FIGHT TO SURVIVE

Constant economic upheavals have made South America one of the most challenging environments in the world in which to operate an airline

JACKSON FLORES JR / RIO DE JANEIRO

After dropping plans for a merger with TAM, Varig is looking to improve its position in the Brazilian market

MARK WAGNER/AVIATION-IMAGES.COM

There can be few tougher places than South America to operate an airline. Not only are carriers exposed to the same global crises as everyone else – worries over terrorism, security costs, fuel prices, health scares – they have to contend with a series of unique regional challenges, including South America's volatile economies and politics. The past two and a half years have been especially hard for the region's scheduled operators, with more than a quarter of them suspending operations, changing owners or being absorbed by a larger rival since the World Trade Center attacks.

So what hope is there for South America's airlines? There are some positive signs emerging, with Argentina's economic rebound boosting the prospects of its troubled airline sector, and Brazil's flag carrier Varig newly confident after a difficult rationalisation. Meanwhile, in the continent's other big economy, flag carrier LanChile has managed to escape the worst tribulations of the economic downturn and is nurturing a family of subsidiaries all over South America.

Embattled Argentina

Perhaps no other South American country has suffered greater recent hardships in the air transport sector than Argentina. The protracted period of economic upheaval has led to reduced load factors and loss of revenue. In addition, its airlines also complain of an inadequate government air transport policy.

Many of the country's key airports lack proper air navigation facilities. This and other shortcomings led to the US Federal Aviation Administration's July 2002 decision to downgrade Argentina to Category 2 status – a blow for the country's airlines, which had planned to launch services to the USA and Europe.

The sharp devaluation of the peso two years ago only added to the problems. Around 40% of an airline's costs, which include aircraft lease payments, fuel bills, spares, airport landing fees and services, is paid in US dollars, while revenue is mainly generated in local currency. It is not surprising that only five of the 11 larger carriers operating during 2001 remain.

After entering bankruptcy protection in mid-2001 with a net loss of $392 million and watching its market share evaporate to just 17%, the demise of national carrier Aerolíneas Argentinas was thought to be virtually inevitable when it was taken over by the Spanish Marsans Group later that year.

Yet the new management stemmed the financial haemorrhage, achieved a profitable 2002, emerged from bankruptcy protection in early 2003, and built a 78% share of the domestic market.

Predictions of an even better 2003

proved true when Aerolíneas Argentinas grossed $658 million, a 59% growth on the preceding year. With net profits of $43.8 million, up from $13 million in 2002, chief executive Antonio Mata believes an even better 2004 lies ahead, with profits forecast to exceed $56 million. Ironically, one of the underlying factors for this strong recovery is that the devaluation of the peso has boosted tourism considerably.

After two years streamlining its domestic and international route network, Aerolíneas Argentinas is introducing strategies to further improve its position. In the first half of this year the airline expects to whittle its global debt by another $100 million, and is finalising plans to trade shares on the Buenos Aires stock exchange – a first for an Argentinian airline. Reportedly, an initial package comprising 10-15% of the airline's common stock will be traded, with more packages to be offered in the future. Shares may also be sold on the New York and Madrid stock exchanges.

In January 2003, the flag carrier revealed plans to establish subsidiaries in neighbouring countries. The first, Aerolíneas Austral Chile, will be launched at next week's FIDAE 2004 air show in Santiago. Aerolíneas Argentinas sources say the Chilean carrier will use Boeing 737-200s on domestic routes and Boeing 747-200s, probably taken from the national carrier's current fleet.

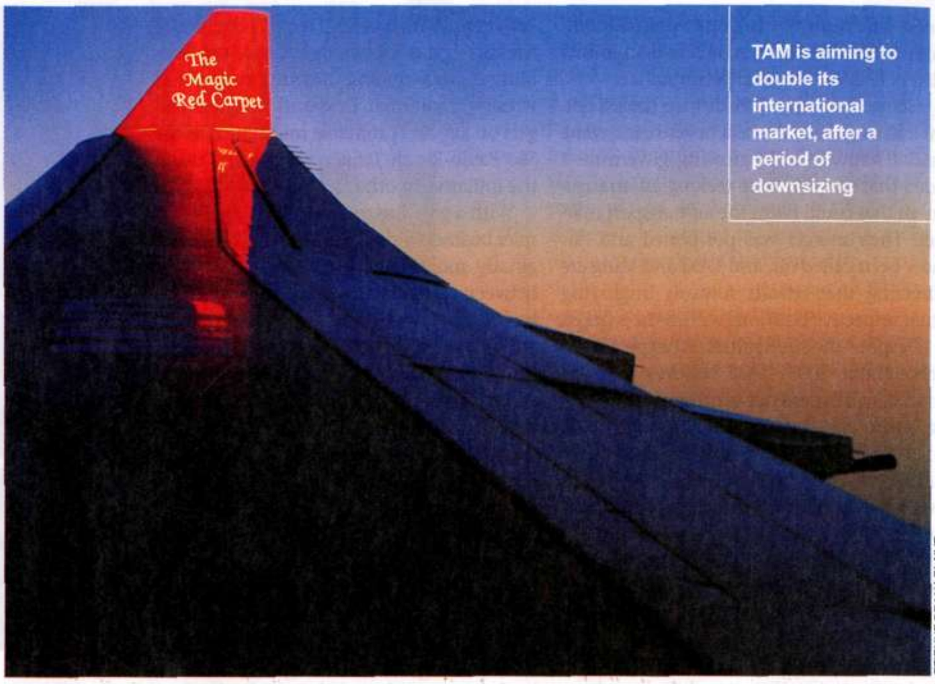
Around $9 million will be invested in subsidiaries in Bolivia, Paraguay and Uruguay, respectively, to be named Aerolíneas Austral Bolivia, Aerolíneas Austral Paraguay and Aerolíneas Austral Uruguay. Aerolíneas Argentinas has already started negotiations with Uruguayan carrier Pluna's major shareholders and has signed a letter of intent with Brazil's Varig – which holds a 49% stake in Pluna – and the Uruguayan government.

Varig commercial director Alberto Fajerman confirms the talks. "If they make an offer we cannot refuse, we'll obviously accept it," he says. Aerolíneas Argentinas objective is to secure a 70% stake in Pluna, although it has contingency plans to establish a new airline in Uruguay if talks fail.

Aerolíneas Argentinas recently took delivery of an Airbus A310-300 and an ex-Air Canada Boeing 747-400. Between May and September, it will receive a further two secondhand 747-400s, with a third arriving in January 2005. An A340-300 will be delivered in June, followed in October by an another A310-300.

The domestic fleet will be modernised between May and December with eight 737-500s and two Boeing MD-83s, the former replacing an equal number of 737-200s, an undisclosed number of which will probably join Aerolíneas Austral Chile.

Elsewhere in Argentina, Cordoba-based



TAM is aiming to double its international market, after a period of downsizing

ETIENNE DE MALGLAIVE

Southern Winds gained a much-needed respite after forming a partnership with LAFSA, a government-owned carrier created after the demise of LAPA. Posting revenues of $65 million during 2003 – up by 112% over the previous year – Southern Winds plans to expand its domestic route network to southern Argentina, a growing tourist attraction. Two ex-Varig 737-200s joined the airline's six 737-200s and two 767-300s at the end of 2003.

The ending of American Falcon's scheduled services in Argentina has left regional carrier AeroVip able to expand its operations. The Buenos Aires-based airline, now flying six BAE Systems Jetstream 32EPs, has consistently enjoyed high load factors to the five domestic and international destinations that it serves.

Brazilian tribulations

Boasting the largest air transport market in South America, with 48 billion revenue passenger kilometres flown in 2003, Brazil faces similar problems to those seen elsewhere in the continent. The devalued local

"For little more than a bus fare, a passenger can take a 3h flight that would otherwise take three days"

TARCISIO GARGIONI, GOL

currency and absence of clear government air transport policies, coupled with an economy that is only now beginning to show signs of recovery, have taken their toll among Brazil's airlines. According to TAM commercial director, Klaus Kunast, market forecasting is a complex and trying task. "Every time there is a hiccup in the US dollar exchange rate, shock waves are sent up and down the Brazilian air transport industry," he says. Yet, excluding major carrier Transbrasil and its regional subsidiary Interbrasil Star, none of the 20 largest scheduled carriers in Brazil have suspended operations – although most have had to reduce fleets, routes and staff to survive.

The heavy government tax burden imposed on the airline industry is one of the chief complaints voiced by the more than 30 airlines that operate in the country. Despite near stagnant traffic growth since 2000, the Brazilian government levied a complex string of taxes on air transport services, eroding ever-smaller profit margins. Amounting to around 35% of an airline's revenue, the taxes further hinder whatever competitive edge Brazil's two flag carriers TAM and Varig might earn on destinations abroad. With European and US airlines frequently offering significantly lower fares on the same routes, local passengers tend to opt for foreign airlines. Although the Brazilian government has indicated its willingness to address what has been described as a "lop-sided tax burden", no solution has been forthcoming.

To survive, many of Brazil's airlines have downsized. In early 2003, TAM and Varig started merger talks, seen as essential for their survival. The two agreed initially on a codeshare deal covering more than 60 common domestic routes, which had an immediate effect on financial performance.

Helped by a near 20% drop in the US dollar exchange rate, the deal nevertheless came under scrutiny amid growing government fears that the two were seeking an arrangement that could harm the air transport market. Their merger was postponed and has now been called off, and TAM and Varig are directing their efforts towards improving their respective positions within the market.

Despite the difficulties it experienced throughout 2003, TAM believes that the market will experience some growth, which is borne out by an industry-wide 10% increase in domestic traffic during January and February compared to the same period last year. Running a sleeker operation in which 71% of its tickets were sold through the e-TAM electronic system, the airline is gearing for growth. "This March we started to regain one of our traditional niches – that of flying businessmen between Brazil's key destinations," says Kunast.

TAM is aiming to double its international route network, which accounts for around 15% of total income, by opening routes to New York and increasing weekly flights to Paris. Together with its Paraguayan subsidiary TAM-Mercosur, TAM is also aiming to serve further South American destinations, including Caracas and Santiago.

After suffering proportionately higher losses in terms of route network and fleet, Varig is slowly recovering. Its regional subsidiaries Rio Sul and Nordeste, now absorbed into the Varig Group, operated a 144-aircraft fleet shortly before 11 September. That number has been slashed to 96, which is expected to fall to 85 with the return of the 11 remaining Embraer ERJ-145s on lease. Varig has meanwhile taken delivery of its fourth ex-Swiss Boeing MD-11 and a further two Boeing 777-200s as it seeks to relaunch its African services to Johannesburg and Luanda.

Having overtaken Vasp as the country's third largest airline, newcomer Gol Transportes Aéreos is snapping at Varig's heels with a 24% share of the domestic market versus Varig's 30%. Free of huge debts, the carrier has shown an aptitude for flexibility in unfavourable circumstances. It has wrested traditional TAM and Varig passengers on key and profitable routes such as the São Paulo-Rio de Janeiro shuttle and taken the initiative in other segments.

With a growing reputation as Brazil's premier business airline and offering fares marginally more expensive than a bus ticket between distant state capitals, low-fare Gol has captured traditional motor vehicle users and other clearly defined slices of the market. The rationale is easy to understand, according to Tarcisio Gargioni, Gol's marketing vice-president. "For just a little more than a bus fare, a passenger can take a 3h flight that would otherwise require a three-day trip," he says. Gol has also identified potentially profitable market segments such as night flights between five major state capitals, including Rio de Janeiro and São Paulo. The airline has posted an average 95% load factor since it began the new service, spurring TAM and Varig to launch similar flights.

High-flying Chileans

With three local airlines catering for most of its domestic and international air transport requirements, Chile hosts some of the more enterprising carriers in the continent, which have overcome many of the difficulties affecting other airlines in the region.

LanChile has carved itself a niche as one of the world's leading airlines and will launch its new corporate image at the end of March, renaming itself and its subsidiaries Lan. With $1.6 billion in gross revenues last year, LanChile more than doubled its net profit to $83.6 million. Profitable for the tenth consecutive year, the carrier has followed a path of judicious growth and consolidation, while reacting quickly to market changes.

LanChile's domestic airline, LanExpress, secured a 63% market share in 2003. The flag carrier received its first two new Airbus A319s in December 2003, and 12 are on the way. A leased 767-300 was added, with an additional four scheduled for delivery this year to cater for international growth. With subsidiaries in Ecuador, Peru and the Dominican Republic, LanChile has its sights set on establishing an Argentinian subsidiary by acquiring a share in LAFSA. It also made overtures to obtain a stake in Colombia's flag carrier, Avianca.

MARK WAGNER/AVIATION-IMAGES.COM

LanChile is launching a new corporate image as simply Lan

LanChile and LanExpress are now encountering a new adversary that is capturing an increasing slice of the domestic market. Established nearly two years ago, Sky Service maintained a market share during the last half of 2003 that never fell below 15%, at times exceeding LanChile's own share. Currently operating five Boeing 737-200s, Sky Service's initial charter services has given way to scheduled flights to key Chilean destinations.

While most established South American airlines face challenges, not least the rise of the lower-cost carriers, innovation and sharper strategic planning has staved off disaster for some. As long as the international scene remains relatively stable, there is no reason the market should not experience a period of reasonable growth. ■

Aerolíneas Argentinas is enhancing its long-haul fleet with secondhand 747-400s

MARLO PLATE