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THE TRANSFORMER

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Latin Beat

The low-cost/hybrid carrier model has begun to take root in Latin America, forever changing the region's industry.

By Marcela Lizárraga | *Ascend* Contributor

The low-cost principle has made its way to Latin America, and in some countries in the region, it has already set interesting industry standards.

Latin America's airline business is noted for being overregulated, overpriced and strongly government subsidized. It's a region where airlines' revenues are driven by local and devaluated currencies, and main costs (fuel, equipment leases and distribution) are either in U.S. dollars or euros. Nevertheless, against all odds, some airlines are doing all the right things not only to survive in this unforgiving industry but to achieve amazing results and set the leading paths for others to follow.

What is so special about their businesses, and what are they doing differently than in the past? Latin American carriers have taken the original low-cost model and adapted it to fit local conditions. In general, low-cost/hybrid carriers are characterized by flying from secondary, less-congested and less-expensive airports. In contrast, most Latin American LCCs generally fly from primary domestic or international airports, as most countries in this region lack necessary infrastructure to have alternate options. One thing is for certain, they're flying

to a new "Latin beat," closely evaluating their strategies and successfully lowering their operational costs.

Low-cost and hybrid carriers are gaining a foothold in Latin America as they are around the world. The financial performance of GOL, for example, the leading low-cost carrier in the region, compares favorably with other leading LCCs around the world, such as Ryanair, jetBlue, Southwest Airlines and WestJet. During the first half of the year, GOL added nine aircraft and four new destinations. The airline also announced plans to help launch an LCC in Mexico. Globally, statistics show that in 2001 low-cost/hybrid carriers accounted for 6 percent of worldwide available scheduled flights. Today, penetration has reached 12 percent and accounts for more than 15 percent of all available seats; one in every eight scheduled flights globally is from a low-cost or hybrid airline.

The Simpler the Better

Latin American low-cost/hybrid carriers have adopted the same middle name as their counterparts in the United States and Europe — simple — and they are taking that notion to the limit in every way they can in areas including:

Fleet

- Migrating to or starting operations with a single, modern fleet type, providing substantial economies of scale and efficiencies in areas such as maintenance, crew, training costs and fuel optimization;
- Maximizing the use of aircraft:
  - During the first quarter, GOL Linhas Aéreas Inteligentes, ranked last year by *Airline Business* as the most profitable airline in the world, reported an average utilization of 14 hours per day, among the highest publicly reported worldwide.
  - LAN reported up to 17 hours per day for freighters last year.
  - TAM Brazilian Airlines has significantly increased utilization of its fleet, operating its aircraft more than 11 hours per day in August, up from 10.6 hours in the second quarter and 8.7 hours in the second quarter of 2004.

Fare structure

- Offering significantly lower fares (attractive enough to shift travelers) than traditional airlines;
- Allowing minimum to no overbooking;

Network

- Operating direct, point-to-point service;

Marketing

- Marketing straightforwardly with visible and tangible differentiation:
  - In May, TAM implemented a new marketing strategy focusing on the principles of nationality, leadership, competitive pricing and tradition.
- Building a strong brand;
- Incorporating best practices that fit market strategies;
- Defining clear segments;
- Targeting travelers directly in high-density, underserved markets;

Ticketing

- Adopting a strong e-ticketing program despite low overall penetration in Latin America;

Check in

- Keeping the process simple and easy;
- Providing several self-service options, such as on-line or kiosk check in;

Distribution

- Reaching high-end travelers through Internet-driven or own-agency portal sales:
  - Latin American airlines are striving to achieve up to 80 percent booking rate on their Web sites.
- Continuing to challenge traditional global distribution systems:
  - Local airlines maintain minimum to no presence on GDSs.
  - They engage in creative alliances and solutions with GDS partners.

Cabin configuration

- Operating a single class of service as a general rule for domestic routes;

Outsourcing

- Using third-party experts for areas such as call center, ground handling, information technology or any other service that can be more efficiently and effectively managed externally;

Frequent flyer programs

- Taking a "one-solution-does-not-fit-all" approach:
  - Some airlines, such as GOL, elect not to have a FFP.
  - Some, such as LAN and Click, offer FFPs through their alliance partnerships.
  - Some carriers, such as TAM, have a very strong program.

Asset utilization

- Stimulating demand to increase load factors;
- Turning aircraft quickly;
- Employing strategic, targeted maintenance;
- Implementing efficient ground processes;

Finances

- Trading publicly in the United States as well as the local country to increase financial strength (i.e., TAM and GOL).

Quality is Key

A visible differentiator of low-cost and hybrid carriers in Latin America from those outside of the region is that they must maintain a high level of service to attract local travelers. Taking into consideration that main competitors for targeted high-density markets are first-class bus services with top-of-the-line equipment manufactured by Mercedes-Benz and Volvo, the airlines must maintain a high level of amenities. These competitors account for more than 98 percent of potential travelers in those markets, which is a significant opportunity for low-cost/hybrid carriers to pursue new business and look for creative ways to attract these passengers. The opportunity definitely exists; it's just a matter of being able to operate at a low enough cost to lure the demand, specifically from cost-conscious leisure travelers and small- to medium-size corporations that would often use other means of transportation.

Quality is not only measured by the level of in-flight services, but also in every area of customer service that can help retain a current passenger or attract a new one. The Latin beat is evident from the moment the customer makes a reservation, whether online or in person, by the simplicity of the process and by the Latin-American touch — focusing on providing customers with exceptional service through the entire travel experience.

Image is also an important element that reflects quality. Some airlines, such as TAM with its unique image of in-flight personnel, have made a trademark of their image, paying utmost attention to details that equate to high standards — spending months training cabin personnel how to present themselves and service passengers.

Crossing the Border

Mexico, like Brazil, has the right market elements for a low-cost carrier, and some airlines and new investors are tapping into this opportunity. Click, which emerged from AeroCaribe as the LCC offshoot of Mexicana, has recently taken off and promises to lead the way — if, of course, it is able to truly maintain a low-cost operation while still keeping connections with Mexicana.

Other quasi LCCs in Mexico, such as Avianca, AeroCalifornia, Aeromar and Azteca, will have to pay special attention to their strategy and cost structures to stimulate demand and continue to compete effectively.

Mexico is opening doors to new entrants, enabling international carriers to enter this land of interesting opportunity. These entries will finally create a more healthy competition in a country where traditional carriers (Mexicana and Aeromexico) dominate more than 70 percent of the market. Benefits from these new entrants will not only be measured in terms of lower fares, more options and frequencies, but they will also help stimulate domestic economy and tourism, making it more attractive to travelers to fly within Mexico, since today it may be cheaper to fly

Photos courtesy of Airbus and Boeing

Top Latin American carriers such as Copa, LAN, TACA and TAM are leading a resurgence of the region's air transportation industry.

abroad than domestically. It is estimated that air traffic in Mexico could increase to 50 million passengers per year from the current 18 million.

GOL is not the only carrier with plans to enter the Mexican market; others are already lined up. El Salvador-based TACA recently announced alignment with strong Mexican investors, including Televisa, Mexico's largest television company and businessman Carlos Slim, to launch low-cost carrier Vuela Compañía de Aviación.

ABC Interjet, as Vuela, plans to take off at the end of the year from Toluca, an airport about 40 miles from Mexico City, Mexico, which has the potential to attract affluent travelers.

Expansion Plans

Low-cost/hybrid carriers in Latin America are here to stay, and they plan to grow, either domestically or within the Latin American region. Such is the case with GOL in Brazil, with plans to double capacity by the end of 2009 to expand within Brazil, and the airline is also exploring opportunities to start business and export its successful model in other high-density countries such as Mexico.

LCC/hybrids are also looking into strengthening their intra-Latin American alliances to expand their horizons, and LAN's rapid expansion in the region continues to challenge other airlines to fly to new skies in neighbor countries or add frequencies to existing ones. In their quest to expand, some airlines are reaching unprecedented agreements to fly domestic routes within countries previously impossible to penetrate (as Grupo Marsan's Aerolineas del Sur entered Chile in late 2004, LAN is now able to fly within Argentina, and GOL and TACA are serving Mexico). This has already resulted in significant growth; reports show an intra-market increase of almost 12 percent in revenue passenger kilometers in May, 25.1 percent higher than the same period last year.

Airlines, especially in Brazil, have adopted their models and have experienced very good results attracting customers from existing airlines and creating new demand. Carriers such as TAM and GOL have demonstrated it can be done, even in one of the most regulated countries in the world.

An excellent plan of action, focus to segment the market they want to tackle and unstoppable leaders with a great team to execute, as well as strong financial support, are key elements necessary to succeed in these underexploited Latin American markets.

The results and best practices set by some Latin American carriers, such as LAN, TAM, GOL, Aerolineas Argentinas and Copa, which are now flying with a Latin beat, are setting industry standards and achieving worldwide recognition.

Taking into consideration Latin American gross domestic product, disposable income, and significant price differences between land and air transportation, Latin American carriers have to fly as cost efficiently as possible to be able to sustain discounted prices.

The new way of flying at a Latin beat is here to stay, and it will be fascinating to see how strong the beat becomes.

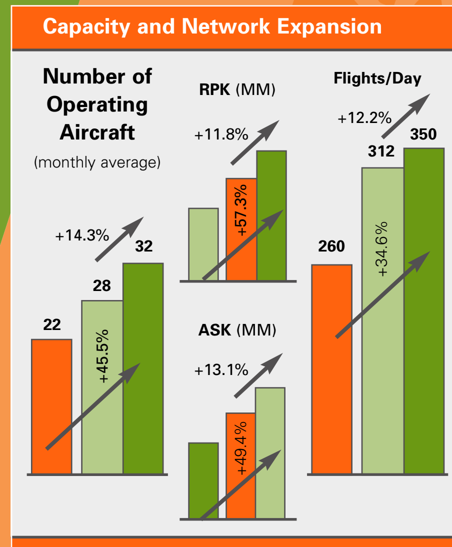
Industry Benchmarks — 2Q05[1]

	GOL	Ryanair	Southwest	jetBlue	WestJet
EBITDAR (US$ MM)	312[2]	571[2]	1,318	266	129[2]
EBITDAR (US$ MM)	37.1%	34.4%	19.6%	19.7%	13.4%
Net Income (US$ MM)	155[2]	331[2]	409	30	–26[2]
Net Income Margin	18.4%	20.0%	7.0%	2.2%	–2.7%
EPS Growth[3]	20.0%	15.0%	10.0%	20.0%	20.0%
P/E 2005[4] (x)	13.4	20.3	24.6	91.3	27.3
P/E 2006[4] (x)	11.2	17.8	23.3	51.2	18.4
PEG Ratio[5] (x)	0.6	1.2	2.3	1.1	0.8

1. LTM June '05 (GOL, SouthWest, jetBlue, and WestJet); LTM March '05 (Ryanair)
2. Translated to U.S. Dollars at average rate US$1.00 = R$2.729, €1.242, and CAD$1.2787
3. 5-year EPS Growth—Source Yahoo Finance
4. P/E = At Stock Price as of July 29 and EPS supplied by First Call
5. 2006 P/E divided by 5-year projected EPS growth

The financial performance of GOL, Latin America's leading low-cost carrier, is in line with other leading LCCs around the globe, indicating that GOL has successfully adapted the low-cost model to the Latin American marketplace.

Capacity and Network Expansion



Despite operating in one of the most regulated countries in the region, GOL continues to rapidly increase revenue, daily departures, available seat miles and aircraft utilization. With plans for continued growth, the LCC expects to double capacity by the end of 2009.

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