



Vasp owns 39 of its 50 airliners - but it is in talks over lease payments

Sting in the tail

After years of economic woes, at least one of Brazil's airlines could disappear by the end of the year. For the survivors, however, long term prospects look brighter

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BRAZILIAN AIRLINES have survived major financial troubles over the past 15 years, but officials and analysts fear that the latest crisis presents a real danger of a merger or foreign take-over.

The Brazilian industry, which has barely had a chance to recover from an unprecedented fares war which began last year, is being battered by fall-out from the collapse of the country's currency, the real.

All four major airlines — Varig, Transbrasil, Vasp and TAM — are expected to suffer heavy losses in the first six months of the year and have been busy renegotiating leases on their aircraft and closing routes.

Varig alone has debts of \$1.8 billion. "Brazilian airlines are like zombies," says Mauro Gandra, president of the National Airlines' Association (SNEA). "They really should be dead, but they somehow keep walking."

Gandra says that the airlines' woes go back to 1985, when control of airline fares was transferred from the Civil Aviation Authority (DAC) to the Finance Ministry. Gandra blames the

Finance Ministry for fixing air fares at unrealistically low levels, causing huge losses from which the airlines are still suffering.

During the same period, the companies were buffeted by a series of recessive economic packages as the Government struggled in vain to bring down inflation, which at one stage reached the exorbitant rate of 80% per month.

PLANNING FAILURES

In the space of seven years, the Cruzado Plan, the Cruzado Plan 2, the Bresser Plan, the Summer Plan, the Collor Plan and the Collor Plan 2 all attempted to bring roaring inflation under control. The plans were generally the same, with one or two changes nearly always featuring some sort of combination of high interest rates, new currencies (with three zeros knocked off), spending cuts and price freezes. None were successful.

This, combined with incidents such as the bombing of Pan Am flight 103 over Lockerbie, Scotland and the Gulf War, which affected airlines worldwide, cost the airlines around \$4 billion between them from 1985 and 1992, according to SNEA's statistics. ►

The situation improved in July 1994, when the government produced yet another plan, called the real after the new currency which came with it. This time, however, the real was tied to the US dollar and the plan successfully reduced inflation to around 10% a year. In four subsequent years, the government of Fernando Henrique Cardoso privatised inefficient state companies, the real remained stable and the economy grew, turning Brazil into a target for foreign investors.

For a while, the airlines could celebrate. After seven years of losses, Varig announced a \$201 million profit for 1994, while TAM turned from a small regional airline into a national carrier and VASP took controlling stakes in Lloyd Aereo Boliviano and Ecuatoriana. Transbrasil set up its own regional subsidiary, InterBrasil Star, and began flying internationally with routes to Vienna, Amsterdam, Miami, Washington DC and London.

PRESSURE TO LIBERALISE

However, pressure grew on the government to liberalise the airline industry. The companies were accused of perpetuating a comfortable cartel and charging some of the highest domestic fares in the world.

Only Varig, Transbrasil and VASP were allowed to fly non-stop between state capitals, while smaller companies such as TAM and Nordeste were restricted to flying regional routes. (TAM cleverly got around this by introducing quick stopovers in small towns on flights between main cities).

Things changed drastically at the start of last year. The DAC gave permission for smaller airlines to fly non-stop between state capitals, allowed charter flights to be flown on any route and increased discounts of up to 60% on official fares. The result was an unprecedented fares war, with a host of new routes springing up.

The Brazilian public were delighted, as air travel suddenly became accessible to a portion of the population, who until then, had been forced to endure marathon bus journeys to travel around the country.

Adapting to a new reality, the airlines suffered a fall in revenue however, even though the number of passenger-kilometres flown went up by around 20% percent. The SNEA estimates that the price war cost the airlines \$330 million between them in the first half of last year alone, as fares dropped by an average of 37%.

Worse was to come at the start of this year when the real, the central part of the government's anti-inflation plan, went into free-fall, dropping from 1.15 reals per dollar in January to over 2.00 per dollar in early March.

Hardest hit was Varig, which leases two-



Despite modernisation efforts, Varig carries a huge debt and plans to dispose of 10 aircraft

thirds of its fleet of 95 aircraft. All the airlines faced a huge drop in demand, especially for travel abroad, which became prohibitively expensive for most Brazilians.

Meanwhile, competition from foreign airlines has increased dramatically, with American, Continental, Delta and United all flying from the USA. "For the first time, more passengers were transported between Brazil and the United States on US airlines than on Brazilian ones last year," Gandra says.

For Brazilian airlines, the situation looks dim. Varig may have to delay the delivery of 39 aircraft purchased from Boeing that are due to be delivered after mid-2000 as well as renegotiate lease payments. President Fernando Pinto, who took over three years ago after achieving impressive results with Varig subsidiary RioSul, has made big efforts to modernise the company, giving the aircraft a new look inside and out, reducing the work-force from 23,000 to 17,000, slashing unprofitable routes and bringing Varig into the Star Alliance.

Nevertheless, the company still carries its huge debt (although this has been reduced from \$2.4 billion) and also suffers from a structure that makes Pinto's position almost as precarious

as that of the manager of Brazil's national football team. Only last month, the company's nine-man Administrative Council suggested his dismissal. The idea ran into opposition from the Rubem Berta foundation, which controls 87.2% of Varig shares and basically is run by the employees.

VASP SET TO RIDE STORM

The Administrative Council, having lost out, resigned en masse and a new one was voted in by the Rubem Berta foundation, which gave its backing to Pinto.

Meanwhile, the company announced that it would get rid of 10 aircraft — four McDonnell Douglas DC-10-30s and six Boeing 737-200s, from April ditched its routes to Zurich, Porto, Orlando and Washington DC, and announced changes to domestic services as well. The plan, according to Pinto, is to reduce costs by some \$160 million a year.

VASP is in a slightly more comfortable position as it owns 39 of its 50-strong fleet. Nevertheless, company spokesman Rui Nogueira says that international routes from Sao Paulo to Athens, Seoul, Osaka and Aruba have been suspended and that negotiations are taking place with Mitsui over lease payments. Nogueira insists the airline is well structured to ride out the storm.

"VASP is a slimline company," he says. VASP reported a loss of 182.06 million real (\$105.5 million) last year, compared to a 48.2 million

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real profit for the year before.

Transbrasil, whose headquarters are housed alongside VASP's at Congonhas airport in Sao Paulo, admitted last year to being the airline most vulnerable to the fares war and the changing economic situation. But the airline has earned a reprieve, at least for now, after being awarded \$700 million in a court case it launched against the Brazilian Government. Transbrasil successfully claimed that it had been damaged by the government fixing the air fares too low during the period when the Finance Ministry determined the tariffs.

Like Varig, Transbrasil has modernised its aircraft's appearance and has also gone for codesharing schemes, throwing its hand in with TAP-Air Portugal on routes to Europe, and Delta Air Lines on routes to America. But it has still been forced to cut some international routes, and no longer flies to London and Amsterdam. It also has greatly cut back on its Sao Paulo-Miami run.

For TAM, by far Brazil's most successful airline in terms of results in the last few years, the crisis has come at a particularly inopportune moment. The airline's revenue is almost entirely in local currency but, having taken delivery of

two Airbus A330-200s, it now has leases to pay in US dollars. The airline has also thrown its hat in with foreign partners, signing codesharing agreements with American Airlines on its route to Miami and Air France on its route to Paris, which has yet to be inaugurated.

Gandra believes there is little that the airlines can do, other than to pray for the economy's quick recovery. On the other hand, he certainly

believes the government can ease their woes by reducing what is known locally as the "Custo Brazil" — literally the Brazil Cost.

This refers to the huge range of taxes the airlines must pay, as well as the high costs of many items. Varig, for example, paid \$90 million on its \$3.3 billion revenue in the Cofins tax alone in 1997.

Gandra complains that fuel costs about 40% more than in the USA and kerosene carries the same 25% tax usually applied to imported perfumes and other luxury goods. Social security benefits per employee are generally between 90 and 100% of the employee's wages, compared to 47% in the USA, Gandra complains.

Brazilian law prevents foreign companies from holding anything more than a 20% stake

in a local airline. But circumstances may dictate change by the end of the year, predicts Sao Paulo-based analyst José Carlos Martinelli.

SHORT-TERM CASH CRISIS

Brazil's economic future is still in the balance. Martinelli is amongst the optimists, but fears the recovery may come too late for the airlines. "The medium and long term prospects are still reasonable. The problem is the short term, as the airlines don't have a penny to spend. By the end of the year, there could be one less major company on the scene," he says, predicting that at least one could merge or be bought up. "The Brazilian aviation scene will not be the same by the turn of the century."

Gandra, who also foresees change, laments the possibility of an essentially Brazilian aviation industry falling into foreign control. "A country of 8.8 million square kilometres, with a population of 160 million people, cannot survive without aviation," says Gandra. He points out that the number of passengers carried has increased from 13 million in 1993 to 22 million last year.

"Brazil is a country with a distinguished history in aviation," he says. "The accident rate is 0.9%, which is better than Europe, and when the Sivam [Amazon surveillance] system is complete in 2003, it will cover a bigger area than Eurocontrol. It would be a great shame if any of our airlines were to end up in the hands of foreigners." □

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