

Wishing on a star

Varig of Brazil is buoyant about its future as a member of the Star Alliance



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VARIG IS ENTERING one of the most pivotal periods in its 70-year history. After successfully struggling to turn its fortunes around in 1996, the Brazilian flag carrier figuratively hitched its wagon to a star in 1997 when it joined the growing band of airline members of the Star Alliance.

"We celebrated our 70th birthday in May this year and, for the next 70 years, I think our membership of the Star Alliance will be the most important thing," says Varig president and chief executive Fernando Pinto. The airline signed a letter of intent to join the Alliance on 14 May, but entry was delayed until 26 October while Varig honoured the remaining few months of its agreement with Delta Air Lines – an agreement which was terminated as part of the tie-up with the Star Alliance.

Pinto sees his airline's membership as a "win-win" situation for all parties. It plugs Varig into the Alliance's global network which, excluding other new entrant Singapore Airlines, spans 642 worldwide destinations and transports 184 million passengers a year with 6,692 daily departures on 1,446 aircraft. Varig's direct contribution to this includes 390 daily departures with 82 aircraft carrying 9.7 million passengers a year to a network of 122 destinations.

As Brazil straddles the Tropic of Capricorn, Varig's enrolment also provides the Alliance

with its first southern-hemisphere-based member as well as much wider access to Latin America. In subtle recognition of this, the "Star" symbol of the Alliance – which at first represented five airlines (Air Canada, Lufthansa, SAS, Thai Airways International and United Airlines) – is said now to represent the five continents.

"There is a lot of development still to be done, but already it is starting to look good," says Pinto. "Even though we're all talking about cutting our costs, the first priority is to serve the passengers better. So we plan to adjust our schedules to fit the others closely, bring our check-in areas closer together and adjust our baggage system to enable one single check-in process. There's a lot to be done, but you have to make it easier for the passenger by offering a superior service. This will help us build up higher-yield traffic and earn more revenue. You must also remember that, even though we are in this together, we still compete."

STAR FIT

Membership of the Alliance therefore dovetails neatly with the two main drivers of Varig's existing improvement plan – those of growing levels of higher-yield traffic and lowering costs. The introduction of a yield-management system, and the reconfiguring of the fleet with increased executive-class seating in the second quarter of 1996, marked the beginning of the airline's

recovery process. Revenue losses dogged the airline right through to May 1996, when the revised strategy began to take effect. Profitability, nevertheless "...continues to stand out as a major concern", adds Pinto, who says that attacking costs will remain a priority. "We've gone a long way already towards achieving our goals of cost reduction and we are fine-tuning that process now," he says.

Varig's costs had been "...threatening to get out of control", mainly because of the airline's collective salary settlement of December 1995. The carrier's dramatic restructuring plan put into effect in 1996 allowed it to trim costs by \$140 million during the year and further savings are expected from continued measures which have been taken throughout 1997.

One such measure is Varig's continued swing towards operating leases. Under this type of lease, an aircraft is not recorded under permanent assets and neither are the financial obligations recorded under long-term liabilities. This has the effect of reducing artificial distortions which drastically alter the perception of the airline's true economic health. For example, the 1996 results show a loss of Real 63.9 million (\$58 million), based on accounting principles accepted in Brazil as the basis for corporate legislation. Taken another way, however, in terms of constant purchasing power (or full monetary restatement), the airline recorded a healthy profit of Real 97.1 million.



The Star Alliance now embraces five continents

Varig's health measured in constant purchasing power increased dramatically in 1996, a trend which Pinto is naturally eager to encourage. Stockholder equity increased from Real 334.4 million in 1995 to Real 431.6 million in 1996, a rise of 26%. Net income for the year similarly rose, from a loss of Real 7.5 million in 1995 to the Real 97.1 million profit in 1996. "Of course, we continue to look for increasing efficiency in the airline and we have adopted a plan called 'Challenge 800', which is very important for us. We hope to have reached a level of around Real 800 million equity before tax by 1999 or 2000," says Pinto.

ECONOMIC THREAT

One constant threat to Varig's plans, and one which it has come to live with, is the vagaries of Brazil's national economy. Although it has been relatively robust in recent years, the sudden doubling of interest rates (to 40%) earlier this year was a reminder of the "bad old days" when the economy was essentially in freefall. "Four years ago, we had a very high rate of inflation [around 2,400%] and that was difficult for us because we had to find a way of adjusting the ticket prices all of the time. Now, that has gone away and we're living with inflation which should be around 5% this year, and we expect the same or lower next year," adds Pinto.

The sudden rise in interest rates has dampened forecasts for rapid growth, however. "The rate more than doubled, from 18%, which was crazy. We expect it will eventually drift down to around 12% as it is already down to about 36%," he says. Although the rate has little direct effect on the aircraft leases or purchases, which are all arranged outside Brazil, it will affect the country's general economy and reduce travel. "We are concerned because of the reduction in growth which was forecast originally to be 4% to 5% in terms of GDP [gross domestic product]. Now, the feeling is about 2%, so we will slow down and have reduced our growth forecast accordingly. We would have been growing by about 8% this year, but now it will be down by 2% or 3%".

Fortunately for Varig, the recent changes to the airline mean that it is in unexpectedly good shape to take the impact. With the bulk of its restructuring plan in place and bolstered by the prospect of new business through the Star Alliance, Varig is also experiencing a lull in fleet re-equipping. "In the near term, we have only two new Boeing 737s to be delivered at the beginning of 1998 and two [Boeing] MD-11s," says Pinto. "At the same time, we are re-adjusting a lot of our international services and increasing frequency on them. In that case, we are not planning to reduce anything, but rather to improve the service. We have to expect a lower seat-occupancy on those aircraft, so of course we are looking for more efficiency."

In 1996, international traffic formed 72.1% of Varig's business in passenger-kilometres. Of this total, Europe accounted for 27.6%, North America 19.7% and Asia some 14%, although this is expected to show growth with the continued expansion of the codeshare deal linking Brazil with Japan in association with Japan Airlines. The heavily competitive routes within Latin America, on the other hand, produced only 10.8% of Varig's international traffic.

The next major fleet purchase for Varig will be of the Next Generation 737-700/800. The order was converted from an earlier deal for 14 737-300s, and will begin with the hand-over of the first five -800s in 1999. A further five will follow in 2000, with the first -700 expected in late 1999, says Pinto. Further orders and options could eventually extend Varig's total Next Generation purchase to 32.

In larger-scale aircraft, the trend "...will be to increase the Boeing 767-300 fleet and reduce the [McDonnell Douglas] DC-10s. This will be a slow trend, however, because the DC-10 is a very good aircraft. We've also revamped the interiors so much that passengers can't tell them apart from the MD-11s and the crews call them DC-11s." Varig operates eight DC-10-30s, the eighth aircraft being delivered back from lease to Uruguayan carrier Pluna in 1996. Varig also has two DC-10-30 freighters.

Varig's passion for tri-jets is alive and well with its MD-11 fleet, which it intends to retain and even to grow. "We have nine MD-11s in



Pinto: Star gazing

service now, and will have 11 by the end of 1998," says Pinto, who hints that the fleet could grow to 14 within a few years. "It fits perfectly for us. It has just the correct cargo and passenger capacity for our routes, and this means we can take off with full loads and no restrictions from all our destinations. It is very important for us that Boeing kept the line open," he adds.

BOEING FLEET

There are no changes planned to the Boeing 747-300 fleet, which includes three passenger versions and two combis. The 767 fleet, although earmarked for future growth, will stay at the present level for now, says Pinto. Varig operates four -200ERs and six -300ERs, and is "...quite interested in the -400ER", he adds. The airline has also begun low-level studies of "an airliner for the next century", says Pinto, who adds that this is most likely to be in the Boeing 777/Airbus A340 class.

Varig is therefore in confident mood. It faces its eighth decade in a healthier state than perhaps ever before in its long history. Yet the airline's optimism is tempered by knowledge of the fragility of both its national and regional economies. As Varig begins to work closely with its new partners for the first time around the festive season, it may well be wishing on a star for its future prosperity. □