A MAGAZINE FOR AIRLINE EXECUTIVES

2004 Issue No. 2

ascend

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A conversation with …

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INSIDE

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Linking Latin America

As with most parts of the world, alliances are becoming more prominent and more important in Latin America. However, the region's alliances are taking some unique forms to adapt to the local landscape.

By Marcela Lizárraga and Nadja Killisly | *Ascend* Contributors

Few would argue that forming an alliance among airlines is the future of the industry — alliances enable airlines to protect themselves in a highly volatile climate, where the economy is unstable and competition is high. They are also a way to increase revenue.

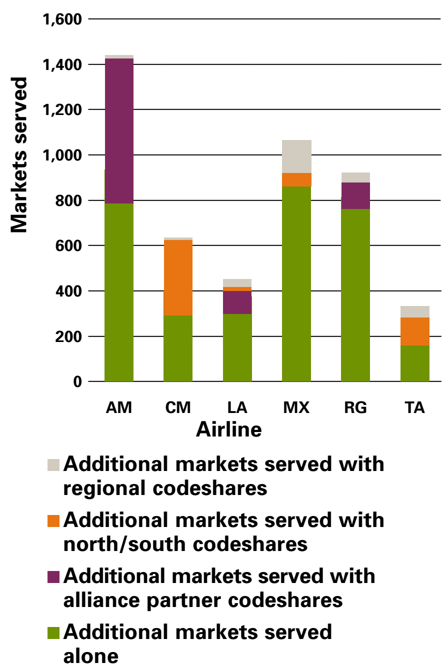
In Latin America, the trends toward consolidation and alliances are consistent with those in Europe and North America. However, they have been developing at a slower rate and with a different emphasis, focusing on building traffic from other regions as well as leveraging the strength of the region's flag carriers, which have strong ties with local governments. Also, some alliances have had better chances to succeed than others — those with common/shared goals in which the partners complement each other and are willing to work productively with each other.

The Latin American Airline Market

Latin America is a growing marketplace. The region's gross national product is increasing, resulting in air travel growing at a constant rate, particularly in markets such as Central America, Argentina, Chile and Colombia. Today, Latin American countries are considered to be among the fastest growing markets. Tourism between the United States and Latin America and within the region is increasing at a rapid rate.

At the same time, leadership has shifted while the market is increasing: North American and European carriers such as Air Canada, Iberia Líneas Aéreas de España, American Airlines, Lufthansa German Airlines, Continental Airlines and Air France are taking advantage of the increase in demand to open new routes to Central and Latin America, where fares and corresponding yields are significantly higher, and grow their market share. Today, European carriers hold four of the top five market share positions in Latin America, where trans-Atlantic non-stop capacity has almost doubled during the last 10 years.

Codeshare Market Reach for July 2004



Sources: market information data tapes, *Sabre® Planet®* profitability forecasting system

Alliances have provided benefits to a number of Latin American carriers. COPA and TACA have highly benefited from their respective alliances with Continental and American Airlines. LAN and Aeroméxico have increased the number of markets they serve through the development of numerous regional codeshare partnerships.

When it comes to regulation, the development of open skies agreements has resulted in Latin America experiencing globalization. This has allowed some existing carriers to expand. In addition, the multiplication of alliances between a North and South American carrier is continuing to create even more pressure on governments in the region to sign open skies bilateral agreements with the United States. The results are rewarding: Costa Rica, Chile and El Salvador are examples of how open skies agreements have benefited airlines and passengers by allowing carriers such as TACA to build a regional network and, in the case of LAN, earn record profits.

However, there are still some challenges to overcome:

- Latin America remains very nationalistic and is characterized by a patchwork of aviation agreements that considerably limit the business development of its airlines. In fact, the outdated regulatory systems do more to generate income for the government than developing airlines.
- Latin American carriers, which are small and medium sized, are plagued by high costs and low efficiencies. Therefore, despite the growing traffic, Latin America is still experiencing economical crises and financial difficulties. This is evidenced by the economic fleet-size reduction among Latin American carriers and the fact that economic turmoil and high jet fuel costs have caused airlines to struggle to survive.
- At the same time, pressure is building for airlines to improve safety systems and the quality of service that is expected by global travelers.

As these issues are considerable, alliance and consolidation strategies are topics of critical importance. They are viewed as a way to gain strength and survive globalization.

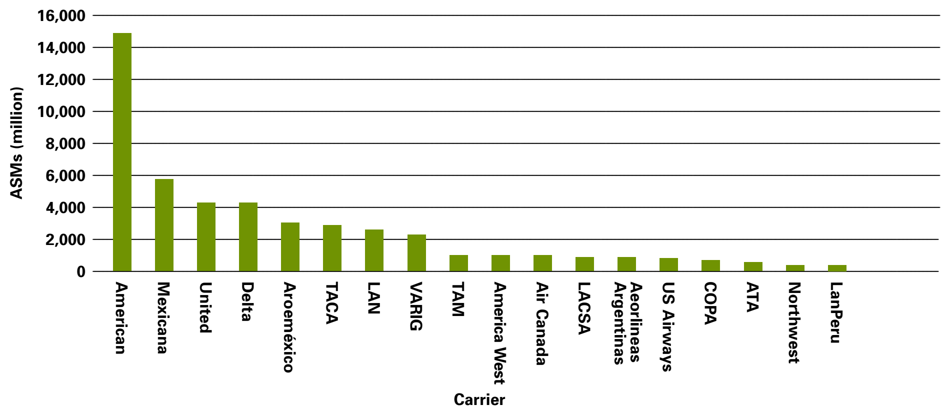
Proliferation of Alliances and Consolidation in Latin America

Consolidation in the region began with TACA's highly successful mergers, which resulted in one of the best networks in Latin America. Since TACA began its consolidation program, the number of similar efforts has been increasing continuously. Currently, alliances can be found from Mexico to the southernmost points of Latin America. Although they take various forms, they are mainly driven by the necessity to head off competition, create economies of scale, and increase revenue by expanding their presence and market share in other regions.

U.S. and European carriers' expansion in the market has forced Latin American carriers to focus not only on the cost side but also on the revenue side. Developing a more attractive network with U.S. carriers and offering better customer service has allowed Latin American carriers to become more competitive, particularly those based in countries that are too small to provide a sufficient market to survive.

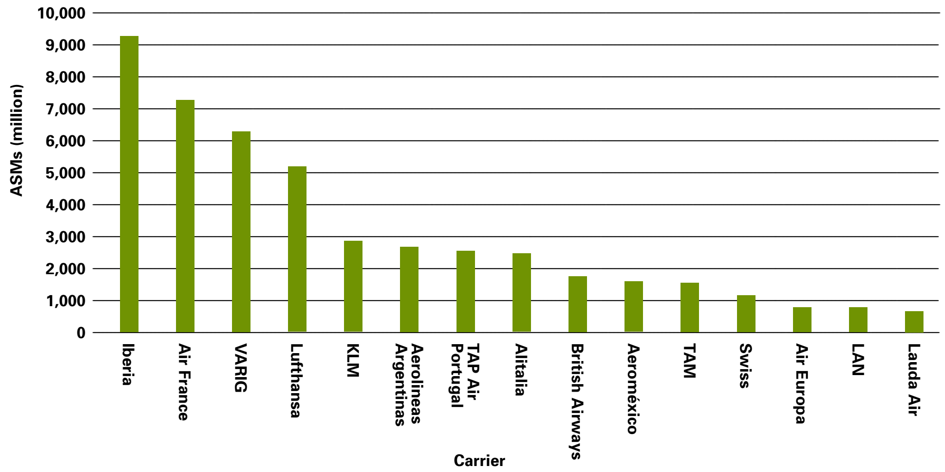
Although numerous alliances exist today in the region, they can be categorized in two ways: geographic (global, regional or interregional) or by the level of equity interest.

2003 Non-Stop ASMs Per Carrier Between North America and Latin America



A comparison of the available seat miles performed in 2003 for non-stop segments between North American and Latin American carriers demonstrate that North American carriers (American, Continental, United and Delta) hold four of the seven top positions, which allowed them to increase their market share in the region.

2003 Non-Stop ASMs Per Carrier Between Europe and Latin America



A comparison of the available seat miles performed in 2003 for non-stop segments between European and Latin American carriers demonstrate that European carriers (Iberia, Air France, Lufthansa, KLM and TAP Air Portugal) hold four of the top five, five of the top seven and seven of the top 10 positions.

Global Alliances

A global alliance enables Latin American carriers to expand in other continents. Aeroméxico, for example, has been able to offer routes to France and Italy as a result of its relationship with Air France and Alitalia. As of today, only LAN (**one**world), VARIG (Star Alliance) and Aeroméxico (SkyTeam) have joined this type of alliance, which still does not extensively cover Latin American countries. However, depending on their partners, these alliances cover a specific region. Star Alliance, for example, covers Brazil extensively through its member airline VARIG.

The benefits recognized by Latin American carriers when joining a global alliance include:

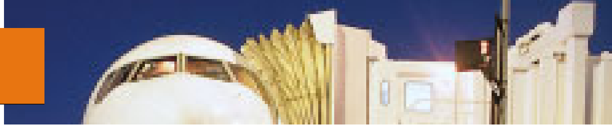
- Acquisition of world-class experience from alliance partners,
- Ability to offer a more comprehensive range of services and programs (i.e. lounges),
- Improved branding,
- Expansion of the network in a cost-effective manner,
- Impetus to bring operation to a world-class standard.

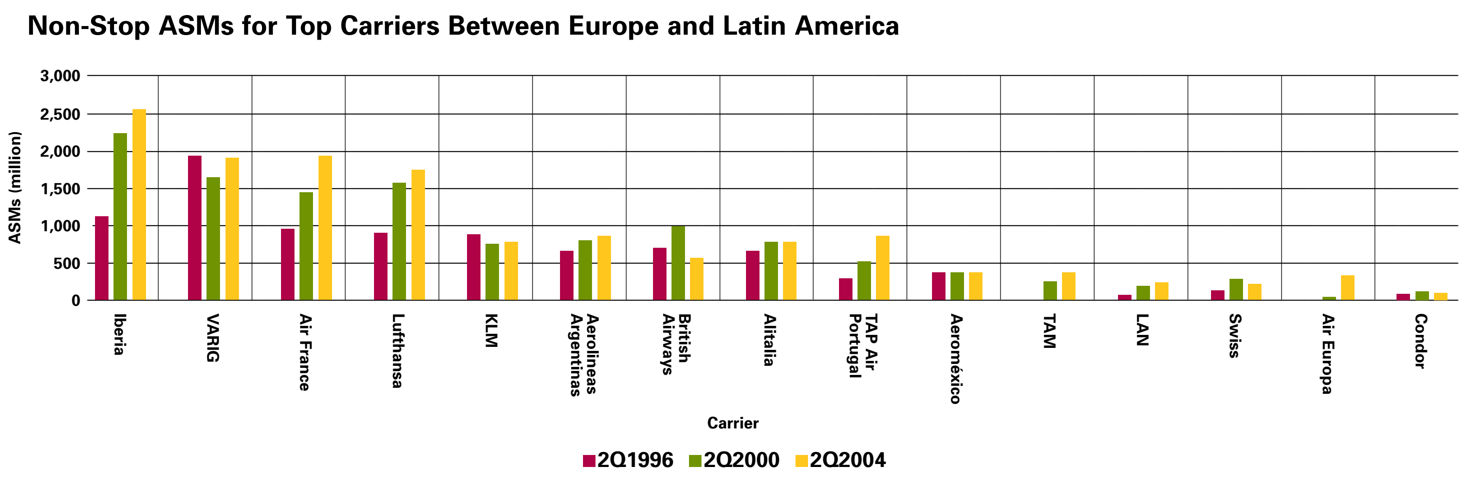
North-South Alliances

One trend in the region has been the development of north-south alliances — COPA and Continental Airlines, Delta Air Lines and Aeroméxico, TACA and American Airlines. The results of the alliances are varied. On one hand, they open additional gateways in the United States and improve Latin America market presence there; on the other hand, many North American carriers have been attracted to Latin America because of its growth potential, which could lead to further competition in the home markets of the region's carriers.

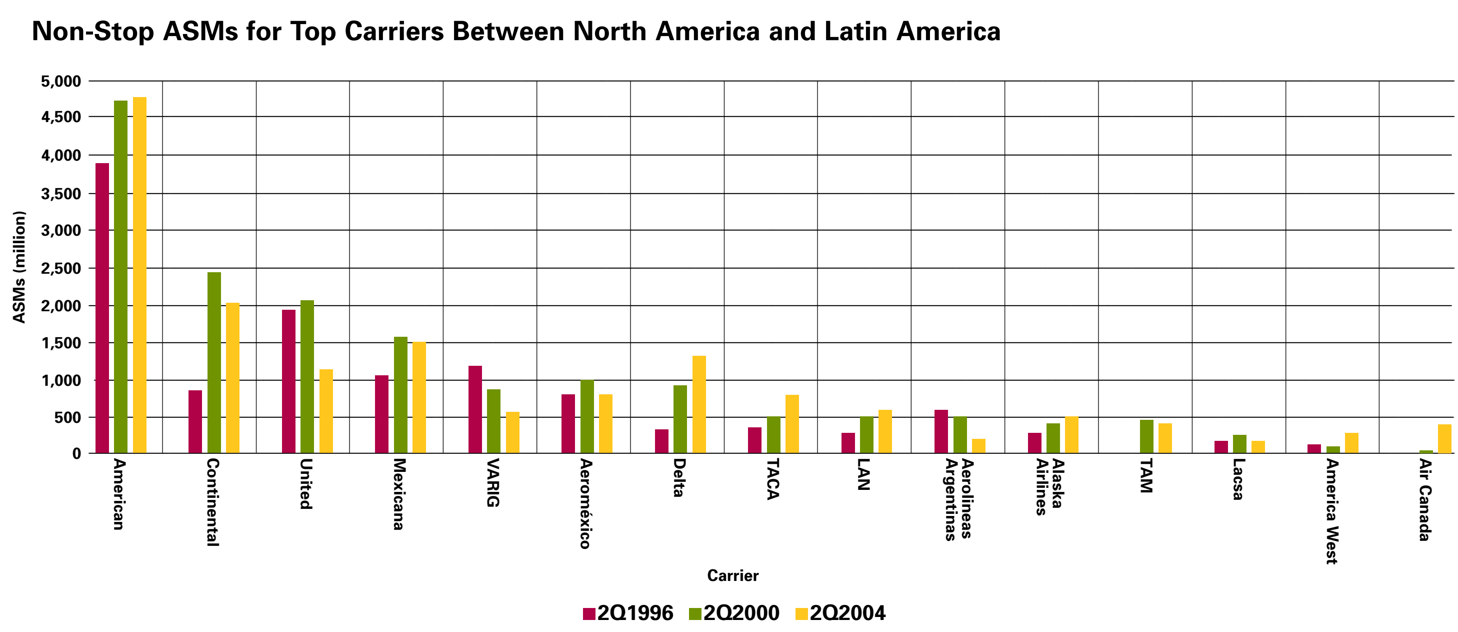
Despite the fact that COPA, TACA and Aeroméxico have been successful with this type of alliance, other airlines see limitations. Some believe this trend could create tension among global alliance members because they may compete for the same customers in Latin America.

Some carriers also fear the dominance of the large North American carriers and believe that this type of alliance benefits the





Most of the leading European carriers that provide service to Latin America increased their available seat miles to the region during the last six years; therefore, they profited largely from the traffic increase and open skies agreement. Latin American carriers are loosing their leadership in this market.



The trend varies for non-stop available seat miles between North America and Latin America. For example, for Latin America-based carriers such as TACA and Mexicana, ASMs increased. American Airlines maintained its market share gained during the last eight years. Some United States-based carriers such as United and Continental showed a decrease in the last year.

North American carrier more than its smaller Latin American counterpart, which, they believe, would be on more equal footing with European carriers.

Regional Alliances

Latin America is exemplified by the numerous regional alliances that have been developed by small, successful airlines that are strong in their home country, such as LAN.

Regional alliances allow area carriers to:

- Compete at the regional level and throughout Latin America,
- Provide services to smaller markets,
- Reach cities that cannot be served with a specific fleet type,
- Increase network reach.

The success of this type of alliance can be explained by the fact that markets are small and carriers need to expand regionally in order to grow. TACA, for example, formed a codeshare alliance with Avianca to take advantage of the increased traffic between Central America and Colombia. However, not every country has the size to have regional alliances and may find it more difficult to overcome the economic burden.

Alliances by Equity

Finally, as nowhere else, the history of alliances in Latin America is characterized by

Alliance Status in Latin America

	Equity alliances	Regional	North-South	Global Alliances	Codeshare and inter-regional alliances
TAM	TAM Mercosul 80% share in Transportes Aereos del Mercosul of Paraguay		American Airlines		Air France, American Airlines, KLM, TAM Mercosul, VARIG, Uair
TACA	TACA has equity stakes in TACA (49%), LACSA (10%), AVIATECA (30%) and NICA (49%)	Yes	American Airlines		American Airlines and Air France
LAN	LAN 73.3% share in Aerolinhas Brasileiras, 100% in LanDominicana, 70% in LanPeru, 25% in Florida West International Airways, 45% in LanEcuador, 25% in MAS Air (Mexico)	Yes	American Airlines	oneworld	Aeroméxico, Alaska Airlines, American Eagle, British Airways, Iberia, LanExpress, LanPeru, TAM Mercosul, Qantas Airways, Florida West International Airways
VARIG	99% in Nordeste Linhas Aereas Regionais, 97% in Rio Sul Servicos Aereos Regionais, 49% in PLUNA			Star Alliance	Air Canada, Alitalia, Aserca Airlines, Mexicana, PLUNA, South African Airways, Spanair, TAM
COPA	49% owned by Continental Airlines, 51% by Mota family		Continental Airlines		Commercial with Lufthansa, Aerosur, South African Airways, United Airlines, Nordeste Linhas Aereas Regionais. Codeshare with Cubana de Aviacion (Havana-Panama), Gulfstream International (Florida, Carribean, Bahamas), Mexicana (Mexico-Panama City, Cancun-Panama City), TACA
Aeroméxico	Belongs to CINTRA along with Mexicana, Aeroperu and several regional carriers within Mexico		Delta Air Lines	SkyTeam	Air France, Alitalia, CSA Czech Airlines, Delta Air Lines, Japan Airlines , TACA, Korean Air, Atlantic Southeast Airlines (Atlanta-Mexico City, Monterrey and on 14 flights from Dallas/Forth Worth), Continental Airlines (United States and Mexico), Aeromar (within Mexico), LAN (Mexico City-Santiago), Mexicana (numerous markets within Mexico, and Mexico City-Santiago and Mexico City-Guadalajara and Mexico City-Oakland), TACA (Mexico City-Lima)
Aeropostal	Equity in Aerocontinente, 33% stake in AeroRepublica (Colombia) and a 45% stake in Sol Air (Honduras)	Yes			Codeshare with Cubana de Aviacion and Air Europa
Mexicana	CINTRA 99.95%				Air New Zealand, All Nippon Airways, Iberia, Lufthansa, Scandinavian Airlines System, American Airlines, VARIG, Air Canada , Aeromar and Aeroméxico (within Mexico), Avianca (Mexico City-Bogota), COPA (Mexico City-Panama, Cancun-Panama), commercial agreement with Austrian and Asiana
Avianca	94% of SAM Colombia — Owned by Federación Nacional de Cafeteros 50%, Grupos Valores Bavaria (43.73%), Helicol (4.77%) and Inversiones Fenecia (6.14%)		Delta Air Lines		Codeshares with ACES, Delta Air Lines, LACSA (Guatemala, San Jose and San Salvador to Bogota, Cali and Medallin), Mexicana (Mexico City-Bogota), TACA (Colombia-Central America)
Aerolineas Argentinas	92% owned by Grupo Marsans of Spain, 3% employees, 5% government of Argentina	Yes			No alliances/codeshares except that Austral Lineas Aereas and Aerolineas Argentinas operate as one airline, commercial agreement with Aerosur, Austra Lineas Aereas, Iberia
GOL	Has stakes held by American International Group (12.5%), Grupo Aurea (87.5%)				
LAB	48.27% owned by the Bolivian government and 50% by a private investor				LAB codeshares with TACA Peru (Santa Cruz-Panama, Mexico City-La Paz) and with TAME Linea Aerea del Ecuador (Quito-Lima, La Paz-Lima)

airlines acquiring an equity stake in another carrier. LAN, formerly LanChile, started its expansion by acquiring almost 57 percent of Ladeco and then merging with Fast Air in 1998. Over the course of the next few years, the airline established subsidiaries in Peru, Ecuador and the Dominican Republic.

TACA — by acquiring an equity position and management control of Aviateca in Guatemala, TACA de Honduras in Honduras, NICA in Nicaragua and LACSA in Costa Rica — formed one airline under centralized management. In so doing, it not only became a regional conglomerate but also built one of the best networks in Central America, achieving economies of scale.

Other airlines in the region have also pursued alliances by acquiring a stake in fellow carriers. Colombian carrier Avianca resulted from a merger of SCADTA and Servicio Aero Colombiano. COPA believed that an equity alliance would enable it to move from a small domestic airline into a regional hub-and-spoke carrier. Today, 49 percent of COPA is owned by U.S.-based Continental Airlines and has one of the region's more successful hubs. Small Brazilian-based carrier Ocean Air is looking to expand its regional network via equity alliance. And Aeropostal has equity in Aerorepublica and Caribiana.

The announcement in May by a Brazilian investor of plans to purchase Avianca confirms the region's growing trend of weaker airlines consolidating with larger, more stable carriers in order to grow and survive.

Lessons Learned

The experience of several Latin American carriers regarding alliances in the region has provided several lessons:

Alliances Bring Benefits

Many carriers believe that alliances provide substantial benefits in terms of increasing the ability to compete at a regional or continental level by extending their networks.

During the past several years, alliances have been developed with various degrees of success. The region's most successful have been LAN, TACA and COPA:

- COPA went from a domestic carrier to a successful regional hub operation.
- TACA's early move not only resulted in the airline becoming a strong competitor but also positioned it ahead of the curve in the region before U.S. carriers began to enter the market.
- LAN has become one of Latin America's most successful airlines.

Clear Goals and Objectives

Alliance partners must not only share a strategy and a vision but also common goals and an understanding of how they can complement each other through the partnership.

"Probably the main reason of the success is that everybody worked toward the goal of being one single carrier in many aspects," said Guillermo Bran, alliance and interline manager at TACA.

COPA is a clear best-practice example. From the beginning, COPA and Continental shared a vision of establishing hubs in Central America. Today, Panama is seamlessly connected to Houston, Texas, the Continental gateway to 31 cities in 20 countries in Latin America.

Alliance Resource Allocation

Alliance relationships are complex. They bring profit opportunities but also losses if not managed correctly. For larger airlines, a carrier needs to have a planning and negotiating team dedicated to managing the process and keeping efforts productive. Smaller airlines must also take advantage of the tools and methodologies used by larger airlines to simulate the increase in traffic that will be gained from the alliance.

TACA's planning department has run rigorous financial and market analysis during the creation phase of the alliance. "We do an analysis based on different options that are present at the current time," Bran said. "We then run financial analysis based on connectivity and market sizes."

Proactivity

Once airlines have selected their partners, they should actively manage the direction and process of the alliance.

"In most cases, Latin American airlines need to proactively approach the alliance to present the case on how there is a mutual benefit if their airline gets to participate in that alliance," said Alfonso Acosta, director of regional alliances at Mexicana. "Only in a few cases, the airline will be approached by other domestic or regional carriers to develop a partnership, and in fact, some smaller airlines in the region do not have a lot of visibility."

That principle was applied by Aeroméxico, which took an active role in developing its alliances.

"Aeroméxico, along with Air France and Delta, was a founding member of SkyTeam and actively works toward the development and growth of the alliance," said Nicolas Rhoads, director airline strategy for Aeroméxico.

Preferred Models

If the emphasis has been on north-south alliances, more thought is given today to interregional alliances, which are seen as the preferred model because of more common political and economical alignment.

Also, many airlines see equity alliances between Latin American airlines as preferable to the so-called vertical alliance between U.S. and Latin American carriers because they may relegate Latin American partners to a secondary role.

Role of Information Technology

IT plays a key role in alliances, including:

- Providing a seamless experience to the traveler when IT is properly integrated,
- Leveraging IT knowledge and skills among partners,
- Integrating required IT processes, such as in codeshare, commercial, and frequent flyer interactions and agreements.

Perceived Risks of an Alliance

In addition to the lessons learned, Latin American carriers also recognize a number of perceived risks when engaging in alliances, such as:

- Disagreement among partners,
- Uneven distribution of revenue sharing and benefits,
- Adverse reaction from local governments,
- Less ability to react to market changes,
- Less flexibility in managing individual objectives and standards,
- Dilution of the small player in the alliance,
- Discrepancies in terms of sharing objectives,
- Cultural and political differences.

Global alliances also include risks:

- Exorbitant expense due to IT commonality requirements,
- High cost of participation to fulfill global alliance standards,
- The dominance of stronger carriers,
- Less flexibility in meeting individual objectives and standards.

Next Steps

Latin American carriers value the benefits alliances offer to both the airline and the passenger. The region has begun to see open skies agreements signed, and the initial results provide an indication of the substantial benefits they might offer throughout the entire region if it continues to embrace liberalization. However, some key steps must take place in order to achieve full potential, such as:

- Modernize Latin America's regional aviation infrastructure and update its regulatory systems,
- Embrace alliances as a way to gain access to lucrative routes to the United States and Europe,
- Improve management of the partnership.

For partners that already have a partnership, the challenge is to make it stronger and manage risks. For those that do not yet have an alliance partner, the challenge is to quickly find the right type of alliance. The key success factors include professional management of the process, clear goals and proactive management.

Trends point toward continued consolidation. Many airlines believe there will be a series of consolidations and alliances formed during the next few years, leaving the market dominated by only two or three carriers, with small carriers focusing on niche markets.

Alliances will also impact market trends, changing the rules so that competition may now be between alliances rather than airlines alone.

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