Orient aviation 20 YEARS

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ORIENT AVIATION PERSON OF THE YEAR 2013

YOSHIHARU UEKI

President
Japan Airlines

BREAKING FREE

Pilot turned president re-builds Japan Airlines

Asia's banking honey pot for fleet funding

AAPA: Infrastructure shortfall limits region's growth

Qantas wants new foreign ownership rules

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Orient aviation 20 YEARS

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AGENDA COMING SOON ...

Never enough in the insatiable Asia-Pacific

Airports across the region have announced a series of massive, multi-billion dollar investments in airports, terminals and runways as well as focusing - at last – on developing a more efficient and modern regional Asian Skies air traffic management network.

The burning questions are: is this significant investment sufficient keep up with the region's rapid passenger growth? And will this welcome infrastructure investment be rolled out on a timetable that can match the region's airline growth?

When the heads of the region's airlines met in Hong Kong last month, for the 57th Assembly of Presidents of the Association of Asia Pacific Airlines (AAPA), it quickly became clear the answer might be no. AAPA director general, Andrew Herdman, said the Asia-Pacific is generally ahead of the game but "there are clear signs we are behind the curve" when it comes to aviation infrastructure.

Cases in point included Jakarta's Soekarno Hatta airport, already operating at twice its design capacity as air traffic growth hits double digit pace. A new airport is planned for the country' capital city, but it is years away from completion.

Hong Kong International Airport has a cap of 68 movements an hour and is operating close to the legal peak, at 65 arrivals and departures every 60 minutes. Saturation point is rapidly approaching as traffic forecasts made in 2009 run three years ahead of predicted growth. Yes, a new runway and terminal is planned for construction, but the project's environmental impact study will not be completed until next year. If the all clear is given to the project, Hong Kong's third runway will be finished in 2023!

In Mainland China, despite the unprecedented scale of new airport construction and expansion of completed facilities, there is severe congestion at the three major hubs: Beijing, Shanghai and Guangzhou, leading frequently to costly and intolerable delays of up to six to eight hours. China, like India and the Philippines, is recording 12% plus passenger traffic a year, which will double traffic every six years.

There is undoubtedly potential for crisis. Airlines can buy as many new planes as their finances can sustain in their desire for profitable growth, but if there are insufficient numbers of airport slots available and a shortage of space along airways for expanded networks, larger fleets will have a most disruptive impact on airline efficiency - at a time when airline profitability is difficult to achieve.

The region's governments and airport authorities must understand that inadequate investment in aviation infrastructure will have serious economic repercussions for every country across the region. They must – now and not tomorrow – get the phrase "Fast Track" into their vocabularies and to the top of their "to do" aviation infrastructure list. ■

TOM BALLANTYNE
Chief Correspondent

Qantas calls foul over rival's capital raising

At press time, **Qantas Group CEO, Alan Joyce**, had elevated his public campaign to block **Virgin Australia**'s A$350 million (US$329 million) capital raising with the assertion the Australian government will ensure Virgin Australia will operate under the same rules as the airline group he heads.

Despite reluctance from the newly elected government and the country's opposition leadership to become embroiled in the dispute, Joyce said: "there is a lot at stake, but I have absolutely no doubt the politicians will see sense and reframe the policy network to ensure this is a level playing field again."

Under the terms of Virgin Australia's capital raising, its equity partners **Air New Zealand**, **Etihad Airways** and **Singapore Airlines**, could hold up to 68% of Virgin Australia, with Britain's **Virgin Atlantic group** retaining 10% of the carrier. Joyce said Qantas will operate at a disadvantage if the fund-raising proceeds because the Qantas Sales Act limits foreign investment in "The Flying Kangaroo" to 49%. Joyce alleges the fund-raising is a back door way for Abu Dhabi, Singapore and New Zealand to access what should be rights that are available to Australian carriers. He added that under the Air Navigation Act, an airline has to be 51%-owned to gain access to these routes, under current bilateral air rights agreements.

That element of the argument raised eyebrows in Hong Kong where the Qantas Group and its partners, **China Eastern Airlines** and a subsidiary of the gaming and property group, **Shun Tak**, are planning to start a low-cost carrier, **Jetstar Hong Kong**. Its application for an Air Operator's Certificate is pending - and has been for months. Hong Kong-based carriers argue the LCC will be managed at its top tier by parent company, Jetstar in Australia, which means Hong Kong would not be its principle place of business; a requirement of the Special Administrative Region's Basic Law. See War "Down Under" with no peace in sight page 22. ■

Mainland LCC orders A320s

*Mainland China carrier, **Spring Airlines**, has ordered 30 more A320s, valued at US$2.75 billion, with the low-cost carrier expected to receive the single aisle aircraft from 2015. Shanghai-based Spring Airlines told **Bloomberg** it had intended to build a fleet of 100 airliners by 2015, but that target had been pushed out to the end of the decade because of government delays in approving jet purchases. "Within the last 12 months we have seen many signs that obstacles we currently face will disappear," **Spring's deputy general manager for strategy, Jonathan Hunt**, told Bloomberg.* ■

Shenzhen airport hungry for region's business

Operators of Shenzhen's new airport, which opened last month, said the US$1.392 billion facility can now offer more flights to Australasia, emerging markets such as Cambodia, Vietnam and the Philippines as well as Europe, the Middle East and North America. The sleek Italian designed complex, planned to handle up to 45 million passengers a year by 2020, covers 450,00 square metres and is equipped with 200 check-in counters, 62 boarding gates and 200 retail outlets. However, there is no direct train link to the airport from downtown Shenzhen, as in Hong Kong, and passenger ferry travelling times also are lengthy and heavy on administrative procedures. It's not quite up to its rival, Hong Kong, yet. ■

Xiamen Airlines fleet hits 100

Xiamen Airlines, based in the affluent coastal province of Fujian, accepted the 100th aircraft of its all-Boeing fleet in November. The 27-year-old carrier, which serves 218 domestic destinations and 26 regional and international routes, is the sixth largest airline on the Mainland. It's solid reputation for service and safety has been enhanced by burgeoning Cross Straits business that has developed since the first direct flights – Chinese New Year holiday charters - between China and Taiwan were approved a decade ago. **Xiamen Airlines chairman and president, Che Shanglun**, said the all-Boeing fleet "was a key component of our growth strategy and our ability to achieve 27 years of profitability". Xiamen intends to have 136 aircraft by 2015, with the addition of 30 B737-800s and six B787s. The Seattle-based manufacturer and Xiamen Airlines signed Letters of Request for 70 B737NGs and B737MAXs. ■

Emirates reports US$600 million profit

*Dubai-headquartered **Emirates Group** has announced an interim profit of US$600 million to September 30, a four per cent increase over the same six months in 2012. The aviation group's **chairman and CEO, Sheikh Ahmed bin Saeed Al Maktoum**, applauded the strength of the results, but added that its airline, **Emirates Airline**, only brought in a two per cent profit improvement for the period over 2012. The airline's contribution to the group bottom line was US$475 million, a result the chairman said matched passenger growth. Despite the chairman's caution, Emirates announced a 200 aircraft order, valued at US$99 billion, at November's Dubai Air Show.* ■

LEAP Engine flies through first tests

***CFM**'s new fuel efficient **LEAP engine** has completed a five-week ground testing program of 310 hours and 400 cycles. In the coming year, 15 LEAP engines, which will be a combination of all three models, will be tested including early icing testing in Canada and early endurance testing. The launch of the LEAP engine testing has set in train a three-year program of construction of 60 engines that will go through 40,000 cycles of testing before they enter service. The LEAP engine is designed to provide 15% better fuel consumption and an equivalent reduction in* CO_2 *emissions, compared with today's best CFM engine.*

***GE Aviation** will start purchasing cellulosic synthetic biofuel from The **D-Arcinoff Group (DG)** for its production and development testing of the group's jet engines from 2016. GE consumes 10 million gallons of jet fuel at its engine testing centres. The 10-year agreement with the Washington D.C. company will supply 500,000 gallons of jet fuel at the company's main jet engine testing facility in Peebles, Ohio, with options to increase the annual synthetic fuel volume to 100 million gallons a year. The synthetic biofuel, which will be equivalent in cost to conventional jet fuel, will be produced at a new DG facility to be built in Texas.* ■

SHORTTAKES

CODESHARES: **Cathay Pacific Airways** and **Air Seychelles** have signed a code share agreement that will commence this month, offering a three times a week service between Hong Kong and the Seychelles. Air Seychelles will also codeshare on Cathay Pacific routes from Hong Kong to Seoul, Melbourne, Perth and Perth-Johannesburg.

MRO: Canadian-headquartered **Vector Aerospace** has broken ground on a US$50 million facility in the Seletar Aerospace Park, Singapore, which will offer MRO services to operators of PW150A engines and Bombardier Q400s.

LCCs: Jetstar Japan majority owners, **Japan Airlines** and the **Qantas Group**, have injected an additional US$111 million into the joint venture LCC, increasing their holdings in the carrier to 45.7% and 41.7% respectively. Minority investors, **Mitsubishi Corp.** and **Century Tokyo Leasing**, each had their equity reduced from 8.3% to 4.3%, respectively. **Juneyao Airlines**, based in Shanghai, has applied to Beijing's aviation regulator to set up a low-cost carrier, **Jiuyuan Airlines**, in Guangzhou, intended to capture the surging market for affordable travel in southern China's Pearl River Delta.

ROUTES: **Air China** is now flying twice a week between Beijing and Siem Reap and will expand to a four times a week schedule in January. New long-haul operator, **Sichuan Airlines**, will add a twice-a-week Chongqing-Sydney service to its Chongqing-Melbourne schedule. ■

Opening ceremony of the AAPA Assembly of Presidents

INFRASTRUCTURE ... AND YET MORE INFRASTRUCTURE

Airline chiefs at the 57th Association of Asia Pacific Airlines (AAPA) Assembly of Presidents warned airport and air traffic infrastructure shortfalls threaten to curtail growth

TOM BALLANTYNE reports

Airline growth would stall and the economic advantages of an expanded aviation sector on the region's Gross Domestic Product (GDP) would be eroded unless governments speeded up investment in all strategic sectors of ground facilities and ATM, said AAPA director general, Andrew Herdman, at the AAPA Assembly of Presidents, held this year in Hong Kong.

"The danger with infrastructure is it doesn't just hold you back, it's just a brick wall," he said. "If you don't have the infrastructure, if there are no more slots, it doesn't matter how many aircraft you buy. There comes a point when you are up against the wall with airport capacity or bottlenecking of busy airspace corridors. This issue is important in ensuring the industry delivers its potential growth," he said.

The Asia-Pacific has been ahead of the game and forward looking, Herdman said, but "there are clear signs we are behind the curve [now]". "We have severe congestion in China because of rapid growth in Chinese air traffic. There are chronic delays. They drive down efficiency and destroy customer service. Once you're into that tight spot it's very hard to fight your way out of it," Herdman said.

Indonesia, the Philippines and other countries in the region have grown very rapidly and outpaced the growth in runway capacity, airport terminals and airspace management. Herdman explained that when the industry grows at 5% annually, air traffic doubles every 15 years. If it grows at 6%, traffic doubles every nine years. But Asian countries like China, Indonesia and the Philippines are seeing 12% annual growth, which equates to a doubling of traffic every six years, he said.

"The growth will only be successfully accommodated if infrastructure keeps up. It's no good just buying aircraft. You need airports, runways and terminal capacity. You need air space and efficient airspace management. The runways you have today need to double in six years. The pilots of 2013 have to double in six years," the director general said.

"Given the long development period for infrastructure, planning must be done in appropriate longer term time scales. We must ask: can we double capacity, not can we add 10% and so on?"

As an example, at Manila's Ninoy Aquino International Airport (NAIA) on one day in November (pre-Tyhoon Haiyan) seven scheduled flights were diverted to Clark International Airport because of congestion. They were mostly domestic flights, but also included an Etihad B777 flight from Abu Dhabi and a Singapore Airlines service from its home base city.

Concern about infrastructure constraints was underscored by Garuda Indonesia president, Emirsyah Satar, during the CEO panel at the Assembly. Already rapid air traffic growth in Indonesia has produced constraints on growth, with congestion posing a bigger threat to Garuda and its partners than low-cost carrier (LCC) competition, he said.

Indonesia flew 55 million passengers in its latest fiscal year, with annual traffic forecast to increase very rapidly to 120 million air travelers annually. The infrastructure is not in place to cope with that growth, he told AAPA delegates.

"The growth is going to be there and the market is going to be there, but the biggest issue for us is infrastructure. Garuda will increase its fleet from 131 in 2013 to 400 aircraft by 2025, but it has already been affected by lagging infrastructure development."

Delegates heard that several times a week the airline has to tow eight to ten aircraft into its own hangars at Jakarta's Soekarno-Hatta International because there are not enough parking spaces near the terminal. It has had to delay the launch of its first direct flights to London by six months, until May next year, because the runways and apron at Jakarta are not strong enough to support

Its Love: Dragonair chairman and host of the Hong Kong Association of Asia-Pacific Airlines Assembly of Presidents, John Slosar, with soul brother, Beach Boy Mike Love. The legendary Beach Boys performed at the annual AAPA Assembly of Presidents dinner in November

China carriers to join AAPA?

At least one Chinese airline, and possibly more, are likely to join the Association of Asia-Pacific Airlines (AAPA) in 2014.

An influential delegate at the annual AAPA Assembly of Presidents in November was Li Jiangmin, executive vice chairman of the China Air Transport Association (CATA), which represents the major Chinese carriers. CATA was the voice of Beijing's unequivocal opposition to the European Union's Emissions Trading Scheme. A sole delegate at the AAPA Assembly in Kuala Lumpur in 2012, this time around Mr. Li was not alone. Ma Ling, a vice managing director of Beijing-based national flag carrier, Air China, and Tang Bing, executive vice president of Shanghai-based China Eastern Airlines, also attended the Hong Kong AAPA gathering. Chinese sources told Orient Aviation there was a real possibility at least some of the country's major airlines may sign-up with the AAPA. The sources said the "Taiwanese question" was no longer an issue and that there was a feeling in Beijing that China must be a part of a unified regional voice on major aviation issues.

AAPA director general, Andrew Herdman, wasn't giving anything away on the matter, commenting only that he sincerely hoped Chinese carriers would join the AAPA.

a London-bound B777-300ER at its maximum take-off weight.

"Passenger growth (in Indonesia) is going to be one-and-a-half to two times GDP growth," said Satar. "Indonesia is still growing. In the last six years, passengers carried reached double digits. If you look at Indonesia, the growth of the regional hubs and the mid-sized cities will be phenomenal. There is rising demand and the airports will be built there. The challenge is how fast will be the execution of these plans."

Patrick Yeung, chief executive of Dragonair, which has a significant network into China, said rapid growth and expansion on the Mainland were causing bottlenecks at airports. "Air traffic control is notorious [in China] even though there have been recent improvements by the Civil Aviation Administration of China (CAAC) and the country's related aviation regulators," he said.

"It is still a big challenge for us. Passengers are affected and resources are wasted. They have done some great things building up infrastructure, but there are still many challenges."

Hong Kong, which is faced with severe long-term overcrowding at its award-winning airport, will not have its third runway until 2023. This target will only be met if an environmental impact study is completed in 2014 and construction commences without political interference.

Tommy Leung, general manager projects Airport Authority Hong Kong, said the [Hong Kong] Civil Aviation Department (CAD) had a ceiling of 68 movements per hour at its airport and the airport was operating at 65. "You can see we are gradually approaching the limit of the two runway system," he said.

When the airport opened in 1998, it handled 28 million passengers annually. This year it will hit 60 million. Leung explained a 2009 Master Plan had forecast the two runway system would be saturated by 2019 or 2020, but traffic growth is three years ahead of forecasts. "We are in trouble if we deliver the third runway in accordance with our original master plan. We need to hurry up," he said. Dragonair's Yeung said slots were not just an issue in Hong Kong. "It's the same in China and elsewhere in Asia," he said.

John Byerly, formerly the U.S. government's longest serving deputy assistant secretary for transportation affairs and best known for his groundbreaking work on the US–EU Open Skies agreement, said there is discussion in China about building scores of new airports and expanding existing facilities, a strategy highlighted at a recent aviation conference in Beijing.

"One of the factors that came up was the dearth of staff, in particular pilots, and the search for ways to meet that challenge. It is a country that has, and will continue to have, massive and growing demand," he said. "There was a clear awareness in Beijing that there is a big challenge ahead for accommodating airline growth. They are committing resources," he said.

"The growth is so phenomenal that I am a little bit hesitant to say they are going to make it. It's difficult with over a billion people. Yes, there will be huge expansion in China. They will do their best. Can they deal with the airspace issue, the military/civilian conflict (there are seven military air space zones in China) and who controls it? This is critical to the number of slots available at impacted airports.

"There is a philosophy [in China] which is the right philosophy. It is liberalization. It is building infrastructure. It is doing our best. Now everything is in the execution. That's going to be a big challenge."

One bright spot across the region, according to Byerly, is Japan. "We have seen an absolute revolution in thinking in Japan and Tokyo. You've got expansion of Haneda with a fourth runway and talk about a fifth. You have massive expansion of slot capacity at Narita. Admittedly, Japanese authorities were exceptionally concerned about expansion, but they are adding 50% capacity and there is discussion about increasing that number.

"So for a country that has a

stagnant or even declining population, Japan is taking steps to improve infrastructure. That's great."

At the assembly, AAPA bosses passed a resolution calling on governments to ensure that air traffic management capacity keeps pace with commercial air traffic growth. They urged working with military authorities, where necessary, to reduce airspace usage limitations and regulations.

> Strength lies in collective unity, and if the Asia-Pacific wants to pay a bigger role in global [aviation] discussions, it must speak with one voice. We need to set aside personal interests and political differences and work together on issues of common concern
>
> 2013 AAPA Assembly of Presidents resolution

"Asian governments need to commit to a program of investments in efficient air traffic management, prompt implementation of recognized international standards and procedures and best operational practices in order to avoid unnecessary congestion, delays and inconvenience to the travelling public," said the resolution.

Not surprisingly, the decision of the European Commission (EC) to re-start the clock on charging foreign airlines for their emissions – though this time within European airspace – raised the temperature at the Assembly. "Even after the 38th ICAO (International Civil Aviation Organization) Assembly's success in securing a global agreement to develop a market-based measure to address aviation emissions, the proposal to extend the EU ETS to European airspace has been met with a mixture of incredulity and disbelief," said Herdman.

"To these bureaucrats I can only say: Stop for a moment and think. Do you really want to reignite a trade war with your international partners? We can only hope common sense will prevail, that Europe will reconsider and add its weight and full support to the agreement made at ICAO.

"The AAPA is absolutely convinced the interests of Asia-Pacific carriers, and the industry as a whole, are best served by supporting a global solution and not a patchwork of national or regional schemes that will only distort the market," Herdman said.

Byerly said he was "really upset" the Europeans simply ignored the results of the ICAO Assembly. "It is not going to do anything to affect global warming. It's going to have no effect on the frequency of typhoons, hurricanes or other events. It's purely political. My guess is that many countries that stood up to Europe – China, India, Russia, South Africa – will probably stand up again and they won't be bought off," he said.

"The international community spoke at ICAO. Europe has decided to do its own thing all over again. I can't say I'm totally surprised. It's just a wrong-headed decision. With the opposition it has provoked, I hope there will be another 'stop the clock' or 'just turn the clock off' decision and that everyone gets on with the ICAO program."

He said Asia was speaking with one voice on the issue and was clearly saying: "hell no, we won't go, we will not accept this". "It can be done politely and diplomatically but there should be a clear message from the region as a whole," he said.

Asia-Pacific airlines delivered a strong performance in the last 12 months, a collective result Herdman said was all the more remarkable since several countries have introduced a swathe of regulations and taxes that have impacted negatively on industry growth.

A resolution passed at the Hong Kong Assembly asked the region's governments to carefully consider the overall economic effects of putting more financial strain on the travelling public and the aviation industry by imposing more aviation levies.

"The Association calls on governments to adhere to ICAO policies on taxation and ensure its recommendations are followed by all relevant taxation authorities within those governments. Finally, it calls on governments to avoid imposing unjustified or discriminatory taxes on international aviation, thereby imposing unwarranted costs on global tourism and trade," it said. Herdman said visitor arrival taxes were being considered by Thailand and Indonesia, which were examples of impediments to growth.

The AAPA repeated a call made in 2012, which pointed out that despite the commercial success of Asian airlines, the global policy-making process is largely influenced by the U.S. and the EU.

"This must change. Global regulatory institutions must evolve to reflect modern economic and political realities in a rapidly changing world. Diversity in the Asia-Pacific and the absence of a regional regulator sometimes hold our region back from having a larger voice at the policy-making table.

"Strength lies in collective unity, and if Asia wishes to play a bigger role in global discussions, it must speak with one voice. We need to set aside personal interests and political differences and work together on issues of common concern," the AAPA said. ■

AAPA expands to India

The Association of Asia-Pacific Airlines has widened its sphere of influence. Previously, membership was limited to airlines within specific time zones in the Asia-Pacific, effectively creating a western boundary that ended at the Bay of Bengal. At the Hong Kong AAPA Assembly, new borders were announced that expanded eligibility for AAPA membership to the Indian sub-continent, which would allow Indian, Pakistani, Sri Lankan and Bangladeshi airlines to become AAPA members.

Now we are won

Asia-Pacific LCCs welcomed into the fold

Orient Aviation reports

Airline chiefs across the Asia-Pacific have accepted the region's low-cost carriers, with their booming market share, are a permanent and valuable sector of the aviation landscape.

Forget the old labels of low-cost carriers (LCCs). Or full service or network carriers or whatever we call them, was the message from the airline bosses participating in a CEO panel at the Association of Asia-Pacific Airlines (AAPA) Assembly of Presidents last month.

"We are just left saying they are airlines. It's not so easy to distinguish between them or use different labels," said Andrew Herdman, the director general of the Association of Asia Pacific Airlines, at the Hong Kong Assembly. "It's very difficult to generalize. Wherever you look people are experimenting."

When it comes to the debate about legacy airlines versus LLCs, Garuda Indonesia president, Emirsyah Satar, has one important message: "I don't like the word legacy. You feel like a dinosaur," he said.

"All of us, as full-service airlines, need to be low-cost and efficient. There are so many add-ons if you fly low-cost. Passengers are becoming smarter. If you add up all these on an LCC flight it might cost more than the full service option. Passengers in Indonesia are realizing this. It's up to us to achieve these low costs."

Satar, a CEO panel member at the AAPA Assembly of Presidents, articulated what the region's airline chiefs realize: the lines between full-service and budget operators have blurred and often merged, as the true LCC model has morphed into hybrid forms.

In a recent study, airline IT provider, Amadeus, reported Bangkok's LCC capacity rose 30%, which increased its total traffic share at the city's airports by four per cent, to 26%. At Kuala Lumpur, the home city of the region's first low-cost carrier, AirAsia, LCC capacity expanded by 15%, but the total share of budget business only climbed one per cent to 52%. In Singapore, which has demolished its low-cost only terminal and is building a fourth terminal in its place, recorded a 17% increase in LCC capacity and an expansion of the budget fare market by three per cent, to 29%.

None of this concerns Emirsyah Satar, who believes the Indonesian aviation market is big enough to accommodate everyone. "While Indonesian LCCs are expanding rapidly, they are only keeping pace with rising demand, especially in the domestic market," he said.

"For about the last five years passenger traffic in Indonesia has been experiencing double-digit growth, driven by a rising number of Indonesians switching from ferry, road and rail transport to air. LCCs are bringing in people from other modes of transport, such as boats or trains. They are not just taking other airlines' business. The pie is big enough."

Regional LCC growth is set to continue. Garuda and its low-cost subsidiary, Citilink, are planning to add 120 new aircraft to their combined fleet. Jakarta based rival, Lion Air, has outstanding orders for more than 500 aircraft, although

CEO panelists at the AAPA Assembly of Presidents: Emirsyah Satar, President Garuda International, Patrick Yeung, CEO Dragonair, Robert Martin, Managing Director and CEO, BOC Aviation and John Byerly, aviation consultant and a former U.S. Transportation Department deputy assistant secretary with panel moderator, Tom Ballantyne, Orient Aviation's chief correspondent

not all of these will be flying in Indonesia. Lion also launched a new subsidiary, Thai Lion Air, last month and is operating its joint venture, Malindo Air, in Malaysia.

All Nippon Airways' (ANA) new LCC, Vanilla Air, the replacement carrier for the defunct AirAsia Japan joint venture with the AirAsia Group, will begin operations this month. Ambitious Vietnamese LCC, VietJet Air, which also plans to launch flights to Thailand in the first quarter of 2014, has discussed setting up Thai VietJet Air. It has placed a provisional order for up to 92 Airbus jets, worth $9 billion, at list prices. In India, Malaysia's AirAsia has been cleared by regulatory authorities to launch AirAsia India, in partnership with the local Tata group. Also in India, Air Costa, an operator of domestic regional routes, intends to apply for a licence that will allow it to compete with IndiGo and SpiceJet on mainline routes.

In Taiwan, one of the few major full-service carriers in the region without a budget subsidiary, China Airlines (CAL), appears set to enter the LCC fray. At a press conference in November, CAL's new president, Samuel P. Lin, said the airline "will not shy away from the emerging market". "China Airlines is in an advantageous position to tap the emerging business, which promises to improve services to cities with more than one airport, especially in Asia," he said.

There are clear signs that Mainland China, the region's biggest future aviation market, may be on the cusp of an LCC explosion. Only one Chinese budget carrier, Spring Airlines, has been reasonably successful, mainly because the regulatory environment limits true budget operations. Rules set minimum and maximum airfares, inhibiting LCCs revenue management and fare offerings to customers.

In recent months, China's aviation authorities have started planning a new range of measures designed to support the development of low-cost carriers. Agreement has been secured between the Civil Aviation Administration of China (CAAC) and the National Development and Reform Commission (NDRC) to eliminate base fares to allow airlines to structure pricing on market demand.

A deputy director of the CAAC, Xia Xinghua, said it plans to simplify the application process for new Chinese LCCs, with policies introduced to encourage private capital, along with funding to boost the LCC sector. Specific policies are expected to be announced by the end of this year, including aircraft procurement, airport surcharges and new routes.

Reacting to the regulatory relaxation, Hainan Airlines restructured its Chongqing-based subsidiary, West Air, to the low-cost model and Shanghai-based Juneyao Airlines will set up a budget carrier, 9 RMB Airlines, in Guangzhou, where there are currently no LCCs.

"We have submitted our application to the CAAC. We are waiting for approval," said Wang Junjin, the airline's chairman. China Eastern Airlines is partnering with Qantas in an attempt to create Jetstar Hong Kong, with a decision on its right to launch in Hong Kong now postponed to mid-2014, according to sources.

LCC growth explosion

capital city	*market share (2012)*	*market share (2013)*	*seats (millions)*	*capacity change*
Jakarta	42%	51%	2.8	44%
Bangkok	22%	26%	1.2	30%
Tokyo	2%	5%	1.1	178%
Kuala Lumpur	51%	52%	1	15%
Singapore	26%	29%	0.8%	17%

The CAAC is considering building a budget terminal at Beijing's new airport, which is scheduled for operations in in 2018.

Dragonair, which has a major network from Hong Kong into China, thinks all of this is good for the industry and doesn't fear competition. The airline's chief excutive, Patrick Yeung, pointed out at the AAPA Assembly that the authorities had stopped airline applications between 2007 and 2010. "Now, it is changing and the pricing mechanism is changing. You can see the regulator making changes. I believe there will be more support from provincial governments to start airlines. People are seeing opportunity. We are seeing more applications coming through, he said.

Yeung said China's size and the government's policy of encouraging aviation development in western China will provide plenty of opportunity for all players. "There are lots of places airlines don't fly to. Demand is building up and a lot of money is being poured into the West. This emphasis means that even international carriers are flying to China's secondary cities. These LCC start-ups will operate some of the green routes city-to-city and build their operations," he said.

Some observers point out that despite the government's encouragement it still may not be easy for Chinese LCC start-ups. Robert Martin, chief executive of aircraft lessor, BOC Aviation, said there had not been any start-up activity in the last four or five years. Four airline groups control 91% of the China fleet. Spring Airlines is a successful LCC, but it shouldn't be forgotten that other budget airlines in China haven't been so successful, said Martin.

"So the question is this time round: What are the new entrants going to do differently to make sure they are able to succeed? Firstly, they will need experienced people who understand the business and are able to access experienced pilots and engineering staff. Also, they will need sufficient capital," Martin said.

BOC tracks airline bankruptcies world-wide and the most dangerous period is from start up to achieving 10 aircraft. "During that period, if you look at the bankruptcies, 77% of all airlines that have gone bankrupt have less than 10 aircraft. This has important implications for that first stage of their growth and obviously incumbents aren't going to be offering to give up market share during that period. The start-up phase for these airlines is very important and that's going to tell us whether the market actually does open up," Martin said. ■


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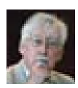
BREAKING FREE

When Kazuo Inamori, the venerated businessman who led Japan Airline's recovery from bankruptcy, handpicked one of the airline's captains as the airline's new president, corporate tradition was turned on its ear. But Yoshiharu Ueki (61), the 2013 Orient Aviation Person of the Year, has made the transition from cockpit to boardroom with ease.

Yoshiharu Ueki
President
Japan Airlines



Geoff Tudor reports from Tokyo

It's been a momentous two years for Japan Airlines (JAL) president, Yoshiharu Ueki, the pilot turned boss who stepped into the mighty shoes of octogenarian Kazuo Inamori, the legendary Japanese business tycoon who led JAL out of its 2010 bankruptcy.

So far, Ueki's score sheet has been impressive. He took delivery of the first JAL B787 'Dreamliner' in March 2012, two months after becoming the airline's president. He led the highly successful JAL re-listing on the Tokyo Stock Exchange in September last year. And most attention grabbing of all, he chose to order the A350 last October, a decision that revealed Ueki was very much his own man.

After the announcement that JAL would buy 31 A350s with 25 options, there was much media speculation about Ueki's choice. JAL had long been considered a 'Boeing only' customer so the decision to buy from Toulouse instead of Seattle suggested, to some observers, that the reported opinion of Inamori, now JAL's chairman emeritus, had been followed to avoid one supplier dependency.

Buy what is best was the only advice he got from Mr. Inamori on this issue, Ueki said when he spoke to *Orient Aviation* in November. "Taking into consideration all the factors – timing, economics and stage of development – we chose Airbus."

In the hugely complex world of airline operations there are few airline bosses who

are former pilots and JAL is no exception. Ueki is JAL's first captain turned president. He was still flying until four years ago, when Inamori, Kyocera founder, philanthropist and Buddhist monk appointed by the government to revive JAL's fortunes, set his eyes on him.

> The B787 is a very innovative airplane, so early stage failures are seen from time to time
>
> **Yoshiharu Ueki**

In April 2010, he chose Ueki to revise JAL's over-extended and unprofitable route network. As head of the route planning section, Ueki impressed his peers with the introduction of Inamori's profit-focused action formula. He axed 45 unprofitable routes, a decision that quickly improved revenue. In 2011, Inamori promoted Ueki to executive officer, a stepping stone to his elevation to president in 2012. He succeeded Masaru Onishi, who became JAL chairman.

"Using Inamori's methods, which emphasized profits and speedy analysis of financial performance, I broke free from my own fixed ideas," Ueki told *Orient Aviation* at JAL headquarters in Tennozu, where Haneda Airport is visible across Tokyo Bay.

At the time, Inamori praised Ueki for his upbeat personality. Lack of corporate experience didn't count for much with the management guru, who expressed his confidence in Ueki's ability to read a balance sheet and 'steer the operations' when he announced Ueki's presidency almost two years ago.

Ueki admits that his debt to Inamori is immense.

During the period from 2010 to 2012, when the Corporate Rehabilitation Law was applied, JAL was obliged to make crucial decisions every day and Inamori was a good teacher, leading by example, Ueki said.

"I can think of a hundred examples of Inamori's management teachings," he said.

For example, he said, many Japanese organizations work on a budget system, allocating funds for projects. In the past, JAL followed this system and budgeted money that was meant to be spent. The conventional wisdom of such a system is, basically, if you don't use it, you lose it.

Inamori disliked the word "budget" and used the word "plan" instead. He urged JAL staff to re-check plans before implementation, even if the budget had been allocated at the beginning of the Japanese fiscal year, which runs from April to March.

Using an illustration from the public sector, Ueki pointed out that in February and March, as the Japanese fiscal year draws to an end, unnecessary – and unplanned – road construction works start all over the place to use up budgeted money. Inamori ruled that if "the plan" is unnecessary then the money should not be spent, thereby controlling costs.

Said Ueki: "It's important to find what is really necessary and what is not. So timely checks of the state of plans and their relevance are always necessary."

Inamori's teachings are incorporated in a 125-page pocket-sized book, the JAL Philosophy Handbook, which covers some 40 items and is carried by all employees.

The handbook is regarded as confidential. Copies are not supposed to leave company premises and only are for use by JAL employees. One exception was made when Inamori gave a copy to American Airlines' former CEO, Gerard J. Arpey, who was a good friend and had expressed interest in the little volume of wisdom.

Ueki showed one important chapter, entitled 'The Equation of Success of Life', to *Orient Aviation*, who asked for a photocopy.

An aide pointed out JAL rules did not permit external distribution of the handbook's contents. Ueki overruled the aide. "I'm the president," he said with a laugh. "It's O.K." The visitor got his photocopy.

Ueki's communication skills are well-regarded. He has started to use social media to reach out and contact both employees and customers.

His first posting on LinkedIn reads: "I joined Japan Airlines as a pilot and spent 35 years flying various types of aircraft, from 50-seat commuter planes to 500-seat jumbo jets. Today, I manage a group of companies and represent more than 30,000 employees in my role as President of Japan Airlines.

"My years of experience, both in the air and on the ground, have taught me about the importance of responsibility. I've come to realize it makes no difference whether you are piloting an aircraft or you are leading a company.

"Passenger aircraft captains are solely responsible for the safe transportation of travelers and crew from the moment they step onboard to block-in at the destination. It's easy to say that pilots should ensure the safety of all the precious lives they carry, but in actuality, they constantly feel the heavy weight of responsibility while assuming their duties.

"This is also true for business leaders as they are responsible

2013 Orient Aviation Person of the Year, JAL president, Yoshiharu Ueki

not only for operating a successful business, but for ensuring the livelihood of all employees and their families. The burden of responsibility is the same, regardless of the number of people being protected."

He confirmed those sentiments in the interview. "The basis of captain and president must be the same," he said. "Otherwise, I should not be able to steer JAL. Of course, the knowledge required of a business executive and an airline captain is different. But decision-making is essentially the same," he said.

"A captain has to cope with a vast range of issues such as maintenance troubles, adverse weather, sudden illness in the cabin and so on. A top manager of a company faces issues too, requiring swift and clear decisions."

Ueki's father was a famous movie star, Chiezo Kataoka, whose acting career spanned six decades, from his debut as a child in kabuki plays to his last films in the 1970s. He had a unique delivery, which may have rubbed off on his son, who has a great reputation for well-composed in-flight announcements.

In those days children of theatre and movie actors often used to follow their parents to screen or stage. As a young child, Ueki acted in several movies with his father, but did not follow him into show business.

"I was born in 1952 and there was a 50-year age gap between my father and me," Ueki said. "He would be 110 years old now if he still lived. Nobody in the Ueki family followed our father's occupation. That was very exceptional by the standards of show business families at that time. I wasn't bound by tradition."

"In any case," he added, "my mother was a very strong woman and insisted that until I graduated from university I would be my parents' responsibility. If, after college, I wanted to be an actor, so be it."

But that scenario never arose. A 1968 visit to Sweden, in a high school home stay program, changed his life. His host family's father was a captain at Scandinavian Airlines System (SAS). He cut a dashing figure in his smart uniform. Young Ueki was 16 years old and greatly impressed. He decided he too, wanted to be a pilot.

Fresh out of high school, Ueki initially failed the entrance exam at Japan's Civil Aviation College. But he did land a place at prestigious Keio University in Tokyo.

Despite that the setback, his mother urged him to retake the aviation college exam. This time he passed. It was a real-life lesson in "not being allowed to back down as a loser", he said. It's a lesson he has never forgotten.

One of the biggest issues facing Ueki is the international day time slot allocation at Tokyo's Haneda Airport.

Japan's Civil Aviation Bureau, part of the Ministry of Land, Infrastructure, Transport and Tourism (MLIT), stunned JAL on October 2, when it announced the allocation of 16 slots to the two leading Japanese carriers would not be on a fifty-fifty basis. Instead, it gave 11 slots to All Nippon Airways (ANA) and five to JAL.

The announcement shocked Ueki too. JAL responded to the MLIT two days later with a request for reconsideration of the decision, citing a lack of transparency in the allocations. The ministry's eventual response, early in November, to JAL's request for disclosure was a blunt refusal to reconsider the slot placements.

Political interference is widely believed to be behind the decision. Members of the Liberal Democratic Party, now back in power, have been extremely vocal in criticizing JAL's rescue by the previous Democratic Party of Japan government.

JAL critics claimed the carrier's rehabilitation with state-backed funds had created an advantage for the airline over rival, ANA, and that some rebalancing was needed to ensure "fair competition".

MLIT's November reply to JAL did not include reconsideration of the decision. A ministry official called it "water under the bridge". Once made, slot allocations have never been changed, the official said.

Said Ueki: "JAL is insisting on an equal allocation of slots, not only for the sake of the company, but for airline customers and the general position of the airline industry.

"Our mid-term plan is completed and is based on equal allocation, so if the reconsideration will not be made, it will cut our operating profit by 16 billion yen annually," Ueki said. If nothing changes, JAL will be forced to revise next year's summer schedule and modify medium and long-term business strategy.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"We can never agree with political interference," said Ueki.

Ueki faces other political challenges as well in his efforts to build JAL's business profitability. Territorial disputes with neighbors, China and South Korea, have negatively hit JAL traffic on key routes to the two nations, with Japanese passengers, always sensitive to political issues, decreasing in large numbers to the near neighbour destinations.

In the first half this year, passengers on Japan-China routes declined by 5 % year-on-year. Fortunately, passengers from China and connecting passengers from North America to China are increasing, noted Ueki.

Chinese visitors to Japan in the first half, to September 30, had slumped until September, when there was a sudden upward surge of 28.5% year-on- year, according to Japan National Tourist Organization statistics.

"I think demand will recover in the course of time so JAL will maintain the present scale on China routes," Ueki said.

While Japanese travelers are heading elsewhere, Korean visitors to Japan have increased by 10%. Since the entry of LCCs into the market, Korean Air and Asiana Airlines have started to reduce air fares, making Korean routes an expanding, but fiercely competitive market. Korean visitor growth to Japan has been constant throughout the year, although it dropped in August.

For the time being, Ueki said, JAL will maintain the present scale of operations. But when Narita-based LCC affiliate, Jetstar Japan. starts to fly to Korea, JAL will consider using the low-cost carrier to complement JAL operations. Jetstar Japan has not decided when it will expand to regional routes.

Ueki keeps a careful eye on the impact of LCCs in Japan, both domestically and internationally. Jetstar Japan's performance, since it started flights in summer 2012, was worse than JAL had expected. Difficulties with its Narita base, bad weather and maintenance issues have dogged the new airline. Expressing confidence that it will succeed, JAL and partner, Qantas, each injected 5.5 billion yen into the LCC on October 31.

According to Ueki, Jetstar Japan needs to work on its business model to better fit the "unique market of Japan". Recently, the carrier signed a distribution deal with the Lawson chain of convenience stores that is expected to give sales a major boost.

From now on, JAL will fully assist and discuss with Jetstar Japan plans to make the carrier profitable, Ueki said.

"I am confident that the LCC will be profitable in future. That's why JAL agreed on the extra capital infusion," he said of the joint venture.

JAL is a major operator of the B787 'Dreamliner'. The four and half month grounding of the aircraft, following battery combustion incidents caused problems.

"The B787 is a very innovative airplane, so early-stage small failures are seen from time to time," Ueki said. "Those have been worrying," he acknowledged, but after the checks and modifications were done, he felt things were improving.

The grounding of the B787 fleet was not a factor in the decision to order the A350, he added.

JAL's next fleet renewal decision will be about single aisle aircraft, mainly for domestic use. For example, Okinawa-based affiliate, Japan Transocean Air (JTA), has 12 737-400s earmarked for replacement. JAL will study both Boeing and Airbus proposals.

Ueki doesn't think JAL is likely to consider the A380 for the near future as JAL fleet policy is more fixed on smaller capacity aircraft for long-haul operations, such as the B787 and the A350.

With almost two years as president behind him, Ueki is now looking into the future. "The past three years were spent forming a stable foundation for the revitalized company," he said. His task in the next three years is to make JAL an attractive airline for customers and employees alike.

"If employees believe in a bright future for JAL, customers will also sense it and it will give them confidence [in us]," he said.

"We are formulating investment plans – for hardware and software – and these are almost finalized. But to be successful, the willing spirit of the employees is of paramount importance.

"We have to break away from fixed ideas and follow what is probably Inamori's most important philosophy, which is that the outcome of life and work is the product of three factors: attitude, efforts and ability.

"JAL people used to focus on effort and ability, but in Inamori's equation, the right attitude counts the most. It's my job to create the corporate environment to ensure that.

"Whether you're a pilot or a business leader, it's all about the destination." ■

> Whether you are a pilot or a business leader, its all about the destination
>
> **Yohisharu Ueki**

PERSON OF THE YEAR DINNER GRAND HYATT TOKYO

Orient Aviation correspondent North Asia Geoffrey Tudor, JAL president Yoshiharu Ueki and Christine McGee, publisher and editor-in-chief of the Orient Aviation Media Group

JAL president, Yoshiharu Ueki and President and CEO Airbus Japan, Stephane Ginoux

The JAL president addresses guests at the 2013 Orient Aviation Person of the Year dinner at the Grand Hyatt in Tokyo.

'When Yoshiharu Ueki took over at Japan Airlines in January 2012, it was a baptism of fire for the pilot turned airline boss. Chosen by Japanese business guru, Kazuo Inamori, to return the struggling airline to prosperity after Ueki had spent a brief period re-structuring the carrier's route network, he took the job knowing Japan Airlines had to change if the carrier was once again to prosper.

From the day he took over at the top, he has relentlessly pursued that goal of transforming the airline from a floundering enterprise into a carrier that once again can proudly call itself a global airline of significance. He has introduced efficiencies that have led to immediate profits and pursued these strategies despite the volatile economic and political environment of today's Japan.

In doing so, he has the challenged the airline's traditions of management and changed the culture of Japan Airlines for the better. He has introduced broad innovation at every level, as he mapped out, with his new management team, a plan for sustainable profits at the carrier.

In 2012, he led the airline in a successful US$8.5 billion initial public offering (IPO), the second largest IPO in Japan for the year, which re-established Japan Airlines as a major player in international aviation.

He has overseen the creation of a Japan Airlines affiliate, low-cost carrier, Jetstar Japan, to keep the aviation group abreast with domestic competition in the expanding LCC sector of the market.

Obstacles have been formidable, both politically and at an operational level. Nimble and aggressive rivals seeking greater market share have tested Ueki and will continue to do so.

He has forged a new Japan Airlines, now and for the future. We, at Orient Aviation, are honored by his presence tonight and have great pleasure in presenting him with our 2013 Orient Aviation Person of the Year award.'

2013 Orient Aviation Person of the Year Citation

Battle joined "Down Under" with no peace in sight

TOM BALLANTYNE reports

Australia's two major airlines, Qantas Airways and Virgin Australia, are suddenly in pitched battle about ownership, with "The Flying Kangaroo" boss seeking support from the country's prime minister in the dispute.

Qantas Group boss, Alan Joyce, accuses Virgin Australia boss, John Borghetti, of operating an unfair playing field by introducing foreign-owned airline equity into Virgin Australia that does not have to conform to the same government regulations as Qantas

Qantas Group chief executive, Alan Joyce, has unleashed a fierce public – and political - campaign intended to halt the expanded foreign ownership portfolio of his airline rival.

In a November letter to the Australian prime minister, Tony Abbott, and transport heads at both state and national governments, Joyce accused Virgin of orchestrating its "virtual takeover" by foreign airlines. He went further and said the carriers are intent on destroying Qantas.

The fierce Qantas campaign was provoked by Virgin Australia's capital raising of A$350 million (US$329 million), planned for launch at press time. Joyce claimed the capital raising would cause potentially damaging shifts in Australia's aviation industry. And, that the strategy involved "predatory" acts by state-owned airlines to undercut Qantas, cripple it domestically and take over its routes.

The "state-owned airlines" are current shareholders in Virgin Australia, Singapore Airlines (SIA), Air New Zealand and Etihad Airways. They were all expected to increase their equity in Virgin Australia via the capital raising. Etihad was committed to a maximum holding of 22.2%, SIA to 22.1% and Air New Zealand, which is sub-underwriting the offer by up to $35.2m, to add to its pre-capital raising approved equity, to 25.9%. The UK's Virgin Atlantic group will retain its present 10%.

The row erupted as Qantas appeared to be heading to another loss-making year, with fears its credit rating could be downgraded. Joyce's campaign has ignited a national debate over the future ownership of the Australian national carrier, including speculation, now debunked, that the government would invest in Qantas.

Prime Minister Abbott did indicate, however that he would consider changes to the Qantas Sales Act, which limits foreign investment in Qantas to 49%.

In a radio interview, Abbott said Joyce had not put a specific proposal to the government. "Maybe Qantas wants to see the restrictions on ownership lifted. I'm not sure they really want to see a new government shareholding. And the trouble with providing a government loan guarantee is - where does it stop?" the prime minister said.

One rumour, now proved incorrect, was that China Southern Airlines (CSA) would invest in Qantas. The two airlines have signed a code-sharing deal, which gave CSA access to major domestic Australian routes, with Qantas receiving equal network reciprocity in China. "We have only been talking to China Southern about a commercial alliance. We haven't talked to them about equity," said Joyce. CSA president and chief executive, Tan Wangeng, said the airline "had no plan as such" or for the future.

Qantas said Virgin Australia's proposed capital raising could see its foreign ownership rise to up to 80% without the need for any further regulatory approval. "Despite this, the airline would retain all the traffic rights given to Australian carriers," said Qantas in its first letter to the Australian government. "If wholly privatised, Virgin Australia's ability to receive potentially unlimited capital from its government-backed owners would seriously distort the domestic aviation market for the benefit of foreign interests."

Qantas has launched an online petition that protests the "unfair playing field" between the two carriers, which also claimed "Virgin Australia has been losing money for 18 months, driven by a strategy of setting uncompetitive low prices to win customers from Qantas across all our flying businesses".

Borghetti accused Qantas of "running scared" and said his airline's strategy, including its fleet and capacity plan and product transformation, was set well before its three major airline shareholders were to come onboard.

"When you bring competition to a monopoly, prices do go down. If this is affecting our competitor's bottom line, I am not going to apologize for that," Borghetti said. "Australian travellers and the Australian economy are benefitting, and ultimately shareholders will too."

> When you bring competition to a monopoly, prices do go down. If this is effecting our competitor's bottom line, I am not going to apologize for this
>
> **John Borghetti**
> CEO
> Virgin Australia

It didn't end there. During its annual general meeting in Brisbane in November Virgin Australia chairman, Neil Chatfield, said legal action against Qantas and Joyce was being considered as the Qantas attempt to undermine its $350 million fund raising is unprecedented in Australian corporate history. He added his board may look at defamation proceedings against Joyce and possibly members of the Qantas board because it believes the Qantas comments attack the integrity of Virgin board members and Borghetti.

None of the foreign airlines investing in Virgin Australia have a seat on the airline board, but this will change under the terms of the fund-raising. Etihad chief, James Hogan, Air New Zealand's Christopher Luxon and SIA's Goh Choon Phong are expected to become directors.

Chatfield told the AGM that he ran the board with a majority of independent directors, with strict corporate governance protocols and with the best interests of all shareholders in mind. "If we do go ahead with board representation for our three largest shareholders, not one of these aspects will change. The board will still have a majority of independent directors, it will still be run with strict protocols and it will still serve the interests of all shareholders," he said.

"Secondly, there is no change in control as a result of the capital raising. All of our eligible shareholders have an equal opportunity to participate in the entitlement offer and may be able to acquire a greater interest than they hold now. While I am not going to waste any more of our shareholders' time with false accusations, let me assure you we have instructed legal advisors to act for us in dealing with this matter.''

Meanwhile, there have also been ownership changes at one of Virgin's major shareholders, Air New Zealand. It has been majority owned by the New Zealand government since 2001, when it had to be bailed out with public funds to avert bankruptcy. It has recovered strongly, despite the upheavals of the global economy since 2008. Last month the government's equity was reduced by 20%, to 53%, producing a US$304 million profit for the New Zealand treasury coffers. New Zealand finance minister, Bill English, emphasized that about 88% of the airline remains in the hands of local investors, including the government. ■

Etihad digs deeper in Europe

Ambitious Etihad Airways has acquired 33.3% of Switzerland's Darwin Airline, as it pursues its goal of establishing Etihad Regional in Europe.

The deal will allow the Abu-Dhabi parent carrier to display Etihad Regional upfront on both sides of the fuselage of the 10 50-seat Saabs operated by the Lugano-headquartered airline. The rear of each of the airline's planes will carry the words "Operated by Darwin Airline" plus the Swiss flag and Darwin Air and Etihad branding. The deal is subject to regulatory approval. Shelley Cole, who until November was on secondment from Etihad as the CFO of Air Seychelles, has taken up the same role at Darwin Airline.

Etihad said it would utilize Darwin Airline's 21 destinations, operating from its Geneva hub, to connect to the main networks of Etihad and its equity alliance partners, Virgin Australia, India's Jet Airways, airberlin in Germany, Air Seychelles, Ireland's Aer Lingus and rebranded Air Serbia in Eastern Europe.

From next June, Etihad will launch daily services from Abu Dhabi to Zurich, which will become one of the regional airline's main operating hubs.

"This is a step-change for Etihad Airways," said Etihad CEO, James Hogan. "With our new partner, we are creating a unique approach to network development for global airlines.

"European travellers will be able to connect from a far wider range of European towns and cities on Etihad-branded aircraft to Abu Dhabi and to our destinations worldwide." Hogan added the new strategy could be extended to other markets.

By mid-2014, Darwin Airline will add 18 destinations to its network, including six European gateways served by Etihad: Geneva, Amsterdam, Paris, Düsseldorf, Belgrade and Zurich. ■

Asia's banking honey pot

In the next two decades the appetite of the emerging world's middle class for travel will add a predicted 14,000 aircraft to Asia-Pacific airline fleets. Funding, too, is shifting as the region's aircraft lessors and airlines turn increasingly to the rich of the Asia-Pacific to finance fleet expansion.

Tom Ballantyne reports

Knock on local doors when seeking financing is the advice of one of the region's leading aircraft lessors because the industry has to find new ways of financing its business.

Managing director and CEO of BOC Aviation, Robert Martin, believes the airline industry should tap into the region's wealth to fund the thousands of aircraft planned for delivery in the Asia-Pacific.

By 2018, the world aviation industry – which currently needs around $100 billion annually to fund aircraft – will require financing of $120 billion a year, Martin said. As a panel member at the recent Association of Asia Pacific Airlines (AAPA) Assembly of Presidents, the BOC boss said historically, industry financing came from the U.S. Ex-Im Bank, the European Export Credit Agency and Japanese and European banks.

"It is clear that is going to change. One thing we have to do in this part of the world is mobilize the growth of the region's wealth and match it with the needs of our industry. The way that is going to happen is through the Asian banking system and through Asian capital markets," he said.

Vast sources of funding are available because the state pension funds of countries across the region are growing and private pension funds are growing. "They need somewhere to invest their money. The aviation industry is a very stable cash flow industry. We have to get that message across to these funds so that they understand this is a great industry in which to invest for the long-term," Martin said.

The BOC strategy underscores the wider global view of financiers who predict airlines will increasingly turn to capital markets to fund fleet development. Recent rule changes at institutions that were traditional sources for aircraft financing have increased borrowing costs.

Kostya Zolotusky, managing director, capital markets at Boeing's financial arm, Boeing Capital Corporation, told *Orient Aviation* funding from Ex-Im agencies alone, which accounted for $29 billion, or about 30% of last year's aircraft purchases, will fall to $24 billion, or 23%, of the $104 billion needed to finance aircraft acquisitions this year.

European-based commercial banks have been a major source of airplane funding. They were expected to provide $29 billion, or 28%, of finance for new aircraft in 2013. But they are restructuring their business units to meet regulatory guidelines being put in place in reaction to scrutiny of the industry in the aftermath of the 2008 Global Financial

> "We have to get the message across to the region's state, pension and insurance funds that this is a great industry for investment"
>
> **Robert Martin**
> Managing Director and CEO
> BOC Aviation

Shanghai-based China Eastern Airlines announced plans to issue up to US$1.4 billion in bonds to finance aircraft purchases, re-structure its loan book and general financing and replenish operating capital

Crisis. Aircraft manufacturers, which often step in to assist the financing of their customers' orders, are also easing back on their funding for new planes.

Martin forecast there will be another shift in the traditional method of aircraft financing - less use of the US$ - as pools of wealth across Asia are tapped. "We (BOC Aviation) just did our first off-shore Renminbi bond in Hong Kong. We raised one billion (Chinese) Renminbi of five-year unsecured money with more than 50% of the funds coming from private banks. This is an actual demonstration of the private wealth affect in Asia. It is really arriving," he said.

Governments in the U.S. and Europe are facing increasing budgetary constraints, which will pressure export credit agencies to increase caps on lending and spending. Martin reflects a larger lessor view when he said that institutions outside the Asia-Pacific can be expected to match the growth in capital expenditure in the industry.

A major issue for many lessors in the region is the growth of the low-cost carrier sector of the industry. Flag carriers from Asia are familiar to global lenders, but the growing crop of new LCCs need brand recognition to tap loan funds. Martin said this will take time and education.

Tight financing has encouraged some airlines to lease rather than buy aircraft, but whatever the source of the funding, lessors look like being the biggest winners. In 1980, said Boeing's Zolotusky, 1.7% of global commercial aircraft were leased. In 2012, the figure was 38%, with a prediction it will increase to 50% by 2020. "Probably over the next five to seven years, as regulation of banking is formalized, there will be less banking in general and less commercial banking available for aircraft," he said.

Annual statistics illustrate the shrinkage in commercial bank lending. Two years ago, French banks were providing 32% of all commercial bank aircraft financing. This year its commitments were halved. The contribution of German banks in the industry sector has declined from 29% in 2010 to 21% this year. Even Chinese banks, who contributed 21% of airline lending in 2009, reported an investment of 11% a year later, although indicators are it will rise to 18% for the full 2013 year. Japanese banks have increased activity in the market in 2013, but final figures are not yet available.

Japanese banks may be in again, but 20 years ago there were some 15 active Japanese banks. Today, it's probably a handful who are active in the market. It is not the big numbers seen previously, said Martin.

Five to ten years ago, Chinese banks mainly financed their own airline fleets, but they are now more participatory in international finance markets. Statistics indicate the big four [Chinese] banks are using their balance sheets globally with an emphasis in the Asia-Pacific. Opinion on the trend is mixed, but the point has been made that as China's banks build their global portfolios their investments are not just in the Asia-Pacific. "I think you are going to see them as much bigger players going forward," said Martin.

Airbus agrees with the general trends of bigger business for lessors in the region. Asian and Middle Eastern lenders are taking a larger share of the aircraft financing market, said Francois Collet, vice president for structured finance at Airbus.

"Some European lenders have halved their lending availability for the aviation sector. They have tried to fill the gap by bringing in other regional and local banks to work together in syndicated deals. Traditional banks are now playing the role of arrangers," he said.

Last year, French banks BNP Paribas, Société Generale, Natixis and other European lenders began cutting their exposure to risky and dollar-denominated

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assets such as shipping and aircraft financing to meet tougher capital rules and shore up reserves. They have given way to Development Bank of Japan, Sumitomo Mitsui Financial Group, Mitsubishi UFJ Financial Group, South Korean and Chinese banks, as well as as the National Bank of Abu Dhabi among others.

All the aircraft manufacturers, including Airbus, Boeing, Bombardier, Embraer and the smaller aircraft builders, agree on the changing numbers. In 2012, an average of 21% of aircraft leasing finance was from commercial banks, 30% provided by Ex-Im agencies, 14% from capital markets, 7% from lessor funding and the remaining 25% from airlines' own cash resources or other sources. This year, 28% is expected to come from commercial banks, 23% from Ex-Im agencies, 5% from lessors, 15% from capital markets and the remainder from cash and other sources.

The big mover, it is universally believed, will be capital marking raisings, which just a few years ago accounted for 2% to 3% of aircraft financing. In 2013, capital markets are expected to contribute at least 15% of funding, with the figure accelerating in the next few years.

A major part of the growth will be in the issuance of bonds, such as Enhanced Equipment Trust Certificates (EETCs) – a secured bond backed by aircraft that can be purchased by investors. EETS until recently had been almost exclusively used in the U.S. for financing aircraft purchases and leases.

Virgin Australia recently completed an EETC deal. Emirates Airline has conducted a $1 billion public bond issue and in June this year British Airways broke ground by raising $927 million to upgrade its elderly fleet through a hybrid bond issue of EETCs. Air Canada also sold $411 million of the bonds in April and Asian carriers are jumping on the bandwagon.

Garuda Indonesia has offered $204.1 million in bonds to back expansion plans, part of a series of bond issues amounting to nearly $400 million over the next two years. About 80% of these funds will finance fleet expansion. In mid-year, China Eastern Airlines informed the Shanghai Stock Exchange it would issue up to $1.4 billion in corporate bonds, with the proceeds to be used to purchase aircraft, renegotiate bank loans, optimize financing and replenish operating capital. Hainan Airlines, a subsidiary of the fourth largest aviation and property conglomerate in China, the HNA Group, announced issuance of $500 million in bonds, backed by a standby letter of credit from the Bank of China.

Products such as the EETC are still very much a U.S. product directed at a U.S. investor market, lessors said. The region's financiers are seeing a lot of the funds active in the U.S. setting up entities in the Asia-Pacific.

Martin said that lessors will do leases or sale lease-backs for airlines around the region and then go to the market. "We go in based on our own credit risk or put pools of aircraft together and issue debt and equity into the market place. That's the market we see will grow significantly over the next five years," he said.

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> **Kostya Zolotusky**
> managing director capital markets
> Boeing Capital Corporation

Aircraft buyers' issuance of bonds, backed by airplanes, are expected to double to about $30 billion next year. "Aircraft-backed bonds will fund about 15% of plane deliveries worldwide this year and rise to a 'high twenties' percentage of the market in 2014," said Zolotusky. Boeing forecasts next year's debt issuance will be equivalent to about 39% of such bonds issued globally since 1987, based on JPMorgan Chase research.

Analysts expect the trend will accelerate and that more major legacy airlines that have traditionally used commercial bank financing, including the Qantas Group and Singapore Airlines, will make forays into capital markets by attracting investment from pension funds, the insurance industry and big investment institutions.

Zolotusky emphasized that investments are made in the aircraft - the asset - not the airline. In the past, planes belonging to bankrupt airlines were often seized and held in limbo, turning them into non-productive assets. The practice was removed by the Cape Town convention, which converted aircraft into a relatively safe, high quality asset against which to lend.

He said the sector now offers attractive returns on investment at a time it is increasingly hard to get worthwhile yields from other avenues of income. Japanese banks recently paid high prices to acquire aircraft leasing assets, including purchase of the Royal Bank of Scotland's leasing business by Sumitomo Mitsui Financial Group in 2012.

"If I had more airplanes (to finance), the capital markets would snap up everything they could. I sleep well at night because I can't name another asset class (other than aircraft) that has performed better over the past 20 years or through the financial crisis. Until 2007, you could have said 'real estate,' but not now. Our track record of loss default is good," said Zolotusky . ■