount a network airline can offer). There is the possibility that the use of small and cost-efficient aircraft feeding smaller widebodies will lead to the profitable improvement in passenger revenues that Ben Smith targets in the restructuring plan.

The overall medium term plan seems still to be in place, just somewhat delayed. The group expects to get back to 2019 levels of capacity by 2024. When it does, it expects that its unit costs will be 10% lower than pre-crisis levels and that it should be able to generate mid-cycle group operating margins of 7-8%. The current management team is very probably the airline's and the government's best chance of completing the turnaround, but then there is always French politics in the background.

Subscription Form

Enter my Aviation Strategy subscription for: 1 year (10 issues – Jan/Feb and Jul/Aug are combined)

- UK: £475
- EU: €610 (+VAT where applicable)
- USA and Rest of world: US$780

starting with the ______________ issue.

❑ I enclose a Sterling or Euro cheque made payable to Aviation Strategy Ltd

❑ Please invoice me

❑ I wish to pay by credit card or PayPal.

❑ I am sending a direct bank transfer of the the relevant sum net of all charges to Aviation Strategy's bank account:
Metro Bank Ltd, 1 Southampton Row, London WC1B 5HA
IBAN: GB04 MYMB 2305 8013 1203 74
Sort code: 23-05-80 Account no: 13120374
Swift: MYMBGB2L

Delivery Address

Name ______________
Position ______________
Company ______________
e-mail ______________
Telephone ______________
VAT No ______________

Invoice Address

Name ______________
Position ______________
Company ______________
Address ______________
____
____
Country ______________
Postcode ______________

DATA PROTECTION ACT

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

PLEASE RETURN THIS FORM TO:

Aviation Strategy Ltd, 6 Langside Avenue
London SW15 5QT, UK
e-mail:info@aviationstrategy.aero
VAT Registration No: GB 162 7100 38