



easyJet: Opportunity to attack the Legacies

EASYJET received £1.2bn of funding from September's fully-underwritten rights issue, following its rejection of Wizzair's takeover offer, putting it in a position to refine and implement its own post-Covid opportunities as the market opening accelerates.

In theory, a merger between Wizzair and easyJet would have been an intriguing proposition — mostly complementary networks, Wizzair's cost discipline and easyJet's superior product, A320 NEO fleet compatibility. But the price offered might have been too opportunistic, or there was a conflict over where the HQ would be and who would be in it, or easyJet genuinely believed that it could do better on its own.

easyJet's strategy has always seemed slightly fuzzy compared to the sharp edges presented by Michael O'Leary at Ryanair and Josef Varadi at Wizzair. However, presentations made by CEO Johan Lundgren prior to the rights issues point towards a stronger position for the airline in the intra-European market, although initial reaction by investors shows no narrowing in the divergence between easyJet's valuation and that of the other two LCCs — see chart on the following page. The company's target is to restore EBITDA margins to 15%, which may be a deliberate underestimate — equity analysts are hoping for 18-20% margins.

The Covid depression has enabled easyJet to make costs saving and introduce higher labour productivity. In 2021 it achieved £500m of savings but only half of this amount is regarded as sustainable. Neverthe-

less, £250m of savings would reduce easyJet's non-fuel operating costs by almost 6% (2019 comparison).

The pricing environment in Europe, post-pandemic, is likely to be much firmer than before because so much capacity has been withdrawn through bankruptcies and network rationalisations. Both Michael O'Leary and Carsten Spohr, CEO of Lufthansa, agree on the inevitability of significantly higher fares. All airlines should benefit from this development but easyJet is particularly well positioned because its brand is generally well regarded by passengers — according to its own research, it is the first choice

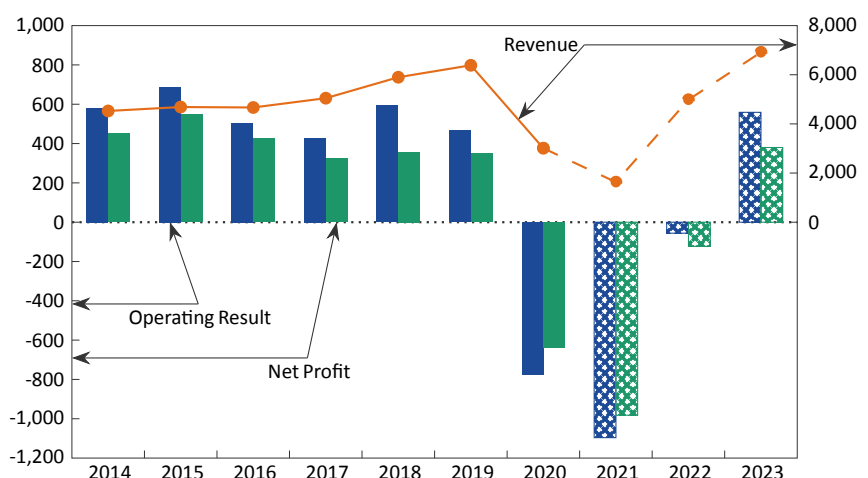
lower cost airline in the UK, France, Switzerland and Berlin (what the rest of Germany thinks was not revealed).

The most interesting "growth opportunity" chart from easyJet is reproduced below; it breaks down capacity shares by three broad carrier

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EASYJET FINANCIAL RESULTS (£m)



Notes: FY end September. Estimates Bernstein.

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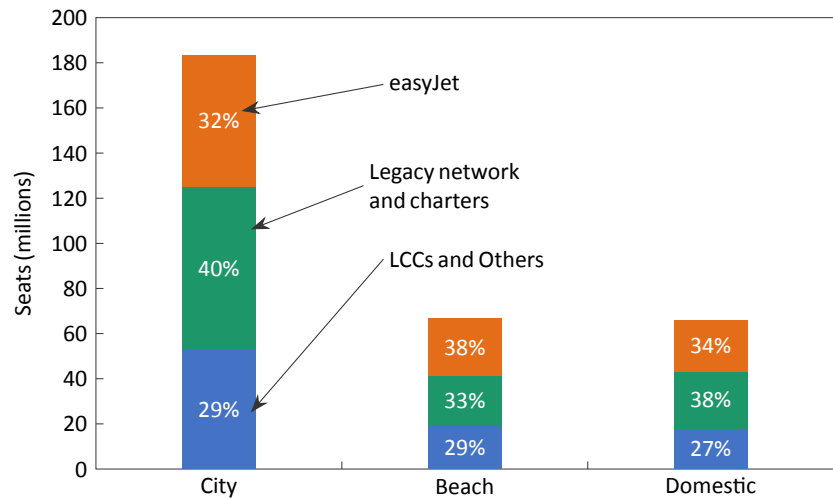
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CAPACITY SHARES IN EASYJET'S MARKETS

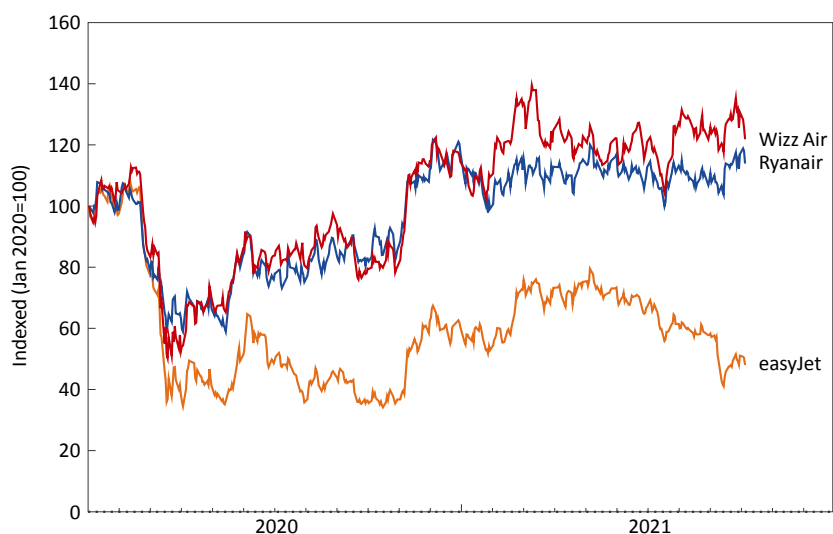


groupings in the three main sectors — City, Beach and Domestic. In total easyJet accounted for 34% of the total, LCCs and others, 28%, and Legacies and Charters, 38%. When we carried out a similar but more detailed analysis (*Aviation Strategy*, December 2019) we identified that only 6% of easyJet's markets were competed by ULCCs (Ryanair and Wizzair) while network carriers (including sub-

sidiaries) were the most important competitor group with a 32% share of easyJet markets; charters only accounted for about 4%.

The point is that that easyJet has a lucrative but vulnerable segment of the European market to focus on and to attack. easyJet itself notes that the Legacies are preoccupied with restoring long-haul operations, restructuring and downsizing short-haul and

LCC SHARE PRICE PERFORMANCE



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also solving “significant balance sheet challenges”.

easyJet’s aim is to return to pre-pandemic capacity by 2023 and also to shift capacity from lower yielding airports — specifically regional French and Italian airports — to higher yielding primary airports. London has been restructured by closing its Stansted and Southend bases and strengthening Gatwick. Ideally, easyJet wants to be in the number one or two position at airports that have slot constraints and at which Legacy carriers are the key competitors.

A secondary strategy is to build up easyJet Holidays, attacking the remaining Legacy tour operators and charters. This will not be a major contributor to the airline’s financial recovery, but easyJet’s product and internet offering are of very good quality and it has the potential to transform the AIT market.

There does seem to be a genuine opportunity for easyJet in the post-pandemic world which it should be capable of exploiting now that its balance sheet has been boosted by the rights issue — £1.3bn of net debt, £2.2bn of equity, about £2.9bn

in liquidity. And the rights issue provided further relief in that Stelios Haji-Iannou declined to take up his family’s share rights, opting for cash instead. This has reduced the family ownership of voting shares from 25.3% to about 15%, at which level his ability to lambast the board and launch lawsuits will be greatly diminished. Airbus will be relieved as well.

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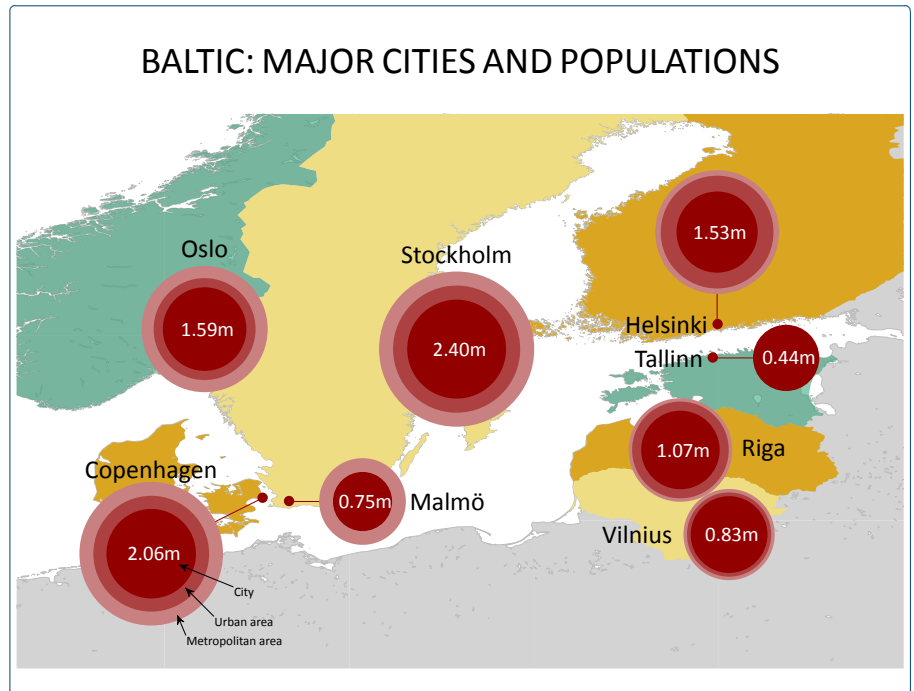
airBaltic: One mini-hub, two micro-bases and 50 A220s

AIRBALTIC is the world's second largest operator of A220s, after Delta, 31 currently in its fleet and another 19 scheduled for delivery over the next two years. It is a truly niche airline operating a hub and spoke system at Riga, the capital of Latvia. It also has bases at the Estonian capital Tallinn and the Lithuanian capital Vilnius.

These three capitals are small in comparison to the main population centres in Denmark, Norway, Sweden and Finland, yet the core strategy is to capture passengers to/from the countries and funnel the thin flows through Riga to cities in western, southern and eastern Europe and even the Middle East; pre-pandemic, about 44% of airBaltic's passengers connected through Riga. Tallinn and Vilnius are essentially point-to-point operations with only two or three aircraft based at each airport.

The three Baltic states are not like the Scandinavian block. For a start, whereas the Danes, Norwegians and Swedes can, with effort, understand each other, Latvian and Lithuanian belong to Balto-slavic, a unique language family, unintelligible to outsiders and also mutually unintelligible between Lithuanians and Latvians. Estonian is a Finnic-Uralic language related to Finnish which itself is unrelated to any other European language (except remotely to Hungarian and maybe Basque). There are also significant ethnic Russian minorities in Latvia and Estonia and, to a lesser extent, Lithuania. (Thank goodness for English!)

What the three Baltic states do



have in common is a long history of being controlled by their powerful neighbours, having been ruled at various times by Sweden, Germany, Russia and Poland. Until 1992 they were part of the USSR, and the political legacy is very strong in all three countries. Although they have been members of the EU since 2004, it is difficult to feel secure with President Putin's Russia as the regional super-power, and it is perhaps even more disconcerting to have President Lukashenko's Belarus as a neighbour.

Securing connectivity with the rest of western Europe is an understandable obsession, hence each of the states has tried to establish its own national carrier regardless of the commercial logic — Estonian Air, FlyLAL, airLituania and others were set up as flag-carriers and failed. We developed the business

analysis for airLituania back in 2012 and produced financial projections for the Vilnius-based carrier which indicated that it would probably be unviable, yet the airline went ahead as the result of political thinking that Lithuania could not risk being isolated from the rest of the EU. Also the Baltic governments generally do not trust LCCs like Ryanair to assure continuous operations, which is sort of justified given the number of times Ryanair has threatened to stop services in order to win disputes over airport fees.

airBaltic, pre-pandemic, came close to solving this politico-economic dilemma, and managing sometimes intense intra-Baltic rivalries, through having three bases in the three states (and painting some aircraft with the national flags of Lithuania and Estonia) although

AIRBALTIC FINANCIALS: REVENUE, PROFIT, CASHFLOW AND BALANCE SHEET (Euro millions)

FY (Jan-Dec)	2016	2017	2018	2019	2020	Total 5 years	Jan-Jun			End June 2021
							2020	2021		
Revenues	284	347	409	503	138	1,681	82	50		Fleet and other fixed assets 790
Net result	19	4	5	(8)	(265)	(245)	(185)	(62)		Current Assets 62
Operating Cashflow	12	43	47	87	(89)	100	(33)	(14)		Cash 68
Capex	(127)	(148)	(53)	(65)	(42)	(435)	(16)	(30)		Total Assets 920
Other Income (Exp)	(18)	(22)	28	25	15	28	2	11		LT debt and lease liabilities 806
Free Cashflow	(133)	(127)	22	47	(116)	(307)	(47)	(33)		Current liabilities 158
Inc (Dec) in debt	45	95	(29)	70	(109)	72	(30)	(47)		Total Liabilities 964
Equity injection	131				250	381	250			Shareholders' Equity (44)
Total Cashflow	43	(32)	(7)	117	25	146	173	(80)		

Source: Financial Reports; 2016 and 2017 partly estimated

the Latvian operation remains the dominant core of the airline. Over 80 points are served from Riga compared to 15 from Tallinn and 11 from Vilnius.

Tourism is important for the three countries. Riga, Vilnius and, especially, Tallinn have beautifully preserved or reconstructed medieval Old Towns, which we would thoroughly recommend for a city-break holiday.

airBaltic itself has a chequered history. The airline was established in 1995 as a joint venture between SAS, with 47%, and the Latvian state, 53%, with the main purpose of feeding SAS's hubs. However, by 2009 SAS had had enough of persistent losses and sold its stake to a company called BAS which was wholly owned by the then CEO Bertolt Flick. Herr Flick was a colourful multilingual character who raised the profile of airBaltic partly through remarkably generous trips to Riga for the press, but his tenure ended in acrimony and lawsuits. In 2011 the airline was in effect fully renationalised with a new capital injection from the Latvian state. Martin Gauss was brought in as CEO and became the architect of airBaltic's current strategy based

on the A220. Herr Gauss had previously been at Malév in Budapest and Deutsche BA in Munich, and has qualified as an A220 pilot at airBaltic.

airBaltic became a launch customer for the A220 in 2016 when it placed an order for 50 A220-300s (then Bombardier CS300s) plus 30 options. We estimate that the price for the 50 firm orders was in the order of \$1.4bn, all the aircraft being financed through sale and leasebacks, notably with ACG and Chorus Aviation Capital

The A220 strategy is at the core of the airline's business plan, entitled "Destination 2025 CLEAN", which in its latest version submitted to the Latvian government in June envisages all the firm orders being delivered by the end of 2023, bringing the fleet to 50 units from 31 in September

this year. The 737-300s have already been deleted from the fleet and the 12 Q400s have been parked permanently and are due to be returned to the lessor, Nordic Aviation, in 2022 and 2023, at a cost of €90m to airBaltic.

airBaltic is effusive about the 145-seat jet, emphasizing its environmental characteristics — a much smaller noise footprint and markedly lower carbon emissions compared to comparable aircraft, hence the "CLEAN" in the business plan title. It is a very green-orientated company; indeed, its 2020 "Sustainability and Annual Report" devoted many more pages to ESG issues than to financials.

The A220 is claimed, probably correctly, to be the optimal aircraft for its business model — econom-

FLEET DEVELOPMENT

	End 2019	Mid 2021	End 2023†
A220-300	22	31	50
737-300	4		
Q400	12	12*	
Total	38	43	50

Notes: * Not operational. † maximum

ical over short hops feeding traffic to/from the Riga hub and also capable of a commercial range of 4,575km. It operates to Tenerife and Dubai, both routes of around 4,500km.

However, competing with LCCs while using a connecting hub system and flying 145-seaters remains a huge challenge. The table below updates an A220 fuel economics comparison from a table in airBaltic's 2018 bond prospectus, which sourced data from Bombardier/Airbus, and showed the airBaltic A220 having a 12-14% fuel cost advantage over Wizz's A320 NEO or Ryanair's 737 MAX in terms of trip costs. But this turns into 13-16% cost disadvantage on a cost per seat basis, and a 29-32% cost disadvantage per passenger when the different average load factors are factored in (75% for airBaltic, 93% for the LCCs).

airBaltic describes itself as a hybrid, meaning having a cost structure something like the LCCs and service quality akin to that of the European networks (better, one would hope). It does achieve an average revenue per passenger of just over €100 per passenger in normal times compared to total revenue of €55 at Ryanair. It also offers a Business Class product — same 32" pitch as in the rest of the plane but you get two seats and plenty of frills like lounges and three course meals. Logically the airline has not joined a Global Branded Alliance (too expensive) but it does have an extensive series of codeshare agreements — 27 in total.

In the four years before the Covid-19 crisis, airBaltic just about broke even — a net profit margin of 1%. Operating cashflow during the period was €189m which was inadequate to cover capex, even allowing for cash inflows from sale/leasebacks. Free cashflow was negative, totalling -€191m, and was covered by an in-

crease in debt of €181m and a public/private equity injection of €131m in 2016. This should have at least stabilised airBaltic's finances, but Covid-19 hit airBaltic hard.

Traffic volumes collapsed by 74% to 1.3m in 2020 and a net loss of -€245m was reported. With schedule cutbacks the connections at Riga no longer worked and the transfer

A220 FUEL ECONOMICS

	A220-300 (airBaltic)	A320 NEO (Wizz)	737 MAX 8 (Ryanair)
Trip fuel (tonnes)	4.75	5.31	5.4
Trip (1 hour) cost Euros	2,778	3,105	3,158
Compared to A220	100%	112%	114%
Cost per Seat	19.2	16.7	16.0
Compared to A220	100%	87%	84%
Cost per Pax	25.2	18.0	17.2
Compared to A220	100%	71%	68%

Sources: airBaltic Bond Prospectus, Aviation Strategy

Notes: Current fuel price, \$680/tonne, seat capacities = 145, 186 and 197, load factors= 76%, 93% and 93%

A220 GLOBAL FLEET AND ORDERBOOK

Owners	In Fleet	Firm Orders	Options
Delta	50	45	50
airBaltic	31	19	30
SWISS	30		
Air Canada	24	21	
Egyptair	10		
Korean	10		
JetBlue	6	64	
Airbus	5		
GTLK Leasing	5		
Air Austral	3		
Air Tanzania	2	2	
Ibom Air	2		
Air Manas	1		
Breeze		80	
Air France		60	
ALC		50	25
Macquarie		29	
LCL		20	
Nordic AC		20	
Ilyushin Finance		14	
Unannounced		11	
Air Senegal		8	
Iraqi AL		5	
Air Vanuatu		3	
Falcon AS		2	
TOTAL	179	453	105

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ratio at Riga was halved to 23% of total passengers (which pushed up average yield by 10%). The main cost-cutting response was to reduce the workforce by 40% from 1700 to 1,000, though it seems that many or most of these will be re-employed as the A220 deliveries are continued through 2023.

In May 2020 the Latvian government injected €250m of new equity into airBaltic as an EU-approved emergency measure. But the first half of 2021 was even worse than the same period of 2020 in terms of traffic numbers — passengers down 59%. Although the net loss

was reduced to -€61m from -€185m in the same period of 2020 through cost-cutting, the airline rapidly burnt through the 2020 cash injection, necessitating another €90m agreed by the state shareholder in August this year and also approved by the EU. This brought the state ownership of airBaltic up to 96% and mostly wiped out the 20% stake held by Lars Thuesens, a Danish entrepreneur who jointly invested in airBaltic along with the Latvian state back in 2016.

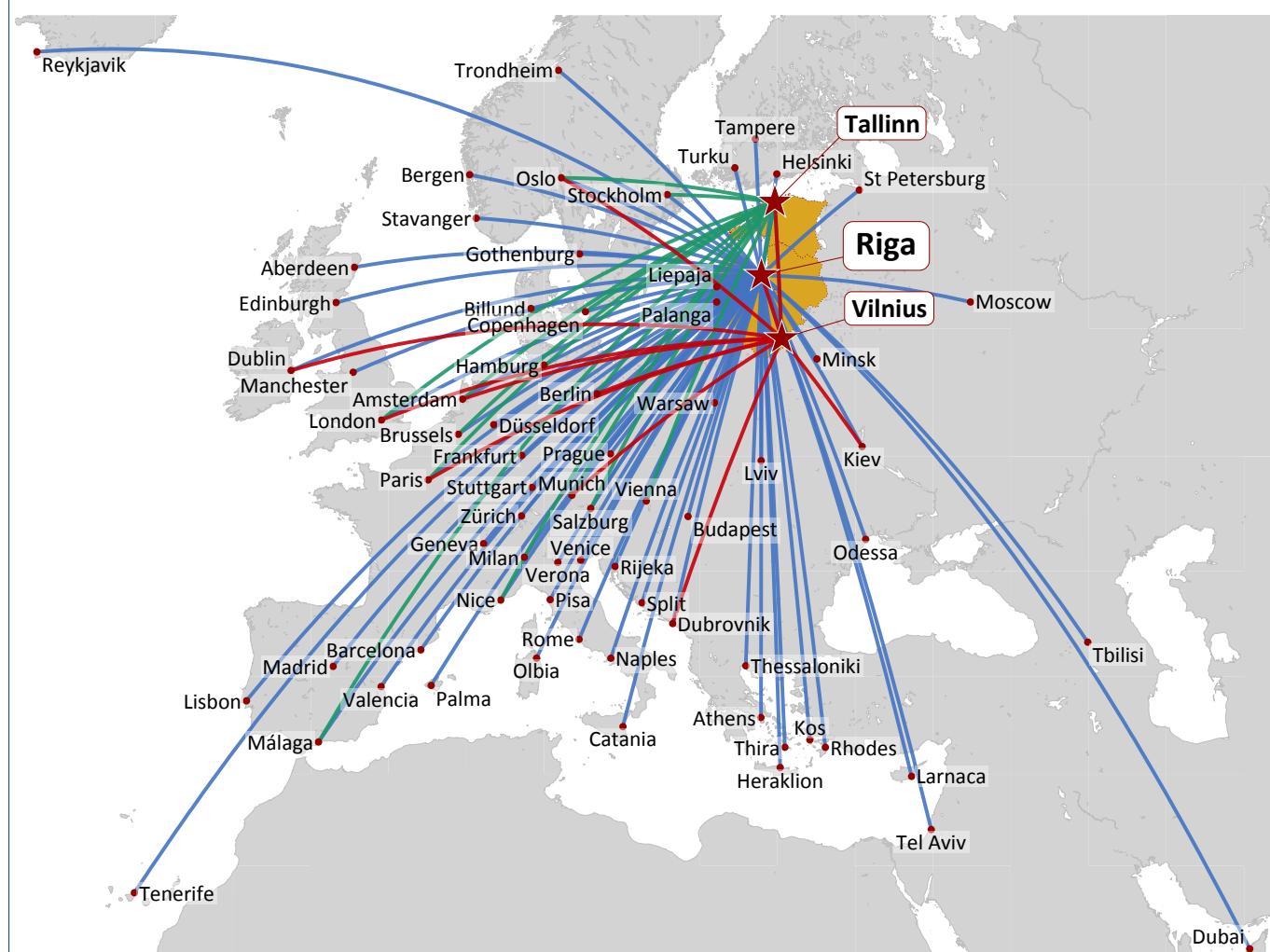
airBaltic's balance sheet as at mid-year showed the carrier to be technically bankrupt with -€44m of shareholders' funds. The cash bal-

ance was €68m which compares to a negative free cashflow of -€33m in the first half of 2021. The €90m injection in August looks like a short-term palliative in this context.

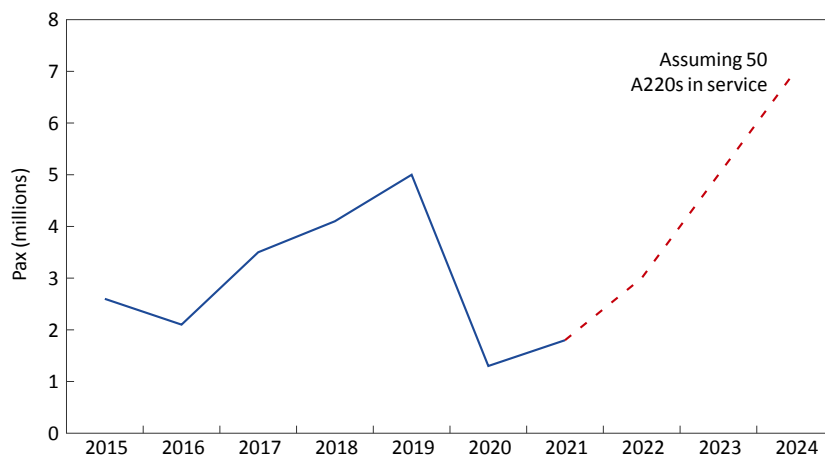
After receiving the latest equity injection airBaltic stated that "the investment is planned to be returned to the Latvian state in form of proceeds from selling shares during a planned IPO." Is an IPO feasible, especially in the short term, 2023 or 2024, as implied by the company and hoped for by the government?

The Destination 2025 CLEAN plan presented by the airline to the Latvian government apparently contained

AIR BALTIC ROUTE MAP



AIRBALTIC: TRAFFIC RECOVERY



detailed projections showing the way to an IPO. Unfortunately, they are not available to outside analysts.

Prior to the pandemic the Latvian government hired two investment banks, Lazards and Greenhill, to try and find an private equity investor for the airline and to operate in partnerships with the state. That failed and the financial numbers continue to be challenging.

Since 2016 the airline has absorbed about €400m of state fund-

ing — we suspect that another cash injection may be necessary next year — and presumably the government is expecting a large portion of this to be returned from the proceeds of any IPO. There is also the €200m bond issued in 2019 and expensively priced at 6.75% pa which falls due in 2024. Meanwhile, the airline by maintaining its aggressive fleet growth plan — 19 additional A220s — will incur over €500m in capex over the next two years. These will be financed through

sale and leasebacks, so the airline is relying on the appetite of the lessors for A220s.

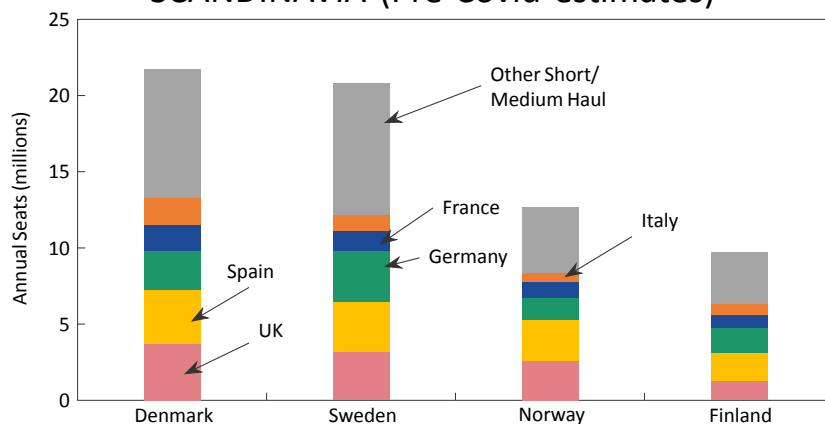
Adding so much new capacity when demand is so depressed and the outlook so uncertain seems like a very risky strategy. The airline simply states that it will lease out spare capacity to other carriers.

Assuming that the airBaltic fleet reaches 50 units by the end of 2023 and the European market rebounds from the Covid-19 depression then airBaltic might be expected to carry around 7.5m passengers in 2024, a 50% increase from the 5m achieved in 2019 — see chart above. Is this feasible?

The chart below shows a high-level estimate of capacity scheduled pre-pandemic from the four Scandinavian countries to other European destinations. This is the main traffic flow from which airBaltic has to try and capture connecting passengers. Very roughly it is (or was pre-pandemic) a market of 52m passengers. If airBaltic restores fully its 2019 traffic base then it would need to capture about 3% of this traffic flow (assuming growth comes mainly from connecting rather than direct services) in order to achieve 7.5m passengers. It is possible.

Overall though, airBaltic seems to be being over-ambitious — or the Latvian government's expectations are unrealistic. The airline has a very good reputation, a truly niche hubbing strategy and a modern fleet of highly efficient aircraft, but it remains a small player in the European scene, vulnerable to LCC competition and with delicate finances. In the post-pandemic European market its future may remain tied to state ownership, as it describes itself, "a strategic facilitator of the Latvian economy".

SHORT/MEDIUM HAUL CAPACITY TO/FROM SCANDINAVIA (Pre-Covid estimates)

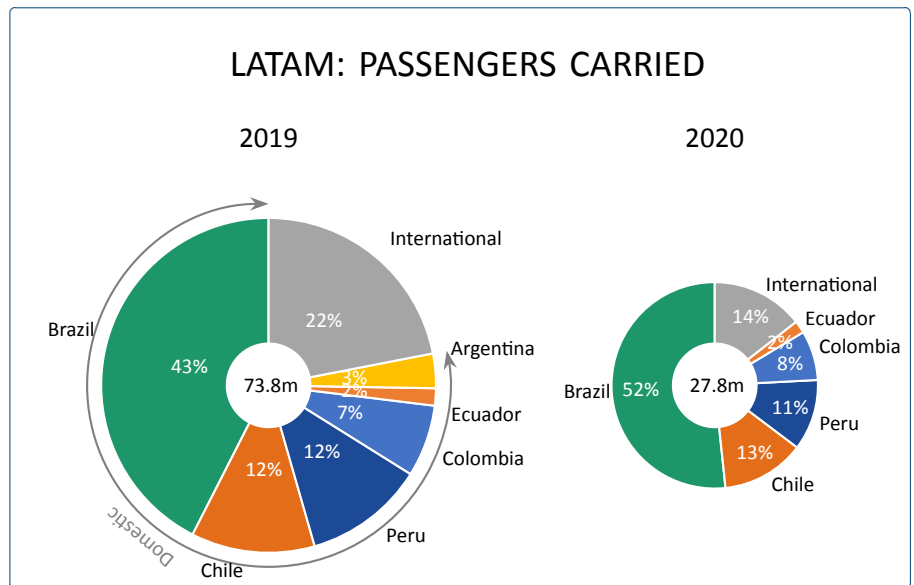


LATAM: The New Reality after Chapter 11

FOLLOWING the merger between Lan Chile and TAM to form South America's leading multinational airline group, LATAM underwent a comprehensive (and profitable) transformation between 2015 and 2019. Balked by Chile's refusal to allow an immunised JV with American and IAG, it left the oneworld alliance after 20 years' membership to hitch up with Delta and form a JV with its new partner (which would hopefully be acceptable to the competition authorities). In the process Delta made a successful public tender for 20% of LATAM's equity in December 2019, making it the largest single shareholder; the Cueto Group, former majority shareholder in Lan Chile, and the Amaro Group, former controllers of TAM, adjusted their various holdings to 16% and 6% respectively (Qatar Airways held on to its 10% stake). It was all looking quite exciting (see *Aviation Strategy* Dec 2019).

What timing!

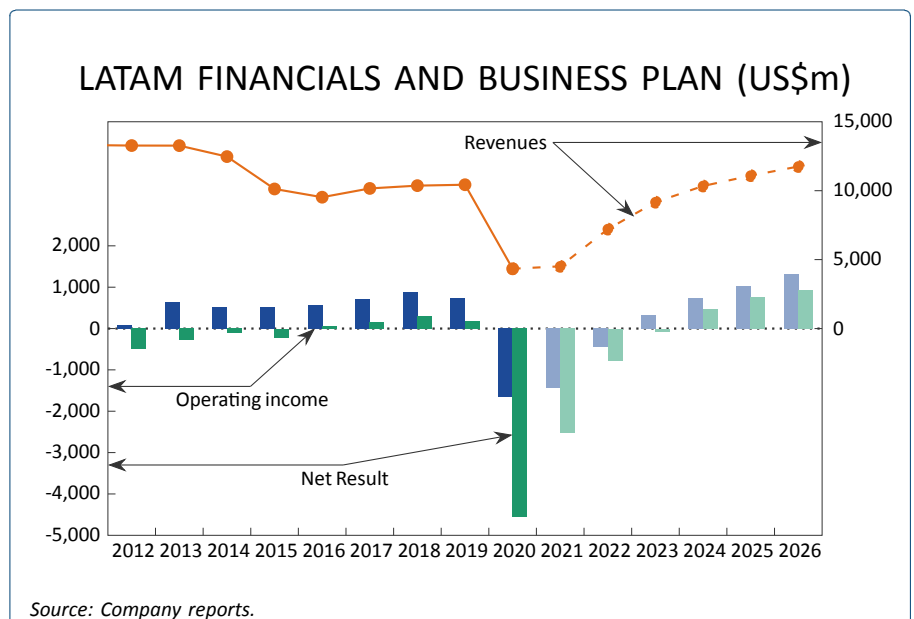
As the pandemic took hold there was not much support forthcoming from any of the seven countries in which LATAM had AOCs (Chile, Brazil, Peru, Colombia, Ecuador, Paraguay and Argentina). Effectively grounded by travel restrictions from mid March 2020 as South America (and Brazil in particular) became the world's epicentre of the Covid pandemic, it was burning cash. At the end of March 2020 LATAM had cash resources of \$1.8bn, 17% of revenues. It's prime priority was to maximise the group's liquidity but it decided to "take advantage of the crisis to transform



LATAM group to a new reality". The group filed for Chapter 11 creditor protection in May in the New York courts.

LATAM tried to act quickly to stem cash haemorrhaging: it cut nearly a third of its workforce — 13,300 jobs went out of a total 41,700 at the beg-

inning of 2020 — and negotiated (or imposed) a 15% across-the-board salary reduction for those remaining. It deferred lease payments, moving some equipment to power-by-the-hour contracts and started "right-sizing" the fleet, planning to remove 43 aircraft from the 342 operated



in 2019. It started outsourcing various parts of operations in Brazil, Peru and Ecuador in order to reduce fixed, and increase variable costs. It ceased domestic operations in Argentina. It paid ticket refunds in vouchers.

LATAM had originally expected that it would be able to recover to 50%-70% of its pre-Covid capacity (in ASK terms) by the end of 2020. Its domestic operations saw a recovery: in Brazil back to 59%, and the Spanish Speaking Countries (SSC) to 46% of 2019 capacity by December. International operations, unsurprisingly, remained severely depressed by the year end still 80% down year on year in capacity terms and with load fac-

tors of only 50%.

For 2020 as a whole passenger demand (in RPK) was down by 66% and passenger revenues by 70%. Total revenues fell by 58% to \$4.3bn, costs by 38%, and operating losses came in at \$(1.7)bn. Implementing big bath accounting, the group wrote off \$2.5bn goodwill and some intangible slot values to produce a net loss of \$(4.5)bn (while also "rejecting" \$2bn of aircraft assets and associated lease liabilities from the balance sheet).

In the first half of 2021, operations continued at a similar rate as in the latter half of 2020. Passenger revenues were down by 77% compared with 2019 (mitigated by a 34% jump in cargo revenues which in the period accounted for 40% of total revenues, compared with 10% in normal times), costs were down by 47% and LATAM reported another operating loss of \$(0.7)bn with a loss of \$(1.2)bn at the net level after charging \$0.5bn restructuring costs for the rejection of aircraft among other things. By the end of June the group's net equity position had fallen to a deficit of \$(3.66)bn.

The management appears to have taken some sardonic pleasure from being able to report that the airline had been ranked the world's most punctual airline in 2021.

At the end of 2020 LATAM received court approval to raise \$2.45bn in two tranches (A- and C-tranches) of debtor-in-possession (DIP) funding (in part supplied by shareholders Qatar and Cueto Gorup) with a third tranche (strangely called the B-tranche) envisaged. By the end of June 2021 it had drawn \$1.65bn of the funds available and had \$1.5bn in cash and equivalents in hand. By the end of July, cash had fallen to \$1.1bn (giving available liquidity of \$1.9bn) and the group started soliciting

interest from potential lenders for the \$750m in B-tranche DIP funding.

Recovery plan

In September LATAM released a five-year business plan — preparatory to presenting its reorganisation plan to the courts in October for creditor approval by mid December. In it the Group forecast a return to 2019 profit levels by 2024 with strong further growth thereafter to achieve an operating margin of 11% by 2026. This would be the highest operating margin since 2010, when Lan Chile (under old accounting rules) achieved 14% and TAM 9% — the average since then has been 5.5%.

In recovering from the pandemic LATAM is fortunate to have strong domestic networks. It had a dominant position in Chile and Peru with market shares in 2019 of 54% and 63% respectively. Brazil is the largest domestic market overall on the continent and LATAM's 38% market share generated 43% of all passengers it transported in 2019. The group also had a meaningful domestic operation in Ecuador (which it shared in roughly equal proportion with Avianca and the now defunct national carrier TAME) and Colombia with a 25% share of the market behind market leader Avianca. In total LATAM's domestic operations accounted for 78% of total passengers transported pre-Covid (and 41% of total group revenues).

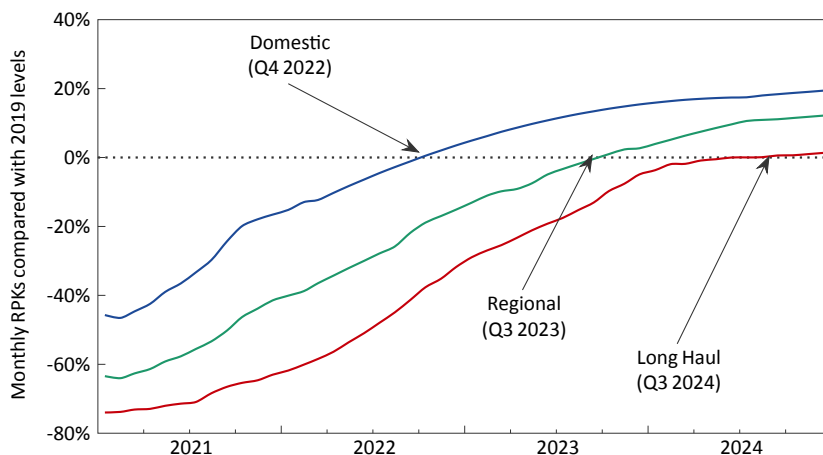
The recovery from the pandemic will be long and difficult, and it is generally assumed that domestic, short-haul VFR and leisure traffic will recover the soonest.

For the seven months to end August this year, LATAM's domestic traffic (in RPK terms) in Brazil have averaged 40% of the levels seen in 2019, and the SSC domestic markets 50%.

LATAM BALANCE SHEET

US\$bn	Jun 2021	Dec 2019
P&E	9.54	12.92
Goodwill		2.21
Intangible assets	1.09	1.45
Other fixed assets	1.30	0.49
Cash etc	1.60	1.57
Stock	0.29	0.35
Drs	0.60	1.24
Other	0.41	0.85
Current Assets	2.91	4.02
ST debt	(5.14)	(1.89)
Crs	(3.07)	(2.22)
Other	(2.78)	(2.85)
Current Liabilities	(10.99)	(6.96)
Net Current Assets	(8.08)	(2.94)
LT & Lease Debt	(5.24)	(8.53)
Crs	(0.67)	(0.62)
Provisions etc	(1.59)	(1.85)
Net Assets	(3.66)	3.13
Represented by:		
Share capital	3.15	3.15
Retained earnings	(5.39)	0.35
Reserves et al	(1.40)	(0.37)
Shareholders' funds	(3.65)	3.13
MI	(0.01)	(0.00)
Net Equity	(3.66)	3.13
Ratios:		
Net debt	8.78	8.84
Net debt/Equity	-240%	283%
Net debt/EBITDA	-16.9x	4.0x

LATAM FORECAST PATH TO RECOVERY



But in August traffic levels in Brazil were only 25% below those two years ago, and in the SSC 30%; and the company projected that in September domestic operations would be 80-90% of the 2019 levels, and even 14% above 2019 levels in Colombia.

International traffic on the other hand averaged only 12% of the levels in 2019, and in August were still 80% down on pre-pandemic levels.

The business plan maps out the company's forecasts of traffic recovery highlighting that domestic traffic is expected to recover to 2019 lev-

els by the fourth quarter of 2022, driven by Brazil and Chile. Regional international traffic, depending on the timing of the removal of travel restrictions, would not do so until the third quarter of 2023. Long haul traffic may not reach pre-Covid levels until the third quarter of 2024 (see chart above). The company mentions that it expects that changes in travel and working habits will lead to a structurally permanent reduction in business travel of around 15% but is hopeful that its joint venture with Delta will be able to offset much of this decline

on routes to the US.

The business plan's capacity projections (shown in the chart below) suggest that total ASKs are unlikely to exceed pre-pandemic levels until 2025, although load factors could rebound to normal levels in the mid-80s by next year.

Fleet reduction and simplification

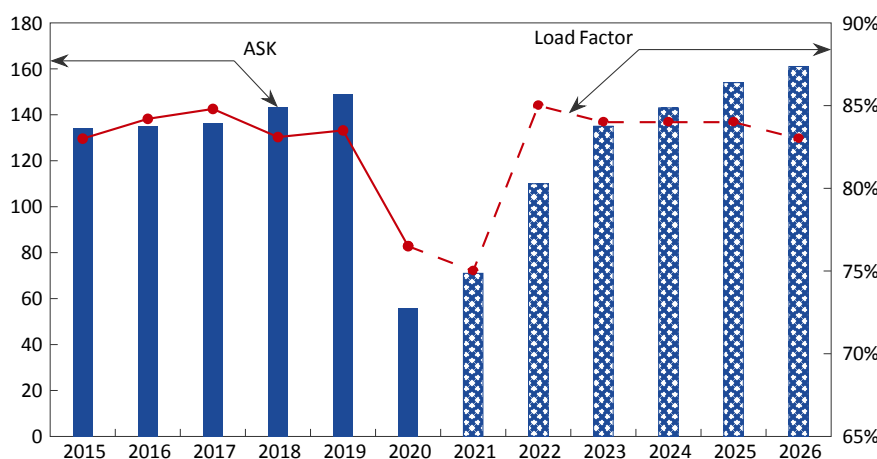
LATAM took the opportunity of the Chapter 11 process to force through a fleet restructuring. It rejected 27 aircraft — which the bankruptcy code allows for leased aircraft that are deemed not to be on market terms — retired 15 of its older narrowbodies and got rid of its 13 A350s to enable it to concentrate widebody Brazil operations round the 787 and 777 which at least has pilot commonality (six of these appear to have ended up at Delta, which was part of the framework agreement signed in 2019).

By 2022 it plans to have reduced the total fleet to 286 units from the 342 it had in 2019 — although the business plan mentions that this number includes six 767 aircraft that are available for sale, or have already been sold, and 10 767s scheduled for cargo conversion.

In the hunt for liquidity it also moved a large portion of its fleet onto power-by-the-hour or interest-only contracts — covering 60% of the narrowbody fleet until 2022 and 50% of the widebody fleet until 2023 — which provides it with significant short term flexibility and is said to provide annual cash flow savings of over 40% compared with 2019.

LATAM renegotiated its outstanding commitments with Boeing and Airbus without penalties. It cancelled orders for four 787s and one 777F although will continue to take two 787s around the end of 2021. The last

LATAM RECOVERY PLANS



Aviation Strategy

two A350 deliveries were cancelled in light of the decision to retire its entire A350 fleet. It postponed its outstanding A320 narrowbody orders for up to three years, eliminating originally planned 2020 and 2021 deliveries, but increased its commitment by 28 units and now has 70 A320neos on order for delivery up to 2028.

In the latter years of the business plan, LATAM is anticipating rebuilding the narrowbody fleet to the size it had pre-pandemic by 2024/25, but the widebody fleet looks set to be a third smaller (see table above).

Compensating for the lack of widebody belly-hold capacity the group is planning nearly to double the number of freighters it operates (no doubt using the 767s earmarked for conversion). The management is eager to point out that its cargo business strategy continues to be “belly-supporting freighter” (in contrast to Avianca’s restructuring plan which seems to hive off cargo into a separate business unit).

To minimise cash drain all air-

craft to be acquired from 2022 will be taken on operating leases, and the company suggests that when it exits Chapter 11 protection its fleet debt will consist of \$2.2bn in finance leases and \$2.3bn in (capitalised) operating leases.

Aggressive cost reductions

LATAM claims that its underlying cost structure was already highly competitive before the onset of the current crisis. Having gone through major restructuring following the merger of Lan Chile and TAM — simplifying its organisational structure to a functional model, getting rid of 13,000 jobs (and 37% of management executives), outsourcing multiple non-core functions — its ex-fuel unit costs of 4.5¢/ASK in 2019 were reasonably on a par with Copa and Azul, 25% below those of Avianca in the region, and nearly half that of the North American majors (see chart on the next page).

But the business plan suggests that the crisis has led the company to extract an additional \$900m from the

cost base through four strategic initiatives:

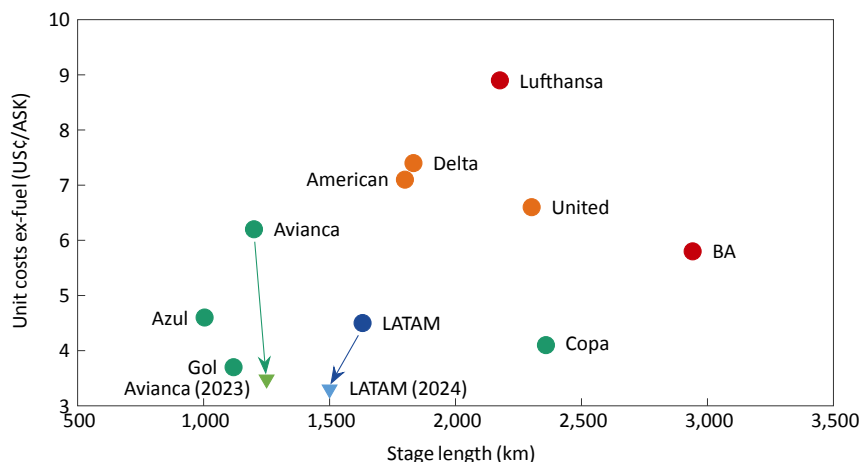
➔ **Simplifying the business.** The largest element of this is the further 33% reduction in manpower since the onset of the pandemic: wage costs in the first half of the current year were running 50% below the levels in 2019 (helped by depreciation of the Chilean peso and Brazilian real), but it states it has also “re-designed benefits for all employees”. The group has also implemented spend Control Towers in all areas of the business. It has accelerated outsourcing of airport operations, particularly in Brazil, Ecuador and Peru, in order to improve efficiency and increase the proportion of variable costs, but also insourced key maintenance work.

➔ **Leveraging digital transformation and IT simplification.** The group accelerated its integration of digitisation to increase direct digital sale penetration and to reduce the number of direct customer contact points. In doing so it reduced the number of city ticket offices,

LATAM FLEET PLAN

		2019	change	2021	2022	2023	2024	2025	2026	
Narrowbody	{	A319	46	-11	35	228	236	246	254	254
		A320	142	-12	130					
		A320neo	13	-1	12					
		A321	49		49					
			250	-24	226					
Widebody	{	A350	13	-13		58	51	53	55	57
		767-300	31	-7	24					
		777-300	10		10					
		787-8	10		10					
		787-9	16	2	18					
			80	-18	62					
		Total passenger fleet	330	-42	288					
	767-300F	12	1	13	16	20	20	20	20	
Total fleet		342	-41	301	302	307	319	329	331	

LATAM: COMPETITIVE COSTS (2019)



removed the requirement to reconfirm domestic flights, introduced automatic check-in (used by 28% of passengers in 2020, the first year of introduction), introduced remote AI powered assistance, biometric boarding checks, and accelerated the roll-out of self-service bag drops.

✈ **Fleet negotiation strategy.** As discussed in the fleet section above LATAM concentrated on revising fleet costs and commitments, rejecting aircraft to reflect the new demand reality, achieving reduction in fleet cash costs, reducing cash outflows through negotiated interest only periods. It is also increasing cabin density.

✈ **Other supplier negotiations.** Under this heading the management highlight attention on rejecting non-competitive contracts, improving fleet utilisation and increasing crew productivity.

The net effect of these measures, according to the business plan, could result in a possible 25% reduction in ex-fuel unit costs to 3.3¢/ASK by 2024. It would also increase the proportion of variable costs to 80% of total costs while the PBH and interest-only contracts continue into 2023 —

thereafter falling to 72% in the latter years of the forecast (in 2019 variable costs accounted for 65% of total costs).

Not that this necessarily means that LATAM would improve its comparative competitive positioning. Avianca, in its own business plan in preparation for exiting Chapter 11, is forecasting a reduction in ex-fuel unit costs of nearly 45% to 3.48¢ by 2023 (from 6.2¢/ASK in 2019). But in their case this excludes cargo operations and its frequent flyer program among other things which it plans to hive off into separate business units (as it will do with its long haul operations).

FFP

It is perhaps relevant that LATAM in its business plan presentation emphasises the need to keep the frequent flyer programme embedded within the airline.

In 2019 the group bought out the 27% minority shareholders in TAM's Multiplus programme, which had gone through an IPO in 2010, reintegrated it within LATAM Brasil, and consolidated the FFP operations under a single brand — LATAM Pass — to make it what claims to be the

fourth largest FFP in the world in terms of members.

The management seem keen to point out that LATAM Pass is not a separate legal entity: the airlines own the FFP liability, which increases when a mile is pre-sold or sold and reduced when redeemed or expired, neither of which represent a cash transaction. (Cash transactions only take place when miles are sold to third parties or non-flight rewards redeemed).

Keeping the programme embedded within the airlines allows the group more easily to enhance revenue management, optimising revenues by balancing revenue and reward tickets; prevents the accumulation of cash within the FFP; and, avoids additional intercompany transactions (with potential tax implications).

Chapter 11 Exit in December?

LATAM now plans to present its reorganisation plan to the court by 15 October, soliciting creditors' and claimholders' approval by the middle of December. As part of preliminary discussions the group came up with a proposed new capital structure that would include \$5bn in equity financing.

When it made the five year business plan public in September, the company announced that in response to requests for proposals it has received "certain non-binding exit financing proposals from its most significant claimholders and its majority shareholders... Each contemplates raising in excess of \$5bn through the issuance of new debt and equity in LATAM... which would be backstopped (underwritten?) by the parties making the proposal". It's an interesting choice of wording, and the company didn't

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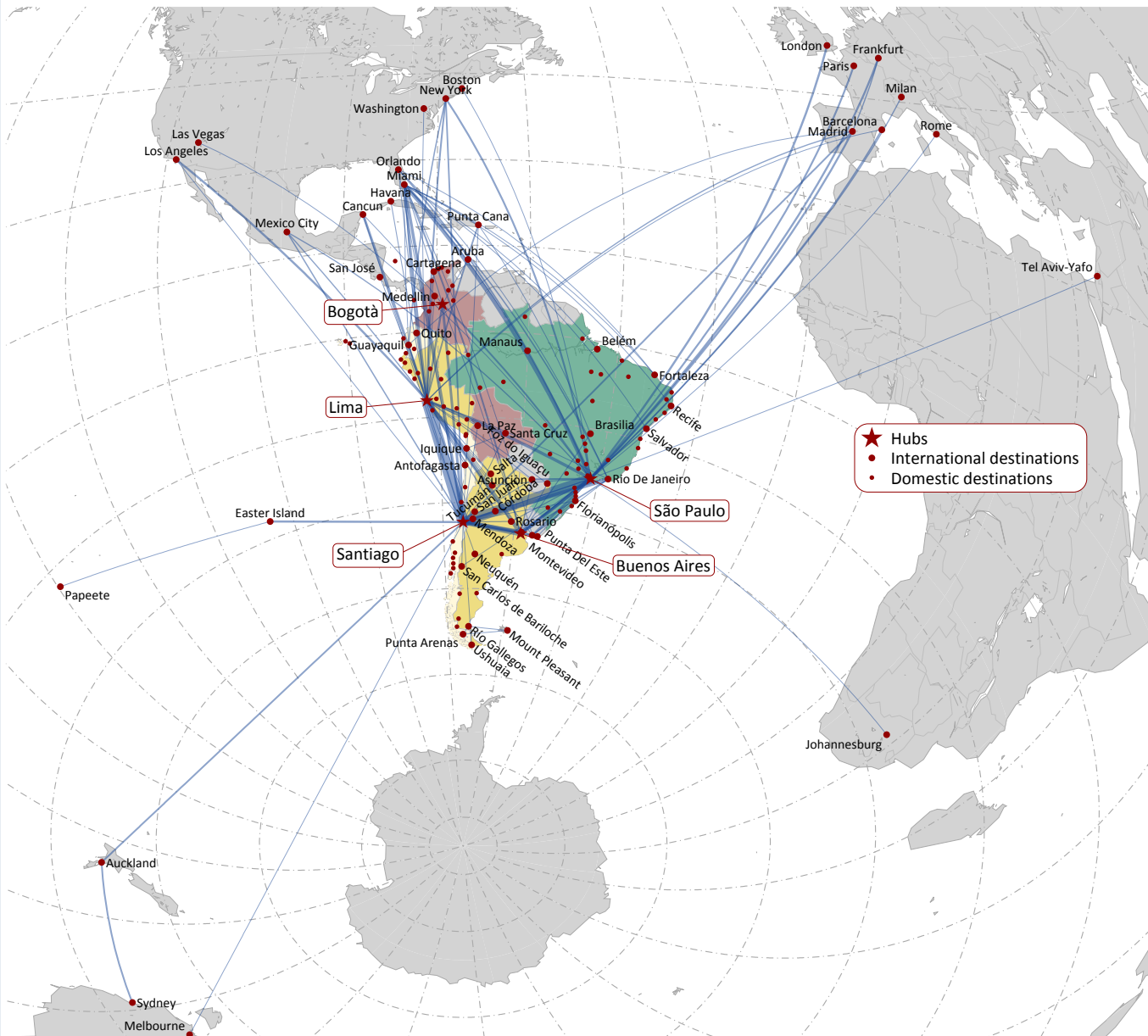
enlighten further, but it must be nice to have a choice of exit options.

Roberto Alvo, Group CEO, is quoted as saying: "Despite the dramatic crisis we have faced, we have taken full advantage of our restructuring, not only by becoming substantially more efficient, but also by cementing a better value proposition for customers, all of

which has been reaffirmed by the significant interest we have received in providing exit financing. We will emerge from this process as a highly competitive and sustainable group of airlines, with a very efficient cost structure, all the while maintaining the unparalleled network and connectivity that LATAM offers in all the markets it serves.”

When LATAM emerges from Chapter 11, existing shareholders will be diluted into insignificance. The new shareholding structure will be interesting. It will no doubt include the Cueto and Amaro groups. It will probably include Qatar. It may also include Delta, despite the apparent restrictions imposed by the US CARES Act.

LATAM (PRE-COVID) ROUTE MAP



Widebodies: Park, Store, Scrap, Return to Service?

THERE are always some aircraft in the world's commercial fleet that are parked, in storage, or otherwise just not in service. They may be on their way to a new operator, getting ready for conversion from passenger to freight, heading for a retirement home, destined for the knackers yard, or just being used for spares. Even in good times this can be around 5% of the available fleet, as it was at the end of 2019.

In each of the past few cyclical downturns, the aircraft boneyards in such as the Mojave desert, Teruel or Alice Springs, have been a temporary solution for commercial airlines to cope with the sudden loss of demand; and the proportion of aircraft in storage has historically risen to over 15% of the total commercial fleet. Industry observers have dusted off their analysis from the previous downturn to point out that a good majority of the parked aircraft will not return to service: the downturn acts as a cata-

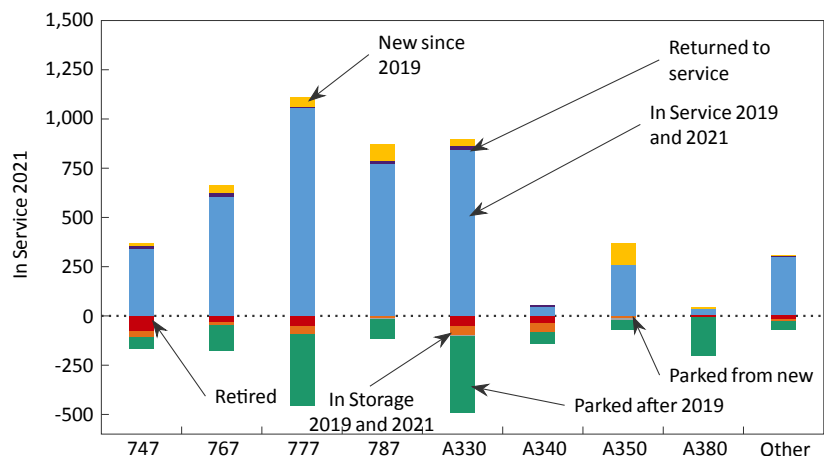
lyst to retire aircraft that had already been worked past retirement age.

Is the current crisis different? Eighteen months after the start of the pandemic, 26% of the world's commercial fleet remains parked. There has been some recovery in short haul operations, but long haul flights remain severely constrained, and may

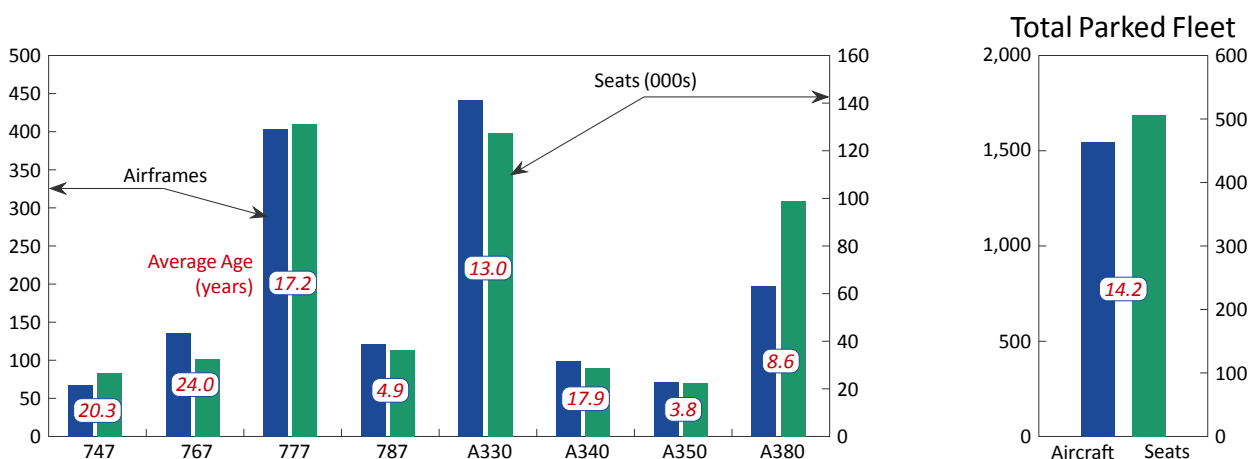
well not recover to pre-pandemic levels before 2024/25. Nearly a third of the world's commercial passenger widebody fleet is in storage.

In this analysis we look at the widebody fleet as a surrogate for long haul — but it's worth noting that not all widebodies are used on long haul routes and not all long haul routes are

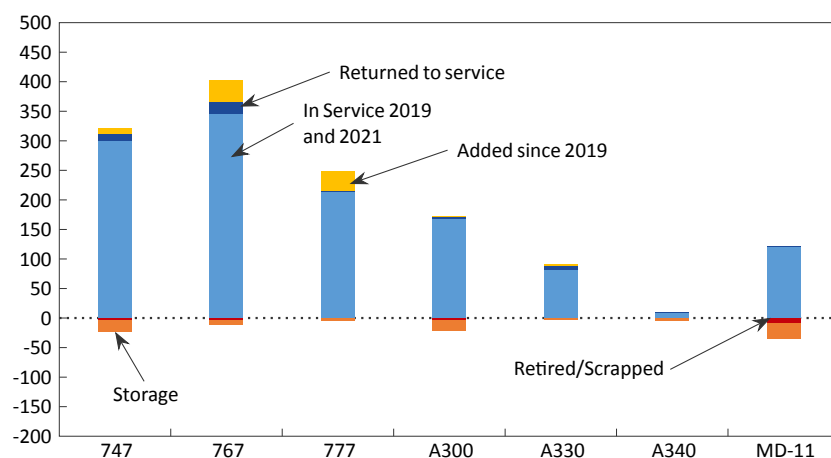
WIDEBODY FLEET DEVELOPMENT 2019-21



PARKED PASSENGER WIDEBODY AIRCRAFT, SEATS AND AGES



WIDEBODY FREIGHTER FLEET 2019-2021



Excludes one 787 and two A350 converted freighters in service

served by widebodies.

Widebody aircraft are seen to play an important part of the industry providing 45% of the total capacity in ASK terms. But in terms of the number of seats flown they accounted pre-pandemic for only 17% of the total.

Equally long-haul is a small part of the total airline business — only 10% seats flown were on routes longer than 4,000km. In the decade leading up to 2019, the total number of long haul seats flown grew at a compound average rate of 6% pa while

widebody seats flown increased at a slightly slower average of 4% pa.

In 2019 the commercial widebody fleet numbered 6,220 units, 5,811 in service and 409 in storage. Since then, some 271 widebodies have been retired or scrapped (half of which had been in storage in 2019), 1,412 put into storage around 90 returned to service from storage, and 344 new aircraft have been delivered. In 2021 the fleet comprises 6,310 units of which 4,677 are in service and 1,633 stored.

1,455 widebodies, a quarter of

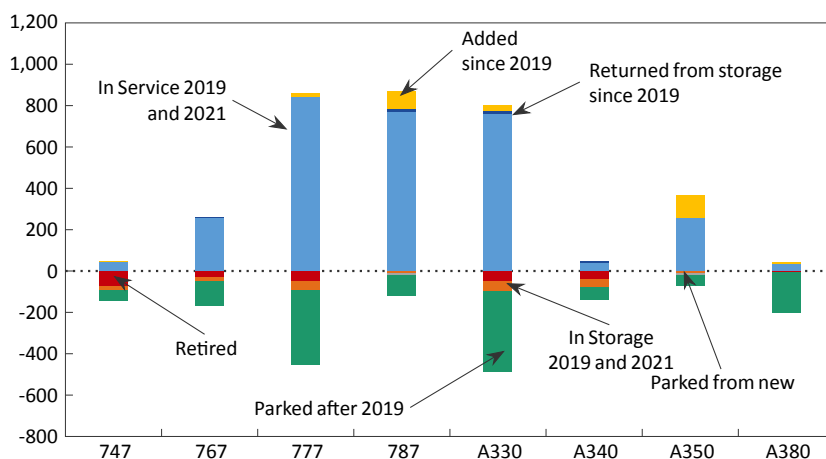
the 6,310 commercial widebody fleet, are configured for cargo operations. The comprehensive grounding of long haul passenger services during the pandemic removed half the capacity from the cargo business (flown in the belly-holds of passenger aircraft), markedly pushing up demand for freighters. Some 130 freighters have been added to the active fleet since 2019, 87 new or newly converted (including one 787 and two A350s) and 40 that had been previously parked. The 84 freighters in storage mostly consist of equipment over 30 years old.

The passenger fleet of widebodies has seen some significant movement in the past two years. Some 260 new aircraft entered the fleet — in descending order of relevance A350s, 787s, A330s and the last of the A380s. About the same number of aircraft were retired or scrapped — 747s (averaging 24 years old), 777s (19 years), A330s (20 years), A340s (19 years), 767s (27 years), and even a handful of youthful A380s (13 years old). 43 aircraft re-entered service from storage (mainly 787s and A330s), while nearly 1,350 were newly placed into storage — including 17 airframes that had been delivered new over the period.

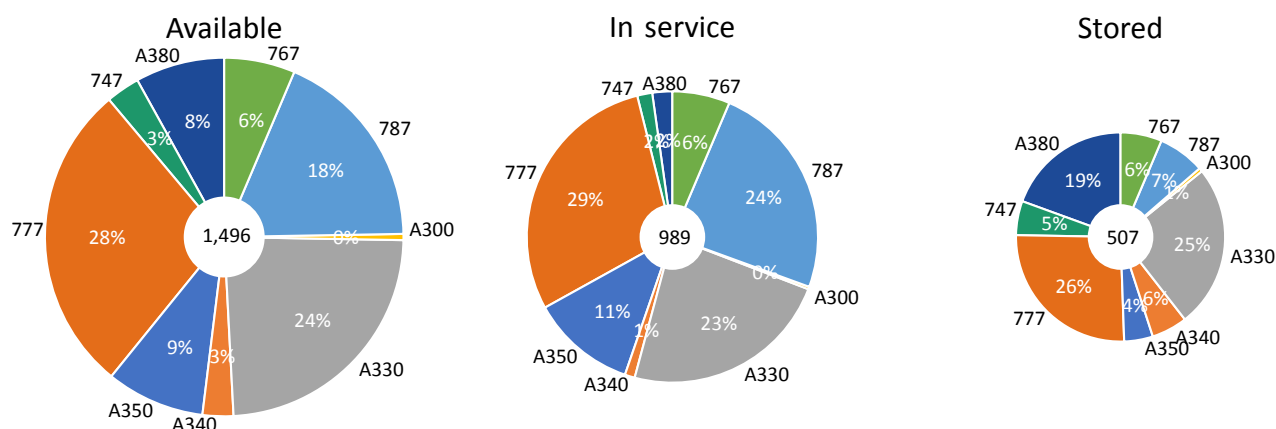
The aircraft types put into the deserts reflect the immediate need to remove equipment with high seat capacity and high trip costs. A380s (with an average 500 seats) and 747s (400 seats) account for 19% and 5% of the total seats in storage (see pie charts on the facing page), twice their respective weighting in the total fleet. But so do the A340s (277 seats), accounting for another 6% of stored seats, burdened also by being unfashionably four-engined.

Many of these will probably not return to service.

PASSENGER WIDEBODY DEVELOPMENT 2019-2021



PASSENGER WIDEBODIES: TYPES BY TOTAL SEATS ('000s)



Half the fleet of A380s is operated by Emirates, and it suggested last year that it would permanently decommission 40% of its fleet, expecting to be at least 20% smaller when the industry recovers. Air France had already in 2019 taken the decision to get rid of its eight aircraft of the type. Lufthansa is using the excuse of the crisis to accelerate the simplification of its fleet from 13 types to nine: intimating that it will remove all its A380s, 747-400s and A340s — concentrating on the more efficient 747-8i and 777-300ER. SIA a year ago suggested that seven of its 19 A380s would not return to service.

Qantas, meanwhile has said that its fleet of 12 A380s will probably fly again in its colours “once a recovery in international markets is sufficiently advanced”: the type is particularly suited to its operations to the US West Coast because of curfews and time differences. Likewise British Airways, with severe slot constraints at its home base at Heathrow has a good need for its 12 A380s — and has recently started bringing some back into service — while it has retired its

entire 747-400 fleet.

Some of the other operators of the A380 probably regret that they ever acquired the type. Unfortunately, there was no second-hand market even before the pandemic, freighter conversion is fraught with difficulties — HiFly, the only carrier to have acquired a second-hand A380, originally announced in 2020 plans to convert it, then abruptly withdrew the jet from service completely.

Another older type unlikely to re-enter passenger service is the 767 — those that are parked average 24 years in age. As with the 747-400, they happily enjoy their later years as freighters and some airlines, such as LATAM, have already progressed plans to for cargo conversions.

Assuming that passenger long haul does not return to 2019 levels until 2024, the long haul market in that year will be 25% smaller than planned for pre-pandemic. Approximately 740 units are scheduled for delivery from now to the end of 2024. Either the delivery rate is slowed, which is probable, or up to 1,100 units currently in storage will have

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