AIRLINE weekly®
NOW PART OF Skift
INDEPENDENT WORLDWIDE COVERAGE

November 12, 2018
Issue No. 695

Earnings

Net result in USD; operating margin

July-September 2018 (3 months)	
Turkish Airlines:	$714m; 23%
Thai Airways:	-$112m; -8%
Garuda:	$4m; 3%
Asiana:	$43m/$30m*; 5%
China Airlines:	$40m; 4%
Philippine Airlines:	-$46m; -8%
Cebu Pacific:	-$10m/$-14m*; -4%
Jeju Air:	$28m; 11%
Azul:	$30m; 7%
Interjet:	-$52m; -16%
Wizz Air:	$282m; 30%
Jazeera:	$23m; 29%

*net result excluding special items

I.A.G. (It's All Good)

Siblings British Airways, Iberia, Vueling, Aer Lingus and Level make their parent proud

In a deep-dive look last month, *Airline Weekly* explained the magic of Aer Lingus, an Irish carrier bringing smiles to its parent company IAG. But Aer Lingus is far from the only thing going right at Europe's most successful intercontinental airline group. On the contrary, IAG's success cuts across its multiple airlines.

In its own deep-dive discussion earlier this month, the group regaled investors with explanations of what's gone right and descriptions of what's to come. In the peak third quarter, remember, IAG's net profits excluding special items topped $1.3b, accompanied by a 20% operating margin. That brought its operating margin for the 12 months to September to 13%, precisely the same figure achieved by Delta, America's most profitable intercontinental airline. Indeed, IAG has established itself as the Delta among Europe's Big Three, consistently outperforming its rivals and always among the most profitable carriers anywhere in the world—Delta and IAG are the only two legacy airline companies among the world's top 10 airlines ranked by operating margin for each carrier's most recent 12 months reported.

But IAG's path to prosperity is perhaps lesser known than Delta's. For Delta, the rise was from rock bottom—bankruptcy, in fact, which preceded a monumental merger with Northwest and the formation of industry-leading joint ventures. Even in its darkest days, it possessed two key structural advantages, one in the realm of real estate (Atlanta is the world's busiest airport) and one in the realm of labor relations (only its pilots were unionized).

IAG never did fall so low—none of the group's current airlines ever went bankrupt. But other elements of its rise to greatness are ones Delta would recognize. Not long after the Delta-Northwest merger, British Airways and Iberia decided they too would merge, creating IAG. The new entity would go on to buy Vueling and Aer Lingus. IAG would similarly if not so aggressively form joint ventures, in its case with Delta's rival American most importantly, but also Japan Airlines, Finnair and Qatar Airways. Just as Delta dominates the world's busiest airport, IAG is top dog in the world's busiest airline market, London. And although heavily unionized, IAG's airlines all possess significant labor cost advantages relative to Lufthansa and Air France/KLM, many born from battles that involved major

CONTINUED ON p. 7

Pushing Back: Inside This Issue

Another European airline, gone. Or at least subsumed by a rival. That's the fate of Wow Air, bought by its next-door neighbor Icelandair. The takeover comes amid struggles by most of the major Nordic-based carriers trying to earn a living in the transatlantic market. Never mind that this market is red hot for the Big Three airlines on both sides of the ocean. The reality is, they have strong exposure to premium demand. Carriers like Icelandair and especially Wow Air do not.

Do not assume, then, that IAG's premium-deprived Level will thrive to the same degree as Aer Lingus. There are signs, in fact, that Level is struggling, a key one being its decision to retreat from Los Angeles and Punta Cana.

No retreats for Turkish Airlines. Those days are done, with inbound tourism booming again. But the Turkish lira crisis? No worries: The airline collects most of its money in dollars and euros.

Azul isn't so lucky. But forex frustrations notwithstanding, the Brazilian carrier reported solid Q3 results thanks to recovering business traffic, a transition to A320-NEOs and contributions from loyalty and cargo.

Cargo strength kept things decent if not great at Korea's Asiana and Taiwan's China Airlines. Trends are worse in the Philippines and even worse still in Mexico, where Interjet looks like an airline not too long for this world. Maybe someone will buy it, like Icelandair bought Wow.

Nobody's buying Wizz Air, which wowed the world with another strong summer, albeit one tainted by air traffic woes and some setbacks of its own making.

Making earnings news this week: Singapore Airlines, for one.❍

" Verbulence

We're not putting capacity in there because we think there's an opportunity to grow. We're putting capacity in there because we think there's an opportunity to grow profitably.

—IAG CEO Willie Walsh "

For many airlines, this is the 10th anniversary of their darkest days, which coincided with the global financial crisis. For **Turkish Airlines**, days were darkest just two years ago, when civil unrest and security fears kept tourists away. After a high of 36m foreign arrivals in 2015, the number plummeted to just 25m the following year. Ultimately, losses in 2016 weren't terrible—operating margin that year was negative 4%. But they were still bad enough to compel the airline to sharply cut labor costs and reduce its 2017 capacity growth (in ASK terms) to just 2%—this was an airline that grew 21% as late as 2013. By late 2016, happily, tourists began coming back, so much so that by 2018, airlines that had shifted capacity away from Turkey (i.e., **Thomas Cook**) were shifting back. In the 12 months to September, tourist arrivals reached a new record 38m, helped, not hindered, by a currency crisis. Naturally, the severe depreciation of the Turkish lira this year hurt the ability of Turkish Airlines to grow outbound business and leisure traffic. But that's not where it makes its money. In fact, only 13% of its revenue comes in Turkish lira, compared to 57% in U.S. dollars or closely-linked currencies (like the Hong Kong dollar and U.A.E. dirham). Another 28% comes in euros. At the same time, 57% of its costs come in U.S. dollars, making it perfectly balanced in this regard, unlike so many emerging-market airlines with heavy dollar costs but little dollar revenue. And with 26% of costs in lira, Turkish is effectively incurring lots of weak-currency expenses at home while earning lots of strong-currency revenues abroad. So with forex not a big concern, with tourism strong again, with rivals **Air Berlin** deceased and with capacity constrained, Turkish last quarter earned a $714m net profit and an excellent 23% operating margin. It wasn't immune to higher fuel prices, which lifted its fuel bill 30% y/y. But labor costs were *down* 6% (most of its workers are paid in depressed lira). Total operating costs rose 12% on just 1% more ASK capacity, while revenues almost kept pace with a 9% increase. To summarize, it was a second straight summer of success for Turkish, which can now feel comfortable that those difficult days of 2016 are well behind. It can instead turn its attention to Istanbul's new airport, which officially opened at the end of last month but with a handful of Turkish Airlines short-haul flights. The real migration will occur late next month, alleviating severe congestion experienced at the old airport. This means Turkish can renew its ambitious global expansion, underpinned by a sixth-freedom strategy with geographically-blessed Istanbul at the center. Like **Emirates** in Dubai, Turkish has become an everywhere-to-everywhere carrier, with heightened economies of scope every time it adds a new destination. This year alone, Turkish has added Freetown, Samarkand, Krasnodar and Moroni. Lusaka opens next month, part of a big African push, followed shortly thereafter by Marrakech, Port Sudan, Linz and Sharjah. And on its wish list: Newark, Mexico City, Cancún, Bali, Luanda, Nantes and another four cities in Russia, a big source of inbound tourism. If some of these are not exactly household city names, their obscurity simply speaks to how deep and broad the Turkish network has become—no other airline in the world flies to as many places. Importantly, though, more than half of its international passengers are on European flights, many of them tourists flying during the summer—for all its sixth-freedom prowess, Turkish remains a highly seasonal airline dependent on outsized peak third quarter profits, almost as much as European LCCs. Taking a closer look at Q3 results, unit revenues rose in all geographies except the domestic market. **Sun Express**, a 50-50 JV with **Lufthansa**, earned a 21% Q3 *net* margin, aided by contracts to handle some **Eurowings** long-haul flying. It also operates planes for the Turkish Airlines LCC subsidiary **Anadolujet**, whose ASK capacity year to date is up 14% y/y (Anadolujet now has roughly 40 planes in total, mostly based in Ankara and Istanbul's Sabiha Gökçen airport, where it makes like difficult for rival **Pegasus**). Cargo is an increasing contributor to Turkish Airlines, with revenues up nearly 30% year to date and accounting for 12% of total company revenues. The airline is now raising wages again and facing more competition as foreign carriers return to the market. For all of 2018, ASK growth should be about 5% to 6%. Growth will accelerate as more B737-MAX 8s and A321-NEOs arrive. Next year, it will start taking MAX 9s, and more interestingly B787-9s. In 2020, its first A350-900s will arrive. These planes will create even more longhaul opportunities, which the new airport—unlike the old airport—can accommodate.

Tourism is at least as important to Thailand as it is to Turkey. And for **Thai Airways**, healthy inbound visitor flows are a necessary if not entirely sufficient condition for its success. How was tourism last quarter? Q3 is off peak, keep in mind, but y/y growth in foreign arrivals slowed to 3%, mostly due to a decline from China after a boat accident in Phuket killed scores of Chinese tourists. The Hong Kong and Japanese markets were themselves disrupted by typhoons. Year-to-date, though, total arrivals are up a still-healthy 9%. It's in this context that Thai Airways dropped to a $112m Q3 net loss and a negative 8% operating margin. While not uncommon to see losses during the off-peak period, losses aren't typically this severe. Last year Thai managed a small Q3 profit, with operating costs 11% lower—blame fuel for this year's rise. Revenues this year, meanwhile, rose just 2% on 2% more ASK capacity. Thailand's shorthaul market is intensely competitive, with **AirAsia**, **Bangkok Airways**, **Thai Lion** and **Thai VietJet** also in the mix. And don't forget about **Nok Air**, which Thai partly owns, and **Thai Smile**, which Thai fully owns. Nobody's smiling about Rolls-Royce engine issues, new domestic fuel taxes and sanctions on Thailand's safety standards, which were only recently lifted by ICAO (and perhaps soon lifted by the FAA when it conducts an audit in January). But the Chinese market still holds great long-term potential, as does a new maintenance venture with Airbus near Pattaya. If given FAA clearance, Thai might revive nonstops to the U.S. In the meantime, it's reviewing fleet plans, codesharing with **Bangkok Airways**, selling non-core assets and taking steps to improve areas of commercial management, including pricing and distribution. It's also working with other local stakeholders to boost tourism to secondary locations within Thailand. In 2021, Bangkok's congested main airport (Suvarnabhumi), where Thai operates its hub, will get a new terminal.

Thai's ASEAN rival **Garuda**, in even worse shape, nevertheless eked out a $4m net profit and a 3% operating margin in the third quarter. But that still doesn't make up for much steeper losses in this year's first and second quarters. Q3 revenues actually declined slightly y/y despite 1% capacity growth. Operating costs rose 6% on a 28% jump in fuel outlays. Natural disasters at home in Indonesia but also Hong Kong and Japan affected the results negatively. So did rupiah deprecation. The B737-MAX crash at rival **Lion Air**, meanwhile, further tarnishes the country's reputation for aviation safely, whether or not that's fair. Garuda, to be clear, is a shrinking airline if you just consider mainline operations. Only with 14% ASK growth at its LCC **Citilink** did the group show any expansion at all. As mainline welcomed its first B737-MAX 8, Citilink is already flying eight A320-NEOs. But Citilink too is losing money this year, with a negative 9% operating margin for the nine months to September. Other subsidiaries, led by maintenance, are doing better. Garuda is now trying develop a cargo and logistics business too.

If South Korea seems a bit nervous about its economic prospects, ascribe that to growing global trade tensions (the country is a major exporter) and two threats from China: 1) its slowing economy and 2) the increasing competitiveness of Chinese manufacturers pressuring Korean conglomerates. South Korea's airlines, however, are unnerved by something entirely different: this summer's rapid escalation in fuel prices. For **Asiana**, the country's No. 2 airline, a 41% y/y surge in Q3 fuel outlays was the chief reason its operating margin fell to 5% from 7% in the same peak period last year. Two summers ago, it managed an uncharacteristic 10% operating margin. Too bad about fuel, because revenue conditions, despite the threats from trade and China, were exceedingly strong. Q3 revenues, in fact, rose 14%, almost keeping pace with a 16% increase in total operating costs. Capacity in ASK terms was up just 3% for Asiana's mainline business, but it rose by double-digits at its LCCs **Air Busan** and **Air Seoul**—Air Seoul, Asiana said, was profitable; it didn't comment on the profitability of Air Busan. Critical to Asiana's revenue strength was the cargo sector, which is still booming for now. Cargo, for which revenues grew 13%, accounts for a full 23% of Asiana's total revenues. But even more importantly, international passenger demand also rose 13%, driving 11% revenue growth in the key transpacific market to North America. With outbound tourism to Europe booming, revenues there rose 19%. Revenues on China routes likewise rose 19% as inbound tourism continues to recover from a political dispute that began in early 2017. Revenue from the ASEAN region, a popular spot for Korean tourists, rose 5%. But it fell 2% on routes to Japan, where low-cost competition is rife and Asiana is outsourcing some flying to Air Seoul. Domestic revenues were flat. Asiana is making good use of its new A350-900s. Soon it will get A321-NEOs. And with global premium demand robust, heavy spending on premium amenities looks "smartium" (that's the rather awkward name for its cabins, i.e., "business smartium" and "economy smartium.") Asiana now wants to push more of its shorthaul flying to its low-cost units, focusing growth on intercontinental routes. But it has zero joint venture partners at a time when its already-more-profitable rival **Korean Air** is tightening ties to **Delta**. Chinese carriers, meanwhile, are growing intercontinentally and attracting more connecting traffic through their hubs, putting Seoul's hub status at risk. It's this that should make Asiana nervous, as it works to clean up its balance sheet by selling non-core businesses and assets, including most recently its headquarters building.

Asiana's independent low-cost rival **Jeju Air**, based in its namesake island in Korea's far south, disclosed a $28m Q3 net profit and a solid 11% operating margin. Its 31% y/y increase in revenues nearly kept up with its aggressive 30% increase in ASK capacity. Fuel inflation, unfortunately, led to a 38% increase in total operating costs. A big part of Jeju's business model is ancillary selling, which yielded 29% revenue growth. Recovery in Chinese traffic provided a major boost, as did strong demand on Japan routes. Jeju's busiest airport is Seoul Incheon, where it's adding lots of new routes. It's also expanding to the ASEAN region and even Guam and Saipan. Earlier this month, it announced a contract with PROS to improve its revenue management. And reports suggest it could be on the verge of a big aircraft order, mostly likely for NEOs or MAXs. It currently flies 38 planes, according to ch-aviation, all B737-800s.

Taiwan's **China Airlines**, another East Asian carrier plagued by low-cost competition, is nevertheless benefiting—just like **Asiana**—from heavy exposure to the currently-strong cargo market. Led by shipments of goods like semiconductors to the booming U.S. economy, CAL saw its Q3 cargo revenues rise 18% y/y—cargo now accounts for 31% of total revenues, significantly more than at its archrival **EVA Air** (which hasn't yet reported for Q3). CAL's passenger revenues, meanwhile, increased a more modest 5% on 4% more ASK capacity. Total revenue grew 11%, not enough to neutralize a fuel-induced 18% jump in total operating costs. That left CAL with just a $40m net profit and a 4% operating margin, a weak showing for the busy summer season. Apparently, transpacific routes to North America aren't doing all that well, judging from recent capacity cuts, even to the big Los Angeles market. U.S. capacity is down even despite new flights to Ontario just outside L.A. One threat stems from Japan's Big Two carriers, which are courting sixth-freedom North America-ASEAN traffic that might otherwise connect through Taipei. Inbound tourism overall is healthy, especially from Japan, South Korea and Hong Kong (no airline market in the world has more scheduled flights than Hong Kong-Taipei). But arrivals from mainland China are still depressed due to political tensions. New airlines are showing up in Taipei, some friendly (SkyTeam partner **Air France**) and some hostile (**Air New Zealand**). CAL itself is adding A350s, making use of its new Amadeus res system and sending its LCC **Tigerair Taiwan** on charter missions to tourist markets like Japan. Competitive headwinds will intensify, however, as an ambitious new airline called **StarLux** prepares to enter the scene.

Just south of Taiwan, **Philippine Airlines** did something that no other major airline anywhere in the world has accomplished so far: report an *improvement* in Q3 operating margin. But before you pop the champagne, consider a less flattering fact: Its margin was still negative 8%, third worst among any airline that has reported. Net loss was $46m. In fairness, PAL tends to peak in winter quarters, when tourists from South Korea and elsewhere visit its beaches. But make no mistake: This is an airline that's not doing well, having lost money last year. Scheduled ASKs in the quarter grew just 3% y/y (Diio Mi). Despite the tepid growth, PAL managed to boost revenues 22% in peso terms, aided by forex movements. Operating costs, satisfyingly, rose just 21%. As discussed in *Airline Weekly*'s Oct. 15 cover story, Phil is indeed still ill, suffering from too few partners, too much LCC exposure, legacy costs, Manila airport congestion and overexposure to yield-sensitive migrant traffic. Transpacific routes tend to be its biggest money-makers, helped by B777-300ERs and most recently A350-900s—Chicago or Seattle could be next. It's also eyeing more European routes.

A big reason of **PAL**'s troubles: **Cebu Pacific**, at times among the most profitable airlines in the world. Profits were down sharply in the first half of this year though, and the off-peak third quarter turned red. More specifically, Cebu reported a $14m Q3 net loss and a negative 3% operating margin. In last year's Q3, it earned positive 4%, which followed positive 9% the year before that. Revenues this time rose 10% y/y on 3% more ASK capacity, but operating costs spiked 19% on a 28% elevation in fuel outlays. Cebu is no less frustrated by Manila's airport shortcomings than PAL. It also faced the temporary closure of Boracay to tourists. And its A330 markets to the Middle East soured badly after the oil bust of 2014. It more recently launched A330 flights to Melbourne, while expanding shorthaul flying from Clark airport north of Manila. Soon, it will add A320/21-NEOs, enabling it to generate more revenue from each of its limited Manila slots.

Turning to Europe, the rising star **Wizz Air** wasn't immune to the two toxic forces bedeviling all European carriers this summer: higher fuel prices and severe air traffic control congestion. The LCC still managed a 30% Q3 operating margin, nothing to sneeze at. But its margin last year was 36%. Wizz also remains

CONTINUED ON p. 4

Who We Are and How to Reach Us

Airline Weekly is a product of Airline Weekly Corp., a Skift-owned company of journalists and former industry professionals with a shared interest in commercial passenger aviation worldwide. *Airline Weekly* is a subscriber-based publication and does not accept advertising from airlines. Editorial policy forbids staff members from owning stock or any other stake in airlines.

Pricing

Individual annual subscriptions (48 issues) are $775; multiple-reader discounts and enterprise licenses are available.

Editorial inquiries
Jay Shabat, Publisher
jayshabat@airlineweekly.com

Media inquiries
Seth Kaplan, Editor
skaplan@airlineweekly.com

Subscriptions and advertising
Jason Cottrell, Marketing Manager
jcottrell@airlineweekly.com

AIRLINE weekly NOW PART OF Skift

+1 954 524 8855 • airlineweekly.com

CONTINUED FROM p. 3

less profitable than its role model **Ryanair**, whose operating margin this summer (never mind its labor woes) was four points higher. Wizz also faced some challenges of its own making, including changes to bag policies that hurt ancillary revenues. In addition, it says it might have overextended itself by at one point adding 17 planes in 17 weeks on top of buying **Monarch**'s London Luton slots and establishing a U.K.-licensed subsidiary. Oh, and it also opened a new base in Vienna, currently an LCC steel-cage wrestling match. Wizz, furthermore, launched a tour operator that it subsequently closed down. Now, much like **IAG**'s **Vueling**, it's dialing back growth plans in reaction to higher fuel prices (notwithstanding recent declines) and a need to improve operations. Growth will be slower, in fact, for the next two years after pushing back some Airbus deliveries. That said, it will still be growing faster than most airlines as larger A321-NEOs arrive. And despite downgrading its profit forecast for the fiscal year to March, it's still one of the world's most profitable airlines, with a fleet that now tops 100 airplanes. That's giving it more scale and bargaining power to go along with an investment-grade balance sheet. It doesn't seem to care at all about what legacy carriers like **LOT Polish** or **TAROM Romania** are doing. Ryanair, it says, is its chief rival, and a rival that's behaving rationally. Wizz has no unions. Its load factor during the spring and summer quarters was 94%. Most of its growth is in airports it already serves. It's developing new in-house training facilities. It implemented a new bag policy this month. It's taking advantage of an "incredibly hot" sale-leaseback market for Airbus narrowbodies. High fuel prices, it says, hurt weaker rivals more. And yes, it will stay in Vienna, expecting others to cry "uncle" first. Wizz did not have anything to say about **Alitalia**, following some expressions of interest earlier in the year.

Like everyone else but **Philippine Airlines** last quarter, Brazil's **Azul** saw its operating margins decline y/y, in its case from 12% to 7%. But as you can see, it's still solidly profitable, even in a seasonally weak quarter for South American airlines. That's all the more impressive given the turmoil in Brazil's aviation sector, emanating from severe currency depreciation, a weak economy, extraordinary rates of crime and massive political corruption scandals. Business traffic is nevertheless recovering, bouncing back after the World Cup and growing especially strong in September, when Azul saw record unit revenues. After the quarter finished, demand slowed a bit just before the two-round presidential election but then picked up again this month, with forward bookings also looking good. That's the case for domestic demand, anyway—international demand was tougher, given the weak real. But even here, Lisbon has quickly become Azul's most profitable international market, benefiting from a partnership with **TAP Air Portugal** and a growing affinity for Portugal among tourists—Lisbon is the new Miami for Brazilians, Azul said. Helpfully, the real has strengthened since the election, although the airline isn't quite ready to restore international capacity that it cut this year. International routes, it notes, take longer to recover because booking curves are longer (in other words, people book earlier). Management is also hopeful that the new administration will implement policies to help the economy realize its potential. As it waits, Azul is proceeding with a transition from 118-seat E-Jets to 174-seat A320-NEOs—it loves this plane so much that it's doing everything it can to accelerate deliveries. On the other hand, it's content to wait longer than expected for its A330-NEOs as Airbus grapples with production issues. Azul now has 17 A320-NEOs, which account for 27% of its ASK capacity. Separately, it now has almost 11m loyalty plan members and is greatly growing cargo revenues, anticipating its first E2-EJets next year, negotiating a joint venture with **United,** codesharing with **Copa** and forecasting a 9% operating margin for all of 2018. Earlier in the year, it was hoping it might earn as high as 11%, but who knew how bad the fuel and currency situation would get?

Speaking of situations getting bad, Mexico's **Interjet** had a calamitous quarter. Its Q3 operating margin was negative 16%, making it the only one of Mexico's Big Four airlines to lose money. Revenues rose 7% y/y, well below its 13% ASK capacity expansion. Operating costs, meanwhile, flew out of control, rising 33% as fuel outlays jumped 60% and labor costs rose 26%. In extravagantly wealthy markets like New York and Boston, operating a premium low-cost business model might work. But being the **JetBlue** of Mexico is much harder given much lower average incomes. In fairness, Interjet had a slightly higher operating margin than its ultra-LCC rival **Volaris** last year. But that was an exception. Usually, Interjet is Mexico's least profitable airline and one that by all accounts now faces a fiscal crisis. Bloomberg, in fact, says it received another dollop of emergency funds from its shareholders. Mexico's three LCCs are all buying lots of NEOs, which have more capacity than the planes they're replacing. That's creating overcapacity at a time of currency depreciation, high fuel prices, weak economic growth and new competition on transborder U.S. routes following an open skies agreement. In addition, Interjet unwisely bought Russian-built SSJ-100s, which have proved difficult operationally due to limited maintenance facilities in the Americas. It's now phasing out SSJs and laying off workers associated with them. It's separately stepping up marketing efforts to emphasize its amenities, adding a second daily flight to Lima and contemplating a future without a new Mexico City airport. That said, its CEO—in an interview with *El Financiero*—downplayed the impact of canceling the airport project.

Jazeera Airways of Kuwait, small but growing again, was surely at least somewhat disappointed in the 29% operating margin its earned in the third quarter. Because as great as that sounds, it was last year able to achieve a 38% operating margin in the same peak period. Unfortunately, 33% y/y revenue growth couldn't keep pace with a 52% increase in operating costs. Jazeera did face some disruptions in the Indian market—floods forced cancellations in Kochi, and an incident at Hyderabad airport left one plane out of service for three weeks. The month of September was also affected by shifts of vacation and school calendars relative to last year. In any event, Jazeera now has its first A320-NEO, with three more coming next year. Its new Kuwait airport terminal is up and running. It launched five new routes to the Indian subcontinent this year. It's benefiting from rivals pulling out of Qatar. And it's keen to develop more ancillary sales. As usual, though, management complains of overcapacity in the region.❍

Margin Madness: Q3 Winners and Losers... So Far

- Not all airlines have reported, but here's a ranking—by operating margin excluding special items—of carriers that have already released results
- Still to come: Singapore Airlines, AirAsia, LATAM, Copa, Avianca, Korean Air, Aeroflot, Aegean, Pegasus, Bangkok Airways, EVA Air and Jet Airways, to name most if not all

Rank	Airline	Operating margin	Rank	Airline	Operating margin
1	Ryanair	34%	25	United	11%
2	Wizz Air	30%	26	China Southern	11%
3	Jazeera	29%	27	Jeju Air	11%
4	Turkish Airlines	23%	28	Norwegian	11%
5	IAG	20%	29	Hainan Airlines	10%
6	Spring Airlines	19%	30	JetBlue	10%
7	Juneyao	19%	31	VivaAerobus	9%
8	Japan Airlines	18%	32	American	7%
9	SkyWest	17%	33	Azul	7%
10	Hawaiian	17%	34	Allegiant	7%
11	Spirit	16%	35	Gol	6%
12	Air Canada	16%	36	WestJet	6%
13	All Nippon	15%	37	Asiana	5%
14	Air China	15%	38	China Airlines	4%
15	Royal Jordanian	15%	39	Volaris	3%
16	Icelandair	14%	40	Garuda	3%
17	Southwest	14%	41	Vietnam Airlines	2%
18	Air France/KLM	14%	42	Aeromexico	1%
19	Delta	14%	43	Cebu Pacific	-4%
20	Lufthansa	14%	44	Philippine Airlines	-8%
21	Finnair	14%	45	Thai Airways	-8%
22	VietJet	13%	46	IndiGo	-14%
23	China Eastern	13%	47	Interjet	-16%
24	Alaska	12%			

SkyMoney

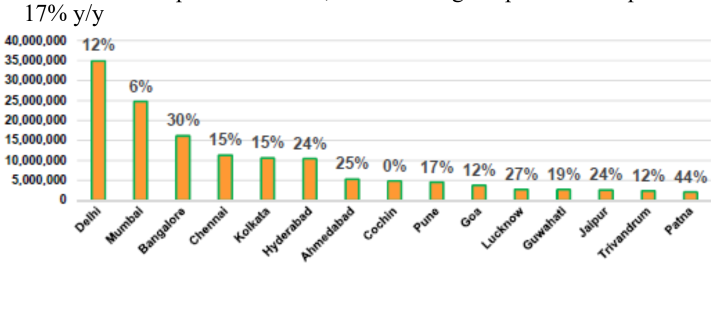
Airline Finance

- Here's one way to solve an overcapacity problem: Buy your closest rival. That's what **Icelandair** is doing, paying a distressed price for its Nordic neighbor **Wow Air**. Icelandair itself is hurting, unable to get the yields it needs to achieve adequate levels of transatlantic profitability. **Norwegian** is competing in the same space and hurting too. So was **Primera** before it collapsed. And to quote the Icelandic band Monsters and Men, the screams all sound the same: overcapacity, high fuel prices and exchange rate headaches. For its part, Icelandair was a quietly profitable airline (among the top third of the world's airlines by profit margin in 2013, for example—particularly impressive given the seasonal variability of demand to Iceland) until Wow's explosive international growth. It was all too much for a small market to absorb. Can Icelandair now reclaim its former standing? The deal does require approval from its country's competition regulators. If things proceed, Icelandair says Wow Air will continue to operate using its own brand. But as an independent airline with its own pricing autonomy, Wow—to borrow again from Monsters and Men—will be gone, gone away.
- **Virgin Australia** never went away, but nor has it thrived in recent years, even after itself buying a rival (**Tigerair Australia**). Last week, at its annual shareholders meeting, Virgin eased investor anxieties with a review of its progress in the fiscal year that ended in June. Improvement to its underlying profitability, cash flow and leverage, Virgin said, was driven by three things: 1) a strengthening position in the Australian domestic market, 2) the simplification of its fleet and network and 3) its disciplined approach to capacity management, capital expenditure and debt through its "Better Business" turnaround program. As **Qantas** also makes clear, conditions in the domestic market are excellent right now. But on international routes, Virgin continues to lose money, hurt last year by volcano-related disruptions in Bali and startup costs on a new route to Hong Kong. Tigerair, for its part, is currently enjoying strong unit revenue trends, but a transition from A320s to B737s is denting its financial results. Who knows if Virgin would have made it through its worst moments without the outsized profits of its Velocity loyalty plan—it had to sell a 35% stake in the company in 2014 because it needed cash. The airline decided against a plan to de-list from the stock market but still has just a tiny portion of its shares publicly traded—most of its shares are held by five companies: **Singapore Airlines**, **Etihad**, the Virgin Group and the Chinese conglomerates HNA Group and Nanshan. *The Age* last week noted that **JetBlue** and **Azul** founder David Neeleman also owns a small Virgin Australia stake that he's looking to sell. As for **Air New Zealand**, once Virgin's largest shareholder, it's now not even a commercial partner anymore, walking away from a trans-Tasman JV. Virgin's outgoing chief John Borghetti, asked about the divorce after the shareholders meeting, told *The Australian* he's happy to have full freedom to do what he wants on trans-Tasman routes, without having to get ANZ's consent. The market between Australia and New Zealand, however, remains "extremely competitive." Virgin, remember, also has a JV with **Delta** for U.S. routes.
- Kazakhstan's **Air Astana**, a government-backed carrier 49% owned by Britain's BAE Systems, announced plans to launch a low-cost carrier. It will debut in the first half of 2019, donning the name **FlyArystan**. It will operate 180-seat A320s from multiple bases throughout the vast oil-rich country, which used to be part of the Soviet Union. Air Astana mentioned **AirAsia**, **easyJet** and **Cebu Pacific** as models for its new unit to emulate.
- On the final day of October, Africa's **Fastjet** said it still had enough cash to keep operating, following a warning that it would shut down in November absent a deal for more capital or relief from creditors. Well, in a new update last week, the LCC said it would live on through at least the end of this month, as it continues its negotiations.
- It's still too early to assess the implications of last week's U.S. midterm elections on airlines. But one note of interest: The congressional seat for Georgia's sixth district, covering parts of suburban Atlanta, was won by Lucy McBath, a former **Delta** flight attendant.
- Looks like there's a winner in the Amazon HQ2 sweepstakes. Or make that two winners, according to news reports. One is New York City, in the same Queens neighborhood where **JetBlue** is based. The other is Crystal City, Virginia, just outside Washington, D.C., and formerly home to the old **US Airways** before it merged with **America West**.
- Lastly but absolutely not leastly, oil prices dropped sharply again last week and are now just 6% above where they stood a year ago. Jet fuel prices, however, haven't fallen quite so much, with the Jet A U.S. Gulf Coast benchmark price still up 16% from a year ago; other regions similarly haven't seen jet fuel fall quite as much as crude oil. Still, it's a welcome relief to see a sharp downward trend since WTI crude prices hit a high of almost $77 per barrel in early October. It's now at $60 (see page 11). For healthy airlines, this might just create the best of all worlds: oil prices not too high and an economy still pretty buoyant.

Airport Traffic Trends in India

Ranked by pax handled in the six months to September 2018; y/y growth above bars (source: Airports Authority of India)

- At all Indian airports combined, traffic during the period was up a brisk 17% y/y



AirBuzz

Marketing, Price, Promotions & Alliances

- **Finnair** is the latest longhaul carrier to bet on a true premium economy cabin—but not anytime soon. Starting in late 2020, it will start outfitting its entire longhaul fleet with the new product, which many airlines have found useful in attracting travelers unable to pay for business class but still looking for something more comfortable than economy class. Finnair separately said it would upgrade the cabins of its ATR regional planes.
- **Etihad** is also eyeing economy-class travelers willing to pay some for a bit of extra comfort. It isn't quite creating a distinct premium economy product like **Finnair**, or for that matter like **Emirates**. But it (like Finnair currently, for that matter) has extra-legroom economy seats. And it's adding more of these on its widebodies, starting with A380s. In conjunction with expanding the number of these seats, Etihad is now marketing them with the brand "Economy Space."
- **JetBlue, TAP Air Portugal** and **airBaltic** all announced loyalty plan changes. JetBlue's changes involve its unique pooling benefits—now not only family members but also friends can share points. TAP, for its part, unveiled a completely new program with a new name. And at airBaltic, an all-new program focuses on loyal but infrequent travelers.
- At its investor day event earlier this month, **IAG** said it estimates price drives about 45% of an airline customer's buying behavior, more than any other factor. No. 2 in importance: network and schedule. And next comes the airline's brand, including both the "intangible emotional" aspects but also functional aspects like the airline's seat, its reputation for punctuality and the overall experience. For this reason, IAG spends a lot of time, effort and money on brand development.
- A quick note from Gogo, which said in its Q3 earnings call it's working with **Delta** to move to free inflight Wi-Fi.

Fleet Sheet

Aircraft Markets

- **United** joined **Singapore Airlines** and **Etihad** in the B787-10 club, taking delivery of its first of 14 on order. The plane, which it configures with 318 seats, is the largest version of the Dreamliner, but without as much range as the other two. It's expected to be useful on transatlantic routes, but for starters, United will use them for its marquee transcontinental routes, beginning with Newark-Los Angeles in January.
- **American**, which has bought B787-8s and -9s but not -10s, spent last week shoring up its regional fleet plans. The carrier ordered another 15 E175s, seating 76 passengers across two classes. These new units will deliver in 2020. Since 2013, American has ordered more than 100 E175s, but not any next-gen E2 versions. **United** and **Delta** haven't ordered any E2s either, if only because they don't comply with current pilot scope clause restrictions—they exceed the weight limit for planes permitted to be outsourced.
- Back in the widebody space, Airbus test flew its first A330-800 NEO. That's the smaller sister of the A330-900, with about 30 fewer seats in a typical configuration. Unfortunately, though, the plane doesn't yet have any customers—**Hawaiian** had a few on order before opting for B787-9s instead.
- At a Robert W. Baird investor event in Chicago last week, a discussion with Boeing steered clear of the **Lion Air** B737-MAX tragedy in Indonesia, which prompted an emergency airworthiness directive to all MAX operators. Instead, Boeing's CFO described how new jets like the MAX and the Dreamliner are bringing new efficiencies to airlines. Demand remains robust with air traffic growing strongly and replacement needs building. Engine partner GE, Boeing said, is on a path to recovering from production issues with the MAX. And there's market pressure to produce more of them faster. But Boeing will be careful in moving to higher rates of production, making certain that its partners can keep up. And the NMA? Boeing will make a decision on whether to build the next-generation widebody some time next year.
- Reuters reports **IndiGo**, the Indian LCC that's losing money for the first time ever, has upgauging on its agenda. Having already converted some of its giant A320-NEO order to larger A321-NEOs, it now reportedly wants to convert a full 125 units, Reuters says, citing a source within Airbus.
- A separate Reuters article says **Royal Jordanian** will likely decide next quarter on an order for 23 narrowbodies, either from Airbus, Boeing or Embraer.
- Bombardier, as part of a divestment play, sold its Q400 program to a smaller Canadian manufacturer. It already sold control of the CSeries program to Airbus. Will it sell the loss-making CRJ program next?
- Air Lease Corp. (ALC), in its Q3 earnings call, gave much the same assessment about industry conditions as other lessors in their calls: Demand for leased aircraft remains strong, with most airlines wanting more planes, not fewer. ALC wonders if the aircraft market might not be as cyclical as in the past, owing to more airline capacity discipline and a fast-growing middle class with travel aspirations. ALC, by the way, says it's looking closely at the A220. As for the B777-X, it's awaiting better pricing and interest from a wider group of airlines.

I.A.G. (It's All Good): Siblings British Airways, Iberia, Vueling, Aer Lingus and Level make their parent proud

CONTINUED FROM p. 1

strikes at British Airways and Iberia. Aer Lingus, too, before becoming part of IAG, endured multiple strikes as it fought for concessions in pay and productivity, concessions it ultimately won.

Today, IAG is advancing a unique business model that's structured to exert further downward pressure on labor costs. By operating multiple airlines, it can allocate capital to those with the highest financial returns. Success at Aer Lingus, for example, grants it the right to grow with new planes. If ever its labor costs rose too much, its profits would drop and some other carrier in the group would get to grow. But as things stand today, all four of IAG's core airlines are earning strong profits while exerting tight cost control.

For British Airways, operating margin last year (14%) was just fractionally less than that of Aer Lingus. It's doing at least as well so far this year, enjoying robust demand for longhaul travel—especially premium longhaul travel—most importantly to North America. As much as it wants a new London Heathrow runway to enable future expansion, the airport's severe capacity constraints today inflate fares. And these days, BA's operations at London Gatwick are hardly just an afterthought. It's not the busiest airline there (easyJet is). But BA is thriving on Gatwick longhaul thanks in part to BA Holidays, as well as the densification and refurbishment of some B777s—it now has five in the new configuration (which adds 57 seats), and revenue per flight on those planes is up 20% on average.

Shorthaul flying is no afterthought either. Once a constantly shrinking and loss-making part of the BA network, shorthaul flying has increased 9% in ASK terms since 2015. Densification has helped here too. So has the acquisition of Monarch's Gatwick slots that BA began using in February, mostly for longer-stage narrowbody routes. Shorthaul ASKs from Gatwick, in fact, were up 25% y/y this summer, and the additional capacity, it says, "has been filled with no drop in yield." At Heathrow, meanwhile, shorthaul profits increased sharply last summer thanks to much higher load factors and a menu of new routes to popular sunshine destinations. All the while, BA is refreshing its shorthaul fleet with A320/21-NEOs. And it's growing profitably at London City airport too, with plans to add another four planes next year.

Nevertheless, Heathrow longhaul is what still determines the ultimate fate of BA. And it's here that the airline is investing heavily in new products and services. With help from slots acquired from British Midland early this decade (not to mention slots acquired with Aer Lingus), BA has managed to add many new longhaul routes from Heathrow in recent years, including Kuala Lumpur, New Orleans, San Jose (California), Santiago (Chile), Durban and—this last one already profitable after just a few months—Nashville. Pittsburgh, Charleston and Osaka start next summer, with more surely to come as A350s arrive to replace B747s next year, followed by B787-10s in 2020. Looking further ahead, Heathrow's third runway should open around 2026, hopefully at a cost BA finds acceptable.

At the investor event earlier this month, BA gave some other reasons for optimism as it prepares to celebrate its 100th anniversary next year: its own non-fuel cost advantages relative to peers, the expected addition of Aer Lingus to its transatlantic JV with American and Finnair, its closer collaboration with American on flight schedules, potential cooperation with China Southern (organic expansion to secondary cities like Chengdu didn't work), a planned phase

CONTINUED ON p. 12

The Backend

Sales, Distribution, Tourism & Corporate Travel

- In one respect, Amadeus has the most precarious position among the Big Three GDS companies, given its outsized exposure to Europe where the Big Three airline companies (**Lufthansa**, **IAG** and **Air France/KLM**) are leading a disintermediation crusade. But the Madrid-based firm downplayed the risk in its Q3 earnings call last week, attributing a 7% y/y decline in western European GDS bookings to factors like **Air Berlin**'s disappearance and unusually warm weather in northern countries. About a third of all bookings through the Amadeus GDS come from western European travel agencies. Worldwide, the company added, industry GDS bookings continue to grow at a healthy pace, with some airlines (like Europe's Big Three) striving for more direct sales and others (like some LCCs) eager to expand their travel agency business. Besides, Amadeus notes, even when airlines move more of their business to their own websites, it's often Amadeus providing the booking engines for those websites. It certainly continues to procure content for its platform, signing new or renewal contracts with carriers including **Norwegian**, **Copa** and **Aerolineas Argentinas**. Like its rivals Sabre and Travelport, it's also helping airlines sell their ancillaries and branded fares through the GDS platform. Of course, the airline-GDS relationship is changing with the advent of IATA's NDC initiative, which gives the airline more control of the products, services and prices it offers each customers—no more just passively sending over some flight and fare data to the GDS, which then creates the offer itself. Threatening? Maybe, but Amadeus, like its rivals, is onboard with the concept, working closely with **American**, for one, and some big travel management companies to help make it a reality. IATA, keep in mind, set a goal of driving 20% of all indirect bookings via the NDC standard by 2020. One area of great success for Amadeus is its Altéa reservation system, never mind losing **LATAM**'s Brazilian business to Sabre. **Southwest** was a huge win, and now Amadeus has won **Air Canada** too, with migration scheduled for early 2020. **Bangkok Airways** is the most recent Altéa customer. Southwest, **easyJet**, **Finnair** and **Malaysia Airlines**, meanwhile, signed up for other software products.
- One week earlier, Sabre and Travelport delivered their Q3 earnings presentations, likewise discussing their efforts to work with airlines and agencies to advance the NDC agenda in ways acceptable to all. Sabre added commentary about its new merchandising platform, a new partnership with TMC giant Carlson Wagonlit and major upgrades to its pricing and revenue management software. Travelport boasted of new GDS deals with **Southwest** and several Indian carriers.
- In China, the online travel retailer Ctrip reported another quarter of double-digit growth in airline bookings, easing fears about the impact of travel on a slowing economy. The company remains bullish on both inbound and outbound China demand, noting that 70% of its customers are under the age of 35. It also believes average incomes will continue to rise as more people move from rural areas to cities (not much more than half of China's people live in urban areas, compared to 90% in Japan). Ctrip, by the way, also owns Skyscanner in the U.K., while Booking/Priceline owns a stake in Ctrip. The latter also owns a stake in **China Eastern**, while developing a new non-equity-based partnership with **KLM**.
- **IAG**, at its investor day event, said point blank that its current GDS relationships aren't working. But it's happy that the GDS companies are engaged in a constructive dialogue. IAG already gets 17% of its bookings using next-generation data communication standards, be they IATA NDC standards or other application programming interface (API) links.

Who's Flying Where

- In a somewhat concerning sign for **IAG**'s **Level**, the longhaul LCC is suspending two of its four inaugural routes. It will no longer fly, Spain's *Global Chronicle* reports, from Barcelona to Los Angeles or Punta Cana. However, it will try its luck with two additional A330-200 routes from Barcelona, one to Santiago, Chile (in March), and the other to New York JFK (July). It also switched its Oakland flights last month to San Francisco. In its Q3 earnings call, remember, IAG also called attention to Level's startup difficulties at Paris Orly. Its other base is Vienna, where it's locked in a shorthaul game of thrones with every European low-cost carrier known to man. Level's choice of New York is intriguing, given that IAG's joint venture partner **American** also flies the route. So does **Delta** for that matter, not to mention **United** and **Norwegian** using Newark airport. The choice of Santiago could hint at a more positive development: that Level's Buenos Aires route is doing well. Overall, there's little indication Level is doing any better than, say, **Lufthansa**'s low-cost **Eurowings** unit, whose results badly lag those of the group's other airline units. But if that's true, Level is less of a problem for IAG than Eurowings is for Lufthansa, because Level is a far smaller and thus a lower-risk part of the broader company.
- **Alitalia**, it's pretty clear, won't be going away. True, Italy's government seems to have little appetite for a proper restructuring that could net it a constructive partnership with **Lufthansa**. And true, the long-stumbling carrier can't survive without more financial assistance. But the government seems willing to oblige, with the help of Italy's state-owned rail operator—sounds like a match made in heaven. Perhaps **Delta** and/or **easyJet** will take some sort of role too. The point is, Alitalia will almost surely live to see another summer, so why not add another route next summer? The carrier confirmed plans to fly from its Rome Fiumicino hub to Washington Dulles with A330-200s starting in May. It also serves five other U.S. cities (New York, Boston, Chicago, Miami and Los Angeles). Last month, recall, Alitalia launched a new Rome route to Mauritius.
- **Virgin Atlantic** and **Thomas Cook** are both big players in the longhaul leisure market from Manchester. The city has its share of North American carriers, Gulf carriers and even East Asian carriers, including **Cathay Pacific**, **Singapore Airlines** and **Hainan Airlines**. **Jet Airways** from India just showed up. And now Israel's **El Al** will join the party, planning three weekly Tel Aviv-Manchester flights next summer. The airline last served the British city in 2001. But it won't be alone in the market—**easyJet** flies the route too.
- **AirAsia** chief Tony Fernandes spends a lot of time in Japan these days. And not just because he likes the sushi. It's increasingly evident that **AirAsia** badly wants to expand from Japan, all the more following the collapse of a planned Chinese venture. The LCC's Japanese ambitions date back to a JV it once had with **All Nippon**. That venture itself collapsed due to disagreements over strategy. AirAsia then relaunched a second reiteration of AirAsia Japan, which more than a year after launching still flies just one route: Nagoya-Sapporo. But **AirAsia X** serves Japan from Kuala Lumpur and Bangkok and even connects Osaka with Honolulu with full fifth-freedom rights. It now wants rights to serve the continental U.S. in 2020, *Nikkei* reports, as well as resort destinations in Asia like Bali and Phuket. AirAsia X is going to need new places to put all the A330-NEOs it has on order. But getting slots and route rights remains an obstacle, and Fernandes reportedly isn't happy with the speed at which regulators are responding to AirAsia's requests. One way to grease the wheels: Buying MRJs from Mitsubishi, an idea Nikkei says AirAsia is considering. Reuters, separately, speaking with a top AirAsia X executive, notes the carrier might switch some of those new orders for A330-NEOs to A321-NEOs. That wouldn't be a good development for Airbus, which is struggling to sell its re-engined A330s.
- In other AirAsia-related news, **AirAsia X** said it would suspend daily service to Auckland, New Zealand, in February—it flies there via Gold Coast, Australia. After a 2011 earthquake, the carrier pulled out of Christchurch too.
- For **Spirit Airlines** in the U.S., a new aircraft deal could be close, if not quite as close as a Florida election. But good news for anyone in Orlando tired of recounting ballots: Spirit has new nonstop getaway options to Denver, Kingston and Montego Bay, those last two in Jamaica. Flights to all three destinations will launch this spring. As it happens, Spirit launched new Orlando service to Bogotá, Medellín and Cartagena last week, all in Colombia.
- Outbound tourism from China remains strong, especially to Europe. So **China Eastern** will try its luck with a new Shanghai nonstop to Hungary's capital Budapest. Flights will begin next summer. China's airlines are also expected to advance the government's Belt and Road Initiative, for which Eastern Europe is a key target of investment and influence.
- Call it an inside-the-beltway initiative for **Southwest Airlines**. It's using slots leased from **Alaska Airlines** to expand from Reagan National airport, debuting, for example, new Oklahoma City nonstops last week. The carrier also added more frequencies to Dallas Love Field and Nashville, suggesting these routes are performing well. Looking ahead to next quarter, Diio Mi schedule data show Southwest's ASM capacity from Reagan airport rising 10% y/y.
- Istanbul is where the action is for **Turkish Airlines**. But the capital Ankara is a busy base too, which will soon see new flights to London Gatwick and Rome Fiumicino. Separately, **Sun Express**—which Turkish jointly operates with **Lufthansa**—will connect Izmir with St. Petersburg next summer using B737-800s. Through September of this year, passenger volumes to Turkey from St. Petersburg are up 23% y/y, reflecting strong recovery in tourism.
- The Cuba market never worked out as well as U.S. airlines hoped. But that didn't stop **JetBlue** from adding a new route—it's now flying Boston-Havana.
- Two East African airlines plan to put Tel Aviv on their route maps next year. One is **Kenya Airways**. The other is **RwandAir**. Kenya is a popular tourist spot for Israelis.
- Yet another East African airline, the undistinguished **Air Tanzania**, has its eyes set on Guangzhou, China, now that it has B787s in its fleet—flights would originate in Dar es Salaam. The Africa-China market is growing, for sure, but it's one dominated by a much stronger East African airline: **Ethiopian**.
- **Jetlines**, a new Canadian ultra-LCC that hopes launch next summer, plans to use the alternative St. Hubert airport to serve Montréal. But it likely won't do so until 2020, after a new low-cost terminal opens. Based in Vancouver, JetLines plans to use Abbotsford as its gateway to Vancouver and Hamilton as its gateway to Toronto. St. Hubert by the way, is just a short drive from downtown Montréal.
- Another Canadian LCC, **Flair**, is already flying. And last week it began its first-ever flights to the U.S. The inaugural route connects Edmonton with Las Vegas. Soon, it will add Palm Springs, Miami, Orlando and Phoenix/Mesa to its network too.

Aviously Growing too Fast

At an investor day in New York, Colombia-based Avianca speaks of efforts to slow growth and improve reliability

- My, how things have changed. In 2003, one year after merging with a domestic competitor, Colombia's **Avianca** was bankrupt. By 2010, it was healthy enough to engineer another merger, this time with the well-respected Central American carrier **TACA**. In the ensuing years, it went public with its shares, joined the Star Alliance, developed auxiliary businesses and became a consistently profitable airline—it earned an 8% operating margin in 2013, 6% in 2014, 6% again in 2015, then 7% in 2016 and—even with a big pilot strike—7% again last year. This year—surprise, surprise—it forecasts a figure between 6% and 8%.
- Earning 6% to 8% operating margins year after year, almost like clockwork, isn't the worst thing in the world. But Avianca wants to do better, and executives last week shared their plan of action.
- One of its priorities for 2019 involves changes to its fleet plan. Avianca thinks it ordered too many planes in the past and now wants to correct that. So it's deferring the arrival of 50 planes while talking to Airbus about the status of another 50, with cancellations a possibility—it hopes to announce the results of these negotiations "very, very soon." Avianca plans to add a net total of just 13 new airplanes in the next four years. Acquiring fewer aircraft, of course, implies lots of money saved. It also allows for accelerated debt reduction.
- The airline still plans to grow ASKs 6% on average from now through 2022, a healthy pace but nevertheless a step down from previous plans. Near-term y/y growth rates are still inflated by last year's lengthy strike, plus the slow operational recovery that followed. In fact, Avianca says it still hasn't fully recovered operationally. The strike, which it calls the lengthiest in commercial aviation history, cost the company $245m in lost revenues and one-off costs, including some expensive wet-lease contracts to maintain service to cities like New York and Madrid—these flights lost money, management says, but had to be maintained so as not to strand valued customers.
- If there was anything positive that came from the strike, it was the realization that Avianca couldn't just forecast demand and grow accordingly. In the past decade, the carrier grew from 30 to nearly 200 planes, which "stressed the organization a little bit." In the past, it said, the company neglected to invest in the infrastructure and technology necessary to handle such rapid growth. The strike couldn't have been foreseen, but difficult airport operating conditions, especially in Bogotá, have long been a challenge. Improving operational reliability is now a bigger priority than rapid growth. Said the carrier's CEO Hernán Rincón: "I'll tell you what the mistake was: The mistake was we used to plan our fleet, our network and our itineraries assuming that everything was perfect, including the weather. And we live in the tropics, and Bogotá is a very difficult city from many angles. We forgot about that, and we're now building into the models the challenges and difficulties that the environment presents." Airports, Rincón added, are his top frustration.
- Avianca's other major hubs are Lima and San Salvador, with Medellín and increasingly Guatemala City considered focus cities. Other major markets include San José in Costa Rica, Quito and Guayaquil in Ecuador and even Miami, which it serves nonstop from 10 Latin American cities.
- This week, Avianca launches a new route from Bogotá to Munich, where its Star partner **Lufthansa** has a hub—Lufthansa itself serves Bogotá from Frankfurt. Avianca's only other European destinations are Madrid, Barcelona and London.
- There will likely be more such intercontinental routes in the coming years despite efforts to slow capacity growth overall. The Colombian domestic market, on the other hand, is already mature. There might be some international growth within Latin America, but as the company points out, of all the people that leave Latin American countries for business or vacation, about 70% go to the U.S.
- That said, Avianca still intends to merge with **Avianca Brasil**, which for now is still a separate company but one also (like Avianca) controlled by the Synergy Group. Brazil's economic and political turmoil has thus far postponed the planned merger, but executives hope conditions there will improve now that the election is over. Avianca is separately exploring ways to enter the Mexican market, working with **Aeromar**, a carrier in which Synergy purchased a stake. Synergy has a small Avianca-branded carrier in Argentina too.
- And other countries? Avianca definitely has no plans to go back into Venezuela, never mind that it was a profitable market until the day it left last year. In fact, as late as 2016, Venezuela was Avianca's *most* profitable market. Operational and security challenges today are simply too formidable. It doesn't plan to enter the Chilean domestic market either. Back in Colombia, Avianca is launching a new in-house regional carrier which it says will save it money and help with operationally reliability.
- Sales and distribution are another top priority for 2019. This includes the introduction of branded fares, more dynamic pricing of ancillaries, increasing direct sales, reducing GDS and travel agency costs and pushing forward with IATA NDC adoption. It's targeting $30m to $40m in ancillary revenues next year. It still gets 49% of its revenues through traditional travel agencies and another 20% through online travel agencies. Only 22% comes through its own web and mobile sites.
- Efforts to adopt new digital technologies, Avianca says, serve two purposes: improving the customer experience and increasing employee productivity. Rincón, a former Microsoft executive, has hired his old firm to help with IT. Another key IT partner is Amadeus.
- Avianca is more than just a passenger airline. It also has a big cargo operation. Its LifeMiles loyalty plan, managed as its own business unit, has more than 8m members. It's developing a maintenance business, a training business and a leisure tour operator. Already, these auxiliary businesses contribute 18% of the company's total revenues, hedging its exposure to conditions in the passenger market. It wants to lift that 18% to 25% by the middle of next decade.
- But does Avianca regret selling a stake in LifeMiles three years ago? Rivals **LATAM** and **Gol**, after all, not to mention **Aeroméxico** and **Air Canada**, are all working to reverse their loyalty plan divestment decisions. But Avianca says its arrangement is more favorable, reflecting lessons it learned from prior divestments. It also says its co-owner (the U.S. private equity firm Advent) provides critical help in generating mileage sales. However, it admits that eventually, it would like to regain full control of the asset, although the contract doesn't expire until 2040. Avianca currently owns 70%.
- A few more facts about LifeMiles: About a third of its roughly $350m in revenues comes from miles sold to the airline, with the rest from mileage sales to banks and other partners, as well as customers. About half of its 8m members live in Colombia. Another 30% live in Central America. And most of the rest live in either the U.S., Perú or Brazil. Soon, Avianca will provide more financial transparency for LifeMiles, eager to attract investors perhaps not keen on the airline sector per se.
- Back in the core passenger business, forming a joint venture with **United** and **Copa** remains a top strategic priority. Talks have dragged on much longer than expected, but a deal should be forthcoming. Although Avianca didn't mention any other potential JV partners, **Lufthansa** is one that's reportedly a candidate.
- For now, Avianca says it's recapturing most of its fuel inflation with higher fares, following a bold decision to become a price leader and raise fares—historically, it was a price follower. Load factors are at record highs. B787 engine disruptions are now a thing of the past. Elections in Colombia, Mexico and Brazil are now finished, mitigating regional political risks. And more LCCs attacking its profitable Colombian market? It's not terribly worried, pointing to the country's lack of secondary airports and preponderance of ultra-shorthaul routes.
- Finally, just like **British Airways**, Avianca will celebrate its 100th anniversary next year. The carrier's name, in case you're wondering, stands for Aerovías del Continente Americano.❍

Around the World

A Look at the World's Airlines, Including End-of-Week Equity Prices

Airline	Share Price	Change from last week	Change from last year	Comment
American	36.22	0%	-21%	IAG says Qatar Airways indeed likely to leave oneworld; "annoyed" at some members
Delta	56.65	1%	16%	Insourcing ramp jobs at Austin and Raleigh-Durham airports as it builds scale
United	92.35	4%	58%	Cutting f/a staffing on some int'l widebody flights to align with Delta, AA; AFA union upset
Southwest	52.49	1%	-2%	Still no mechanic deal after workers rejected last contract; has implications for Hawaii service
Alaska	65.97	3%	6%	LCC Sun Country quietly building a presence at Portland; starts Honolulu-Portland this week
JetBlue	18.10	2%	-5%	Aer Lingus says it would likely keep its JetBlue partnership even after joining AA-BA JV
Hawaiian	36.76	3%	2%	Still awaiting DOT approval for JAL JV; in the meantime codesharing, cooperating on loyalty
Spirit	52.99	-1%	48%	Launched 19 winter-only routes to Florida last week; "swap the cold for the beaches," it says
Frontier	(not publicly traded)			Still negotiating with pilots and flight attendants; only carrier still with bankruptcy-era deals
Allegiant	121.98	-1%	-4%	Paid $2.56 per gallon for fuel in October, compared to $2.41 during the third quarter
SkyWest	56.60	1%	23%	Flight attendants at Air Wisconsin, which flies for United, threatening to strike
Air Canada	26.51	0%	16%	Marketing heavily in Washington, where partner United is big at Dulles but AA big at Reagan
WestJet	18.38	-3%	-27%	Will present at a Scotiabank investor event Tuesday; Air Canada will be there too
Aeroméxico	23.12	-1%	-24%	Cancún airport hoping to be more of an int'l connecting hub given Mexico City airport woes
Volaris	13.15	0%	-29%	Announces five new domestic routes (three from Guadalajara, two from Mexico City)
LATAM	8.07	-4%	-28%	With elections done in Colombia, Mexico, Brazil, next big Latin one is Argentina in Oct.
Gol	10.78	-1%	31%	Rival Azul makes Bagé its 101st Brazilian destination; no other airline serves as many
Azul	25.50	1%	3%	Extremely happy, as it repeatedly reminds investors, that it never sold any of its loyalty plan
Copa	79.25	-2%	-36%	Does a new codeshare with Azul presage deeper cooperation? Both carriers close to United
Avianca	5.31	1%	-25%	Expresses disappointment about vote to abandon construction of Mexico City's new airport
Emirates	(not publicly traded)			Vienna to get its first B777s outfitted with new first-class suites; city home to OPEC
Air Arabia	1.03	2%	-16%	Legacy rival Royal Air Maroc to launch Casablanca flights to Vienna, Amman and Abuja
Turkish Airlines	15.17	0%	52%	Air traffic in Turkey (by pax volumes) has tripled in the past 10 years; approaching 200m
Kenya Airways	10.65	-8%	84%	JamboJet, its LCC, adding more Q400s next year; leasing them from Canada's Chorus
South African Air.	(not publicly traded)			South Africa's finance minister openly supports shutting the airline down; president disagrees
Jet Airways	258	13%	-62%	India still fastest growing major domestic airline market: Sept. RPKs up 20% y/y (IATA)
IndiGo	996	2%	-15%	When Hong Kong launches next month, it will be IndiGo's 15th international destination
Crude oil futures (WTI, for delivery next month; source New York Mercantile exchange)	$60	-5%	6%	Why are oil prices suddenly in freefall? Some observers point to a supply glut following U.S. decision to relax enforcement of Iranian sanctions.

Some stocks traded on multiple exchanges; not intended for trading purposes

Around the World

A Look at the World's Airlines, Including End-of-Week Equity Prices

Airline	Share Price	Change from last week	Change from last year	Comment
Lufthansa	20.18	2%	-25%	Generated 30% of its sales from direct channels in 2015; now the figure is 40%
Air France/KLM	9.79	5%	-13%	Still trying to reach a pay deal with union representing majority of Air France pilots
IAG	643	5%	8%	Began using Monarch LGW slots this summer but hastily scheduled; will optimize in 2019
SAS	21.50	3%	-10%	New cities coming next summer: Catania, Florence, Marseille, Cornwall, Szczecin, Antalya
Alitalia	(not publicly traded)			Bankruptcy commissioners to finish examining bids this week; Lufthansa still lurking
Finnair	7.31	7%	-32%	At the other end of the Nordic region, Icelandair's October transatlantic loads fell 5 pts to 78%
Virgin Atlantic	(not publicly traded)			PPU union representing minority of its pilots threatening to strike; at odds with BALPA union
easyJet	1254	0%	-2%	Latest interline partner is Canada's Air Transat; will link at Gatwick, easyJet's busiest airport
Ryanair	12.97	2%	-23%	Reaches labor deal with German flight attendants; Italian attendants ratify their separate deal
Norwegian	231.0	4%	21%	Hopes to sell more longhaul premium; new website feature helps find lowest premium fares
Wizz Air	2958	9%	-6%	Tourist arrivals to Israel, a big market for Wizz, rose 15% y/y in the first 10 months of 2018
Aegean	6.95	4%	-13%	Carried more than 3m connecting pax in 2017, many between Europe and Middle East
Aeroflot	95.14	-7%	-42%	Expects to receive its first MC-21 aircraft in Q1 2020; will seat 169 pax (same as MAX 8)
Japan Airlines	4078	4%	1%	Goal: Get 50% of its international flight revenue from overseas sales, up from 30% in 2016
All Nippon	3988	6%	-8%	Domestic load factors typically below 70%; more like 75% to 85% on international routes
Korean Air	30000	2%	-2%	Lufthansa's Swiss subsidiary likely to make Seoul its next longhaul destination in 2020
Cathay Pacific	10.78	3%	-13%	Announces codeshare with ferry operator for transport to Shenzhen and other mainland ports
Air China	7.14	-2%	-1%	Might jump into Beijing-Lisbon route, which HNA's Capital Airlines exited, reports CLBrief
China Eastern	4.77	-4%	22%	IATA: China's domestic RPK traffic grew 9% y/y in September on 10% more ASK capacity
China Southern	4.69	-6%	-21%	President Xi to meet President Trump in Argentina at Nov. 31-Dec. 1 G20 summit
Singapore Airlines	9.52	-1%	-12%	Cathay Pacific, Japan Airlines and Singapore Airlines all coming to Seattle next year
Malaysia Airlines	(not publicly traded)			AirAsia growing internationally from Kota Kinabalu; new flights to Macao and soon Brunei
AirAsia	2.68	-2%	-17%	Wants its booking platforms to be used for more than just buying airline tickets
Thai Airways	13.40	-1%	-23%	Rival Thai AirAsia grew its ASK capacity 8% y/y in Q3; up 13% year to date
Vietnam Airlines	33600	2%	16%	LCC rival VietJet planning to serve northern Australian city Darwin from Ho Chi Minh City
Cebu Pacific	65.65	3%	-37%	One of the worst performing airline stocks during the past year as margins plummet
Qantas	5.83	3%	-1%	IATA: worldwide RPK traffic grew 5.5% y/y in Sept.; Australia dom. traffic up less than 1%
Virgin Australia	0.22	5%	-4%	Has the same chairperson—Elizabeth Bryan—as IAG; chair has non-executive role
Air New Zealand	2.81	5%	-3%	Inks codeshare with Star partner EVA Air to support its just-launched Taipei flights

Some stocks traded on multiple exchanges; not intended for trading purposes.

I.A.G. (It's All Good): Siblings British Airways, Iberia, Vueling, Aer Lingus and Level make their parent proud

CONTINUED FROM p. 7

-out of A319s at Gatwick, a new Club World seat debuting on A350s next summer, pension reform and operational improvements. In the coming five years, BA plans average annual ASK growth of between 3% and 4%, which is up from its previously planned 2% to 3%. Asia will grow 5% to 6%. As for Brexit, BA sounds a lot more confident of minimal disruptions than, say, Ryanair.

The story hasn't been quite as positive for Iberia, whose 8% operating margin last year was worst in the group—it's still a more seasonal airline than BA, typically losing money in the first quarter. But that doesn't diminish the great progress it has made in refreshing its brand, improving its revenue management and lowering its labor costs, in part through the creation of Iberia Express for price-sensitive Madrid-based shorthaul routes. Iberia Express, by the way, currently with 22 planes, itself earned a 14% operating margin last year. That's a far cry from the chronic shorthaul loss-making Iberia suffered for many years, especially coming out of the deep recession that hit Spain late last decade. This led to not just deep cost-cutting after its 2010 merger with BA but also deep capacity cutting—Iberia continuously downsized from 2009 through 2013. And during those five years, it suffered operating losses totaling almost $1.2b. It finally broke the tide with a tiny profit in 2014, before achieving a 5% operating margin in 2015, then 6% the next year, followed by last year's 8%.

The recovery of Spain's economy, fueled by tourism, was a big external factor behind Iberia's more recent success. The demise of Air Berlin and Monarch helped too. Iberia also densified planes, teamed with Vueling to tackle train competition on the Madrid-Barcelona route and took steps to restructure its non-airline businesses, including maintenance. Now it's in growth mode, with ASK capacity year-to-date through October up 9% y/y. For the next five years, it plans growth of roughly 6% to 7% annually, pending successful labor deals (it reached one with pilots in August).

Future growth, however, will come less from shorthaul than longhaul, which for Iberia involves a few U.S. markets, two new East Asia markets and an industry-leading portfolio of Latin American routes. This was always its chief competitive advantage but one it never fully optimized. To correct that, it's been adding new planes like A350s, phasing out four-engined A340s, updating its premium offerings (including a new longhaul premium economy product), modernizing its brand, considering free Madrid stopovers for connecting fliers and (most enticingly) forming a JV with LATAM, assuming the companies find conditions by Chilean regulators acceptable.

Vueling's exposure is all shorthaul. But it had the right cost structure early on to succeed, all the way back to its 2008 merger with Clickair, which was then mostly owned by Iberia. Clickair's chief at the time was Alex Cruz, now the top man at BA. Vueling's current executives have a somewhat different challenge, keeping costs low, yes, but also managing growth at a time of severe shortcomings in air traffic management over its core markets, Barcelona most importantly but also France and Italy. More than half of Vueling's flights cross through French airspace, where repeated ATC strikes compounded problems linked to controller shortages. The airline nevertheless had the most profitable summer of any IAG airline, although it's also a highly seasonal carrier that still loses money in the winter. Yet for operational reasons, it's now *decreasing* the seasonal variability of its schedule and cutting ASK growth plans overall from 10% to 7% next year. Two summers ago, it got burned by expanding too fast, beyond its capability to execute operationally.

Aer Lingus, for its part, hopes to continue its remarkable success under the IAG wing, perhaps best captured by its doubling of returns on invested capital since the acquisition. Although it positions itself in the same category as lowish-cost longhaul carriers like Norwegian and Icelandair, Aer Lingus says unlike them, it's thriving for several key reasons, one being the powerful IAG balance sheet. Other critical differentiators: lots of connecting traffic, established sales strength in the U.S. market, use of primary airports and a greater contribution from premium customers—it calls its premium cabin "extremely successful." It's now expanding premium seating. It's updating its brand identity and passenger amenities. It (as noted earlier) hopes to join the American JV. It's adding new routes like Montréal and Minneapolis. It's searching for a new CEO. It wants to get 85% of its revenues from direct channels. And it's adding A321-NEO LRs while looking at the XLR variant Airbus might pursue. Unsurprisingly given its success, Aer Lingus will expand a bullish 7% to 8% annually during the next five years.

Mindful if not exactly fearful of the threat posed by longhaul LCCs like Norwegian, IAG quickly created Level to serve overseas markets from Barcelona, using Iberia's planes and crews. It subsequently used its OpenSkies subsidiary as a platform to do the same from Paris Orly. And now it's flying shorthaul from Vienna. Level currently has nine planes total, going to 14 next year and perhaps as many as 42 by 2023. Shorthaul feed from Vueling is critical in both Barcelona and Paris. Also critical, with lots of potential revenue growth, are ancillaries. Level, however, will *not* be a platform for consolidation, as Eurowings is for Lufthansa.

But make no mistake: IAG remains every bit as much a consolidation bull as its German rival. Its latest target, of course, is Norwegian, of which IAG continues to own a small stake. But the LCC seems uninterested, and for IAG, "the interest wanes over time." Earlier this year, it came close to buying Air Berlin's Niki unit before losing a court battle—the since-renamed Laudamotion would up partly in the hands of Ryanair. Consolidation is certainly happening through airline failures such as Air Berlin, Monarch, Primera and Cobalt, with IAG estimating that roughly 70% of the capacity of a deceased airline gets replaced. Longhaul consolidation, IAG says, is advancing most effectively with joint ventures. The European shorthaul market, though, is where IAG sees the most meaningful consolidation opportunities.

Its enthusiasm for consolidation stems from observing its powerful impact in the U.S., its own track record (especially with Aer Lingus) and the efficacy of its "plug and play" business model. IAG, says chief Willie Walsh, is not a mere holding company passively overseeing its collection of airlines. Rather, IAG has a platform to exert "vertical and horizontal influence" across the group. That means helping its airlines from above with joint aircraft purchasing, for example, while supporting their everyday operations and commercial objectives with a groupwide loyalty plan (Avios) and groupwide back office, IT, cargo and maintenance capabilities.

At the parent company level, IAG is also spearheading the group's development and application of new technologies. This includes leveraging data for better customer insights, more effective pricing and predictive maintenance. It also includes adoption of next-generation distribution—IATA's NDC initiative for sure but also the phasing out of personal name records (PNRs); these are central to the way GDSs handle bookings. Not stopping with revolutionizing the shopping and booking functions, IAG (with the help of IATA and others) also wants to modernize the way people pay for their flights, board their flights and get invoiced for their flights.

But that's for the future. In the present, IAG is doing better than ever, unperturbed even by higher fuel prices—a challenge, yes, but one mitigated by hedging, revenue management and non-fuel cost control. (Note several examples here of how there's more than one way to make money in the airline industry: Delta, for example, like the rest of the U.S. Big Three, no longer hedges jet fuel and has taken a far more conciliatory approach toward GDSs.) Walsh, in fact, says Europe's ATC crisis is even more concerning than the fuel situation, albeit one he thinks will ease; Lufthansa is less optimistic. Demand is currently strong. And Europe's airline industry today is structurally much healthier than it was a decade ago, thanks to better management, new technologies, less government intervention and consolidation. IAG itself is healthier than it ever was, with plans to get even stronger.❍