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ITIC POSITION ON IAG/AER LINGUS

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What is the future for Aer Lingus?

The current debate prompted by the IAG approach is welcome and healthy given the importance of the airline for the country and the tourism industry in particular. Given the nature and complexity of the issue it is not surprising to find that unanimity is unrealistic. However, at least some of the debate appears to be founded on an overestimation of the influence of the Government's minority shareholding in a publicly quoted company, and an underestimation of the business dynamics currently shaping the international airline industry.

The concerns being expressed by business and tourism interests, particularly in the south west and west, and the apprehensions of the company's workforce are very real and must be addressed in any evaluation of the issues facing the Government in weighing up what is best in the national interest.

Foremost in any discussion on the topic has been 'connectivity'- which appears to be exclusively applied to the Heathrow connections from Cork, Shannon and Belfast, though for Shannon it is particularly sensitive in that Heathrow is its sole European hub. The assurances recently provided by IAG which would effectively secure the Heathrow services for a period of 5 years, provides a security of services which currently does not exist. Indeed one could argue that given a strong bonding with BA's global network at Heathrow demand on routes to/from Ireland, including Shannon, will increase as new improved connectivity is opened up.

One need only recall the withdrawal of Heathrow services from Shannon in 2007 taken by Aer Lingus for commercial reasons, to appreciate the value of the security provided by the assurances which IAG are prepared to offer. Many of the analogies cited for BA behaviour on domestic UK routes in the past refer to a different period in time and an outdated business approach. In short, the sale should it proceed would provide Ireland with a global one-carrier network connected to all regions of the world, while securing the future of Aer Lingus as a national brand in stable ownership within the International Consolidated Airline Group (IAG).

Connectivity to markets

Currently Aer Lingus provides over 50% of transatlantic lift to/from Ireland and 42% of short haul capacity to/from Irish airports. Clearly the outcome of any change in ownership could have implications for Irish tourism. However, Aer Lingus, continuing to exist as an Ireland based independent business unit with its valuable brand and personnel intact, could exploit many opportunities with a good synergistic partner. The potential exists to grow traffic on transatlantic routes, as well as a significant improvement in access to new emerging markets via a major European hub. This would provide access to new developing high value source markets for exports and tourism, as well as FDI investment, which is a key consideration for Government when weighing up the proposal. Unfortunately to date the debate has tended to focus on the perceived 'down sides' to the almost exclusion of the potential 'upsides'.

Some alternatives for control of Aer Lingus

Should the current prospective bid not proceed, Aer Lingus as a relatively small former state owned national flag carrier is unlikely to prosper as a stand-alone carrier with a small home market base, although it is probable that the short-term impact on tourism might not be material. Over the past decade several national carriers in Europe have been subsumed into larger groupings or have gone out of business. These include Sabena/Brussels Airlines, Malev, Austrian, Swiss, and Iberia, amongst others. It is likely that Aer Lingus would continue to be a vulnerable take-over target, as the move towards consolidation gathers momentum in the industry. Prospective suitors could include trade buyers such as Ryanair, Lufthansa, Air France-KLM, a less than 50% shareholding by a Middle East carrier, or alternatively a hostile bid for the airline by an investment fund.

Arriving at a decision

Should a formal offer emerge from IAG for Aer Lingus, it is reasonable to expect that it be accompanied by a comprehensive business plan. Among other things this should address the value they see in Aer Lingus, together with an outline of how IAG plan to invest in growing the brand within the IAG Group, and how they intend to commit to maintaining strong aviation links to Shannon and Cork over the longer term. It is hoped this would then provide the basis for a decision arrived at on the basis of what is in the best interest from a national economic perspective.

As with any commercial merger the move is not without its threats to the status quo, but before arriving at a decision one way or the other, the potential threats should be weighed against the potential opportunities.

A Tourism submission on the IAG bid for Aer Lingus
Irish Tourist Industry Confederation (ITIC)
January 30, 2015

Overview

The Irish tourist industry stands to gain from the proposed take-over bid by IAG for Aer Lingus. The bid, if successful, would for the first time provide Ireland with a global one-carrier network connected to all regions of the world, while securing the future of Aer Lingus as a national brand in stable ownership within the International Consolidated Airline Group (IAG).

As with any commercial merger the move is not without its threats to the status quo, but our analysis would suggest that on balance the upsides of the proposed change of ownership, from a tourism perspective, outweigh the perceived downsides.

The context

The international airline industry, while currently on a positive trajectory, is a notoriously volatile business, yielding low margins. The industry has been marked by consolidation and alliances as airlines strive to achieve global reach and economies of scale. The airline industry landscape in Europe has changed dramatically over the past 15 years with low cost airlines, led by Ryanair and easyJet, dominating on point to point short haul routes, while consolidation within the legacy sector has led to the formation of Europe's big-three network carrier groups – IAG, Lufthansa, and Air France-KLM. Of the three IAG has emerged as the most efficient and more profitable.

Aer Lingus as a relatively small former state owned national flag carrier is unlikely to survive as a stand-alone carrier with a small home market base. Over the past decade several national carriers in Europe have been subsumed into larger groupings or have gone out of business. These include Sabena/Brussels Airlines, Malev, Austrian, Swiss, and Iberia, amongst others. If the current bid were to fail then Aer Lingus would continue to be a vulnerable take-over target, particularly after the resolution of the pension issue, with current strong profits and balance sheet adding to its attractiveness. Furthermore, Aer Lingus is an attractive target as it is now amongst the more efficient and lowest cost base legacy carriers in Europe. The company enjoys relative labour stability, controls valuable Heathrow slots, is a reputable brand and has a fast growing and profitable transatlantic business, together with orders for new long haul aircraft.

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Projected benefits to the tourism sector from the IAG take-over

Assuming Aer Lingus will continue to operate as separate business unit within IAG, maintaining its brand identity, personnel and fleet, as is the case with Iberia & Vueling within the group, the anticipated benefits for inbound tourism would include:

- ✈ The backing of IAG's strong market presence and high visibility in the global distribution channels will deliver an immediate benefit to Ireland. The seamless connection into BA's and Iberia's global networks will not only open up new market opportunities but will offer greater capacity, frequency and options for visitors to Ireland.

- ✈ Direct network connections to regions of the world not currently served, most particularly Asia/Pacific, South America, and Africa, fast growing source markets for travel with potential for Ireland. Visitors from these markets are currently the highest spending visitors to Ireland.

- ✈ More transatlantic services, as IAG/BA feed traffic via Dublin due to capacity constraints at Heathrow, effectively using Dublin as Heathrow's 3rd runway and leveraging Aer Lingus' lower cost base. This will effectively open up more gateways for North American visitors to Ireland. Visitors from this market are significantly higher spenders, with a higher incidence of use of hotel, coach and car hire than the typical tourist from Europe.

- ✈ The growth in transfer traffic to/from transatlantic services has also secured the sustainability of a number of short haul routes, and expanded service to/from airports across Britain.

- ✈ The common ownership will boost dual destination visitor traffic to the UK & Ireland and allow the common visa entry programme from selected long haul markets to be exploited to the full.

Risk assessment

The proposed take-over is not without its risks and perceived threats to the existing network of routes served by Aer Lingus, together with concerns of the workforce.

- ✈ The issue of Heathrow slots, undoubtedly the focus of much media coverage in the current debate, tends to focus on the threat of termination of services to Ireland as slots are reallocated to long haul BA services. Much of the debate appears to miss the commercial reality that the high frequency services currently on offer between Ireland and Heathrow are commercially sustainable and cater to demand. The merger is expected to see an increase in connecting traffic, which has been in decline in recent years, therefore increasing demand. Furthermore, capacity on these routes can be increased by the upgrading of aircraft serving Heathrow, a reversal of what has happened over recent years. Presently BA is not in need of further slots at Heathrow, as demonstrated by it engaging in the practice of 'slot sitting' in recent years. The commercial reality is that demand at an economic price will dictate the level of service on Ireland-Heathrow routes. The state holding in the airline is no guarantee of continuity of service, as evidenced by the decision by Aer Lingus in 2007 to suspend Shannon-Heathrow service. Of the three Irish airports, Shannon is the more dependent on the Heathrow connection as its only service to a European hub airport. Cork while dependent on the connection to the Heathrow hub, is also connected to hubs at Amsterdam and Paris CDG. However, the services from Shannon and Cork have proven to be commercially sustainable in recent years and there is no robust evidence to suggest that this would change on any take-over of Aer Lingus, in fact one can convincingly argue that more attractive connecting opportunities at Heathrow will increase demand on these routes.

- ✈ The risk to employment in the airline has been to the forefront of the debate and is not without foundation, although overstated. Experience in airline mergers have resulted in consolidation of a number of functions resulting in a reduction in staffing, while leading to greater security of employment. The analogy with Iberia being quoted is flawed and misleading. The current labour cost base and practices in Aer Lingus, following several rounds of cost cutting and employee contributions, are in stark contrast to those which prevailed at Iberia, when acquired by BA. The positive side is the projected growth in transatlantic traffic would result in increased flight crew and ground handling employment in the company, while an overall increase in the tourism would generate new jobs with every 55 international tourists helping to support one tourism job.

- The maintenance of the current Aer Lingus short haul route network would undoubtedly come under review by any new owner. The likely scenario based on economic sustainability would be likely to see a strengthening of cross-channel routes, based on mainline and franchised operations and a yielding of any 'thin' unprofitable European routes to LCCs reallocating capacity to more profitable services. Existing codeshare arrangements, e.g. with United, JetBlue, Etihad, would most likely be replaced by stronger alliances with BA and its **oneworld** partners, delivering more comprehensive coverage around the globe.

Conclusions

- While the current offer is not without some risks, the synergies and potential for traffic development are attractive and would appear to offer the prospects of a net national gain boosting tourism and trade by expanding Ireland's global connections.

- Failure to accept the offer would open Aer Lingus to an uncertain future, a fall in share price and exposure to a hostile take over from investors or trade purchaser without the strategic fit that IAG would appear to offer. The airline could face the risk of an asset stripping take over.

- The Government's minority stake holding does not provide any security in terms of the sustainability of Aer Lingus, its services, employment, and Heathrow slots.

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