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SEASONED LCC WARRIOR
Andrew Cowen has had lead roles in seven budget carrier start-ups. His experience shows in the winning formula of four-year-old HK Express

Cover Photo: Graham Uden
The A330neo shares many of the same innovations as the groundbreaking A350 XWB, delivering a 25% saving in fuel consumption compared to others in the category. Both aircraft also benefit from a common type rating, which means pilot training costs are significantly lower too. And on top of that, they can be fitted with our beautifully designed Airspace cabins, setting a new benchmark in passenger comfort and wellbeing.

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The A350 XWB generated thousands of innovations, including the A330neo.
The A330neo shares many of the same innovations as the groundbreaking A350 XWB, delivering a 25% saving in fuel consumption compared to others in the category. Both aircraft also benefit from a common type rating, which means pilot training costs are significantly lower too. And on top of that, they can be fitted with our beautifully designed Airspace cabins, setting a new benchmark in passenger comfort and wellbeing.

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Growth of the commercial aircraft leasing sector in China has mirrored the country’s spectacular economic development. No wonder, given forecasts that China will require close to 7,000 new aircraft in the next two decades. The same analysts believe that more than 40% of these new airplanes will be delivered into Mainland fleets under lease agreements.

There are an estimated 60 mainly domestic aircraft lessors operating in China with fleets as small as two or three aircraft, but they still want their share of the US$225 billion global leasing pie.

Their rivals include established BOC Aviation in Singapore, which is a 70% owned subsidiary of the Bank of China, and Dublin-based Avolon, recently acquired by China’s globally acquisitive HNA Group. Avolon is now the world’s third largest lessor.

The strength, and until recently, the profits for aircraft lessors resulted in the passing of Hong Kong tax legislation in July that is intended to catapult the Special Administrative Region into the top three aircraft lessor capitals of the world.

Whether Hong Kong’s ambitions will succeed remains to be seen. Already there are indications Ireland is considering action in the tax area that will nullify Hong Kong’s appeal compared with Dublin. It also is certain that Singapore will not be willing to lose any business of value to Hong Kong.

The proliferation of Chinese lessors and the subsequent competition for deals is pushing down lease rates and making profitability difficult. For some lessors, yields have shrunk to low single figures.

Deep pocketed Chinese lessors will survive. Smaller players either will go out of business or be absorbed by their bigger rivals. Whether this evitable consolidation will guarantee Hong Kong a place of significant aircraft lessor business has yet to be revealed.

TOM BALLANTYNE
Chief Correspondent
Orient Aviation Media Group

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“It has established itself as the primary source of information on industry topics in the Asia-Pacific region”
Japan Airlines-Vietjet code share disappoints analysts

In an eyebrow raising development in late July, youthful low-cost carrier, Vietjet Airlines, and venerable veteran, full service carrier, Japan Airlines (JAL) announced their intention to form a code share union.

On a superficial level, it appeared an uncomfortable matching, but to industry observers it was hardly surprising. Pushing the odd couple carrier’s into the relationship was the simple fact that Vietnam’s flag carrier, Vietnam Airlines, and All Nippon Airways (ANA) had formed their own code share last October after ANA invested 8.8% (US$106 million) in the state-owned airline.

The ANA investment abruptly ended a code share between JAL and Vietnam Airlines that had been in place since April 1996.

Until March this year, JAL was not allowed to expand. The limitation was one of the conditions imposed on the carrier when it was given government backed assistance to progress through its bankruptcy rehabilitation.

The 8:12 Paper, drafted by the Ministry of Transport, applied for five years from August 2012. A director of Japan Aviation Management Research, Haruo Ushiba, said the JAL/Vietjet code share agreement was a replacement for the previous JAL/Vietnam Airlines code share.

“By itself, the JAL/Vietjet partnership is not impressive at all to those who expected a more dynamic, global expansion strategy from JAL now that the 8:12 ban is lifted. It’s really disappointing,” said Ushiba.

Partnerships between LCCs and full service carriers such as code shares are not unusual these days, Ushiba said. He cited precedents set by Ryanair and Air Europe and Emirates and flydubai.

“There are many cases where major legacy carriers have internal LCCs, for example, Lufthansa and Eurowings. IAG has Level and Air France is launching Joon,” said Ushiba, who added JAL is one of many full service airlines which has a tie-up with JetBlue in the U.S.

Benefits for Vietjet and JAL will include code-sharing and the transfer of frequent flyer miles earned on one airline to the other. The arrangement will apply on all routes between Vietnam and Japan and to the domestic routes of both carriers. Vietjet plans to launch scheduled services to Japan in 2018.

In the future, there could be international network gains beyond Japan for Vietjet and the opportunity to benefit from JAL’s international know-how. For JAL, VietJet could be a springboard beyond Vietnam to Southeast Asia. JAL operates daily non-stop flights between Tokyo/Narita and Ho Chi Minh City and Hanoi respectively, in addition to Tokyo/Haneda - Ho Chi Minh.

Vietjet started flying in December 2011 and built its domestic market share to 41.5% in 2016, which was just below Vietnam Airlines’ 42.5%. The Vietnamese LCC plans to double its international revenue by launching several regional destinations in the next 18 months. It has a fleet of 45 aircraft, operates 350 flights a day to 73 domestic and regional destinations in Cambodia, China, Hong Kong, Malaysia, Myanmar, Singapore, South Korea, Taiwan and Thailand. By Geoffrey Tudor in Tokyo

Install onboard WiFi or fade away warns Inmarsat

Two out of three airline passengers in the Asia-Pacific regard inflight WiFi as a necessity when they travel and rated it more highly than onboard inflight entertainment, a new Inmarsat survey has revealed.

The study, conducted with market researcher, GfK, found more than half of all airline passengers in China (59%) and India (51%) expected the same level of connectivity at 35,000 feet that they receive on the ground.

The third annual Inflight Connectivity Survey, which concluded inflight broadband is revolutionizing passengers’ onboard experience, also revealed that 52% of airline passengers in the region would stop patronizing their preferred airline in the next 12 months if it did not allow them to stream or browse online without interruption.

Passengers in China (55%) and India (52%) are most sensitive to the quality of onboard WiFi services. The ability to connect to smartphones, laptops and tablets (40%) is one of the three most important criteria for passengers, after ticket price (53%) and flight slots (44%), when booking airline travel.

In China, passengers expected the “Big Three” carriers to offer the best inflight WiFi and rated them in the following order: Air China (46%), China Eastern Airlines (22%) and China Southern Airlines (21%).

Inmarsat vice president, Asia-Pacific, Otto Gergy, said: “whether using the time to work, connect with friends and family or pass time shopping or viewing entertainment, the availability of inflight broadband has become a major factor when choosing an airline and the annual Inflight Connectivity Survey has become a barometer of passenger sentiment.

“This year’s survey revealed 67% of passengers in the Asia-Pacific believed inflight WiFi is a necessity, not a luxury. This trend will increase as more people experienced inflight connectivity. The opportunity connectivity presented to airlines cannot be underestimated. Airlines in the Asia-Pacific are recognizing this fact.”

The region’s passengers are among the most willing worldwide to pay for inflight WiFi, with 91% prepared to be charged for onboard connectivity on long-haul leisure flights and 79% on short-haul leisure flights. Some 61% of passengers who have experienced inflight connectivity in Asia consider it more important than inflight entertainment when selecting a carrier. By Tom Ballantyne
Air New Zealand and Qantas keep their shareholders happy

Qantas Airways continued to strengthen its balance sheet with the announcement that its latest full-year underlying profit was $1.4 billion (US$1.1 billion), its second best result in its 97-year history. But in a tough year for international business, profit declined by 17%, to $852 million (US$673.1 million), and passenger revenue was down 1% for the 12 months.

Qantas Group CEO, Alan Joyce, said: “All of the group’s divisions - Qantas and Jetstar domestic, Qantas and Jetstar international and its frequent flyer program - were in the black. Jetstar posted its second highest profit in 13 years, but said earnings fell by 8%, to $417 million, compared with 12 months ago.

Joyce confirmed he had written to Airbus and Boeing and challenged them to produce an airliner that could fly non-stop between Sydney and London and Melbourne and New York by 2022.

Joyce said he had asked the manufacturers to give their next-generation aircraft currently under development, Airbus’ 350ULR and Boeing’s 777X, the range to fly non-stop and with a full passenger load on the routes.

The strong Qantas results came a week after rival, Virgin Australia, posted a loss of $2.5 million for the year, a big improvement on the $32.4 million deficit of a year earlier and well ahead of forecast losses of $14.2 million.

Across the Tasman, Air New Zealand (Air NZ) reported a 17% drop in after tax profit, to $NZ382 million (A$351 million), but said the results were still the second best full year earnings in the airline’s history.

Air New Zealand CEO, Christopher Luxon, said: “This year Air New Zealand faced an unprecedented increase in competition from some of the world’s largest airlines and effectively rose to the challenge.” There also was evidence that some overseas carriers were pulling back capacity, he said.

Based on current conditions and assuming an average jet fuel price of US$60 a barrel, the airline is aiming to improve on its 2017 earnings. By Tom Ballantyne

Korea Development Bank sells off Asiana shares

Korea Development Bank (KDB) last month sold its 5.94% investment in South Korea’s second largest carrier, Asiana Airlines, a sale that prompted speculation the buyer was the HNA Group. Asiana and HNA declined to comment on the divestment.

Asiana has repeatedly said it wanted to increase cooperation with HNA Group carriers. In March, the Mainland conglomerate purchased a minority stake in Asiana parent, Kumho.

Group chairman, Park Samkoo, met with HNA Group CEO, Adam Tan, last year to identify areas for cooperation. Asiana and HNA have now launched Gate Gourmet Korea. HNA owns Gate Gourmet Switzerland GmbH. Separately, KDB said it would invest UA$130 million in a “One Belt, One Road project, the expansion of Haikou International Airport, the home city of Hainan Airlines, whose parent is the HNA group. By Dominic Lalk
Choosing ATR’s solutions generates $1 million of savings annually, per aircraft, compared to their direct competitors. This explains the vast success of the program and its leadership in terms of orders, deliveries, backlog, operator base, investor’s opinion and residual value retention.
Asia-Pacific air cargo drought finally breaks

Air cargo is emerging from a painful seven year slump and industry leaders are confident that recovering freight volumes are not a repeat of the false dawn of 2010.

By Tom Ballantyne

There have been signs since last year that air freight has been slowly and steadily recovering and now statistics are available to back up the anecdotal trend.

New data from the International Air Transport Association (IATA), released last month, reported demand measured in freight tonne kilometers (FTKs) grew by 10.4% in the first half of 2017 compared with the same period in 2016.

The results, which are almost three times higher than the industry average growth of 3.9% in the last five years, represented the air cargo industry’s strongest performance since its short burst of prosperity in 2010.

Asia-Pacific airfreight volume grew 10.1% in June alone compared with the matching period in 2016. In the same months, capacity expanded by 7.8%. Seasonally adjusted international freight volumes are 4% above the levels of 2010, two years after the onset of the Global Financial Crisis (GFC).

The air freight market was strongest on international routes within Asia and between Asia and Europe, at 13%-15%. All regions experienced positive freight growth for the six months to June 30, but Asia-Pacific and Europe carriers accounted for two-thirds of demand.

IATA’s numbers were supported by the Association of Asia Pacific Airlines (AAPA) latest statistics, which reported broad-based increases in new export orders. “Global trade activity has picked up markedly since the middle of last year, with air freight volumes growing at a robust pace, said AAPA director general, Andrew Herdman.

“Overall, Asian airlines reported a 10.4% increase in international air cargo traffic during the first half of 2017, supported by an upswing in export orders for both the leading emerging markets and advanced economies.

“Expanding airline networks and the widespread availability of competitive airfares will also help to drive further growth in travel demand.”

IATA director general and CEO, Alexandre de Juniac, said: “The industry is taking advantage of this momentum to accelerate modernization and improve the value it provides to customers.

“However, there are some signs that the cyclical growth period may have peaked. The global inventory-to-sales ratio has stopped falling. This indicates that the period when companies look to restock inventories quickly, which often gives air cargo a boost, may be nearing an end.

“Regardless of these developments, the outlook for air freight is optimistic with demand expected to grow at a robust rate of 8% during the third quarter of this year.”

Carriers worldwide annually transport goods valued at $6 trillion by airfreight, which generates $50 billion in revenue for airlines. Asia-Pacific airlines carry 40% of global cargo traffic. Markets from Turkey to the Middle East and South Asia (+54%), Belgium to the Asia-Pacific (+50%) and Belgium to North America (+46%) had the highest volume increases.

Between Asia and North America yields and volume reported a moderate capacity increase, but there are signs air cargo operators are preparing to add to their fleets. Last month, Hong Kong Air Cargo, a subsidiary of Hong Kong Airlines, agreed to take on three more B747-400 freighters via an aircraft, crew, maintenance and insurance agreement with Atlas Air Worldwide.

“After strengthening our regional network in recent years, it is time to expand our trans-Pacific network and look to markets such as Europe, Australia, Africa and Latin America,” the chairman and chief executive of Hong Kong Air Cargo, Guo Song Zhong, said.
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Etihad board aborts loss-making strategy

The Etihad Aviation Group strategy of building a network through a string of airline investments worldwide continues to fall apart as yet another of its joint ventures, airberlin, enters bankruptcy proceedings.

Tom Ballantyne reports

It’s not the best of times for Abu Dhabi’s Etihad Airways and its parent, the Etihad Aviation Group. In late July, the airline reported a massive $1.87 billion net loss for 2016. That bad news was followed last month by the announcement that one of Etihad’s European equity partners, German low-cost carrier, airberlin, was bankrupt.

Another member of the Etihad airline partnership, Italian flag carrier, Alitalia, went into administration in May after unions refused to support the airline’s latest restructuring plan. And it could get worse for the Abu Dhabi airline group. When he announced the 2016 loss, Etihad Airways’ interim group CEO, Ray Gammell, said the “ever-evolving competitive environment is likely to impact overall performance in 2017”.

Since Gammell formally succeeded James Hogan on July 1, it has become increasingly clear the airline’s owners, the government of Abu Dhabi, are far from happy with the returns on their investments, or lack thereof, from its partnerships in Alitalia, airberlin, Virgin Australia, Jet Airways and Air Seychelles. Etihad’s financial exposure to Alitalia and airberlin alone is reported to be more than $4.5 billion.

The 2016 losses compare with a $103 million profit for the carrier a year earlier. Etihad attributed the loss to one off impairment charges, fuel hedging losses, an $808 million charge on certain assets and exposure to equity partners, mainly airberlin and Alitalia.

When the German LCC went under last month Etihad said it would withdraw financial support from the struggling carrier. “This development is extremely disappointing for all parties, especially as Etihad has provided extensive support to airberlin for its liquidity challenges and restructuring efforts over the past six years,” said Etihad.

In April this year, the Etihad Aviation Group said it had provided “250 million euros ($295 million) of additional funding” to airberlin as well as supporting the airline as it searched for strategic options for the business.

“However, airberlin has deteriorated at an unprecedented pace, preventing it from overcoming its significant challenges and also from implementing alternative strategic solutions,” an Etihad Aviation Group statement said.

That was an understatement. The beleaguered German carrier has accumulated more than $3 billion in losses in the last six years and has net debts of $1.4 billion. The carrier and Germany’s economic ministry said in separate statements that Lufthansa and another unidentified airline are “far advanced” with plans for a partial rescue.

Most analysts believe Etihad’s grand plan to rule the world’s airways is in deep trouble. Under former group CEO Hogan, the airline group embarked on an equity acquisition spree that saw it acquire shareholdings in Alitalia (49%), airberlin (29.2%), Air Serbia (49%), India’s Jet Airways (24%), Virgin Australia (21.8%) Air Seychelles (40%) and Austria’s Niki (49.8%) as well as 33% of Swiss-based Darwin Airways. Etihad sold its interest in Darwin Airways, which was rebranded as Etihad Regional, in July.

Hogan’s strategy has allowed Etihad to penetrate deeply into markets in Europe, Australia and India. Where partners could co-operate, the in-company alliance of airlines also brought significant savings to the group in pilot training, aircraft maintenance and fleet acquisition. But some of the airline investments were high risk. Alitalia, for example, had long been a financial and service basket case.

Some airlines in the group have performed better than airberlin and Alitalia. A re-launched Air Serbia is a solid feeder for the Etihad network and the investment in Jet Airways helped Etihad enter the potentially lucrative Indian market. Virgin Australia has become a viable competitor for Qantas, although it is still reporting losses and has yet to give Etihad’s shareholders a return on their investment.

“A culmination of factors contributed to the disappointing results for 2016. The board and executive team have been working since last year to address the issues and challenges through a comprehensive strategic review aimed at driving improved performance across the group, which includes a full review of our airline equity partnership strategy,” said the chairman of the Etihad Aviation Group, Mohammad Al Mazroui.

At home base, Etihad Airways CEO, Peter Baumgartner, said his airline faced the same issues as the industry in general. “Overcapacity, declining market sizes on key routes and changing consumer behaviour are combining with a weak global economy that is affecting spending appetite,” he said.
TOO MANY FINGERS IN THE LEASING PIE?

Agile aircraft lessors have been earning spectacular profits as the region’s airlines move towards domination of the global market. But increasing competition is depressing yields even as leasing companies pivot to Asia for growth.

By Tom Ballantyne

A decade ago, Chinese aircraft lessors owned 22 of China’s 430 leased aircraft. In January this year, Mainland controlled lessors had a portfolio of 583 airplanes in a leased fleet of 1,235 China-based aircraft.

Even more attention grabbing is the number of Chinese lessors in play. “There are a lot of leasing companies in China,” head of the Aerospace Finance Focus Group and a member of the Working Group on Transportation of the Hong Kong Economic Development Commission, Dewey Yee, told Orient Aviation last month. “The last count was 60.”

He was speaking as Hong Kong formalized its grab for market share in the lucrative aircraft leasing business – valued at $225 billion globally in 2017 - after changes in the tax regime were passed into law in Hong Kong in July.

The new regime is intended to make Hong Kong a genuine competitor with global aircraft leasing giant Dublin, and to a lesser degree, Singapore and China’s Tianjin special economic zone.

A career veteran of the industry who also is a special advisor to the Board of Ireland-based Aergo Capital Limited, Yee said while the overall number of Mainland lessors is big, many of them only have one or two aircraft on their books. In the next several years, he said, there probably would be “a significant consolidation or inactivity by a lot of those lessors”.

“Simply, we will have too many people in the sandbox. There will not be not enough toys to play with and not enough profit to make,” he said.

Yee’s view is shared by the president of Minsheng Commercial Aviation’s aircraft leasing arm, Wang Fuhou, who told delegates at a recent Shanghai conference that “this is a highly specialized and international funding and technologically intensive business. I believe we will see many withdraw or be forced by business problems to quit. We don’t need this many (Chinese) aircraft leasing firms”, he said.

Managing director of aircraft leasing and financing platform, Novus Aviation Capital, Hani Kuzbari, said the competition in China [among lessors] is putting severe pressure on leasing factors and returns. There is “all-time high liquidity and all-time low returns. In the industry cycle we’re very much around the peak or post the peak,” he said.

Separately, it is reported that certain Chinese lessors have told prospective airline customers “whatever offer our competitor has made, take 5%-10% off it. That is what we will give you”.

MAIN STORY
Speaking from Hong Kong, Yee said there is not only pressure on lease rates. “There is pressure on each other to capture the market. All the big boys are trying to grow as fast as they can,” he said.

“They’ve got a ton of money. They have cheap bank money and there are new players coming in such as asset managers representing institutional investors and private network investors that need yield and are very happy with a 3%, 4% or 5% return on their money. So yes, there is a lot of pressure on profitability at these lessors in China.”

Not everyone is so pessimistic and the state of the business is not just about China. Hong Kong-based head of Asia-Pacific at Avolon, Simon Hanson, is one of them. Avolon became the world’s third largest lessor when a division of the HNA Group, Bohai Aviation, acquired it for $7.6 billion last year. He said the industry is cyclical and dealing with it is nothing new.

Since becoming Chinese-owned, Avolon also has acquired U.S.-based CIT Leasing for $10 billion. Following the acquisitions, the lessor has expanded from a fleet of 200 aircraft to 921 at June 30 this year. The book included committed orders.

“What are the risks?” Hanson asked. “The risks in this industry tend to be exogenous risks we can’t foresee. I suppose those on the horizon are geopolitical. We would be concerned about the various environments and potential for instability around the world. Is the cycle going to be like the last cycle? Definitely not.

“Could it be altered by the amount of capital we’ve seen come into the industry? Possibly. There are certainly high levels of liquidity around the world that may dampen the effect of the aircraft financing cycle. But I suspect it’s the one shock we have not thought about that will mark a change in direction for the industry.

“We are sort of approaching that point, but it’s hard to see where it is going to emerge. We have managed through multi-cycles and we are big believers in aircraft being good long-term investments.”

There is little doubt that leasing rates are taking a hit in the present environment, geopolitical or otherwise. The latest figures from Europe’s AviaAM Leasing, for the second quarter of this year, indicated a downward trend in aircraft lease rates compared with the same quarter a year ago. And there is universal agreement that Asia, and China in particular, are strongly influencing the rate erosion.

Narrow body A319-100 and B737-300/400/700 lease rates have dropped by 4.94%, 2.61%, 3.57% and 4.71%, respectively, compared with 12 months ago. Boeing 737-800 lease rates have slumped by 10.62%, although lease rates on Airbus 320-200s increased by 3.84%. Significant decreases in returns also were recorded for B777-200ERs (-32.90%).

Airbus 330-200/300s and Boeing 777-300ERs declined by 11.32%, 9.59% and 6.98%, respectively.

The volume of entrants muscling into the leasing business is hardly surprising. Close to 42% of the global airline fleet is leased and the percentage is rising. In a business once dominated by western lessors, Chinese banks, institutions and individual global investors are eager for a share of the still lucrative business.

Bank of China’s Singapore-headquartered BOC Aviation Ltd is a long term player in the industry, while Hainan Airlines parent, the HNA Group, the Bank of Communications (BOCOM), China Minsheng Banking Corporation and CDBALF are more recent entrants in the industry via their rapidly expanding subsidiaries.

They target Chinese airlines, but also, increasingly, are doing deals globally, traditionally the domain of Western lessors. Chinese local governments, including Tibet and Xiamen, as well as insurers, also have launched leasing arms, supported by government measures to boost growth.

Senior vice president of BOCOM Leasing, Li Ru, said these trends are behind the fierce competition for clients and qualified staff. “Profit margins are shrinking every year. Rents are falling, but our plane-buying costs are still growing annually,” he said. To be noted is the fact that in the case of China many domestic lessors only lease aircraft to domestic airlines.

When it comes to the Mainland, there are valid reasons for global lessors’ attraction to Chinese airlines. In a report released in May, “Land of Silk and Money, an analysis of China’s Aviation Market”, Avolon’s head of strategy, Dick Forsberg, highlighted the impact of China as the world’s largest generator of outbound travel, with more than 120 million Chinese visiting international destinations in 2016.

“Today, 150 airlines provide international services from 82 Chinese airports, operating 800,000 flights annually on 1,200 airport pairs. China’s international air traffic has been growing at an annual rate of 14% since 2010 and reached 126 million passengers in 2016,” the report said. Forsberg forecast more than 3,000 additional aircraft will be required by Chinese airlines in the next decade of which less than 50% have been ordered. All of which is music to the ears of lessors.

It is one of the key reasons Hong Kong has passed into law its generous new tax regime for aircraft lessors. The law offers a tax rate of 8.25%, half of the prevailing Hong Kong corporate tax rate. See Hong Kong’s new tax regime, page 17.
So how difficult will it be to attract lessors and their specialized staff from Dublin, a city with cleaner air, lower living costs and a better quality of life than Hong Kong?

Yee said that question has been answered. A number of companies, such as Avolon and GECAS - Dublin-based AerCap and GECAS are the only lessors larger than Avolon - and some others have set up in Hong Kong.

But it is not about setting up, he said. “It’s about locating the special purpose vehicle (SPV) in the Hong Kong jurisdiction. The main reason there are a lot of companies in Ireland is that the Irish SPV enables you to enjoy certain double taxation benefits because of taxation treaties between Ireland and a number of countries.

“Ireland has 70 or 80 treaties where you lease an aircraft from an Irish SPV to a third country. Because of the agreements, you have a lower withholding tax rate that is anywhere between 6% to maybe 7% or 8%. If you don’t have that treaty in place it’s as high as 15% to 20% in withholding taxes on the rental income.”

For those leasing aircraft into China from Hong Kong, Yee explained, the withholding tax rate previously for Mainland China was 7%. The rates were 6% in Singapore and Ireland.

“The [Hong Kong] government lowered the double taxation, the treaty rate, to 5%. It is now 1% lower than Singapore and Ireland. That 1% is quite significant if you are dealing with very large sums of money,” he said.

“But we have less than half the double taxation treaty agreements with other countries of Singapore and Ireland. The Hong Kong government recognizes this and is negotiating with countries with that in mind, especially when it comes to aircraft leasing. In fact, some recent treaties are actually more favourable than those with Singapore and Ireland.”

That optimism is shared by China Aircraft Leasing Group Holdings (CALC). Chief executive, Poon Ho Man, told Orient Aviation the government’s decision to move ahead with a dedicated tax regime to develop the aircraft leasing business in Hong Kong is welcome news for the industry.

“Hong Kong has a well-developed and sound financial infrastructure with a relatively transparent and simple tax filing procedure,” he said in a statement. “It will be a new driver for economic growth with ripple effects and benefits in employment and Hong Kong’s competitiveness in the global market.

In the meantime, “CALC is working towards being a full value chain aircraft solutions provider for global airlines. We are well positioned to capture significant opportunities globally”, CALC chairman, Chen Shuang, said when the lessor announced its annual results last month.

Poon said CALC will deliver 20 more aircraft by year-end and will have a fleet of 110 airliners in the same period. He expected to take delivery of 40 aircraft annually from 2020, with half of them to be leased to customers outside China.

In July, it ordered 50 B737 MAXs, worth $5.8 billion at list prices. They will be delivered by 2023. In 2014, the lessor made a US$10 billion commitment for A320s. “We hope to play a role in facilitating Hong Kong to become an international aircraft leasing hub. We believe that the revision of the tax code will allow Hong Kong to emulate and catch up with Singapore and other aircraft leasing hubs,” said Poon.

Whether it can remains to be seen. A clause in the legislation requires a lessor to have its central management and control in Hong Kong, which requires the entity’s executive officers and senior management exercising day-to-day decision-making powers to be based predominantly in Hong Kong.

A foreign corporation looking to take advantage of Hong Kong’s lower tax regime cannot operate through a
Hong Kong branch office. It is estimated about 60% of the world’s leased aircraft are owned and managed from Ireland. Will any of these companies move their headquarters to Hong Kong?

Avolon is an interesting case in point. It is now Chinese-owned, but the lessor appears to have no intention of moving its head office from Dublin to Hong Kong. It has offices in Hong Kong, Shanghai and Singapore, said Hanson, but they are staffed by “coverage people” who look after relationships with airline customers and banks or in the trading area.

“We increasingly have a locally based legal presence, a team of lawyers who are documenting our transactions. We find it very helpful to have lawyers in the same jurisdictions as our trading and airline customers,” he said.

“But the main hub of the business is out of Dublin. We are in daily contact at multiple levels with video conferences and telephone calls. That’s the way this business works. It’s very much about going back to the global hub, which is Dublin.

“Then you have the situation where you ask do you want to replicate the environment that Ireland has spent many years investing in and nurturing? Clearly, that’s the way Hong Kong and Singapore are looking at it at the moment.

“From an Avolon perspective, we’re here because we need to be close to our customers. This is where the growth is and we resource that appropriately.”

Interestingly, Hanson said being Chinese-owned did not mean it made it easier to lease planes in China. “We have to compete with the airlines like everybody else. Even with HNA airlines it’s a competitive process. It’s pretty much business as usual for us. We are the same as every other lessor knocking on doors.”

Hong Kong would not be wise to ignore the possibility of Ireland retaliating to its new lessor rival. A tax director with accountants BDO Ireland, Angela Fleming, last month warned about moves [in leasing] by Singapore and Hong Kong into China, particularly after Singapore announced an extension to its existing aircraft leasing regime to 2022 and Hong Kong’s legislation was passed into law.

“While significant growth in Asian markets presents massive opportunities for Ireland, we cannot ignore the threats posed by those jurisdictions which are competing for a bigger share of the aircraft leasing market,” she said.

“The aircraft leasing industry is of such significant value to Ireland that we cannot allow ourselves to become complacent.”

She urged Irish authorities to look for ways to attract and retain the pool of highly skilled professionals that are the cornerstone of the aircraft leasing industry. Recent “hints” from Ireland’s new Taoiseach about tax cuts may be very welcome in the leasing space.

Avolon’s Hanson said: “Asia is a fast growing market. It has good future potential. There is the growth of the middle class. Sixty per cent of the world’s population is here. When you look at the penetration of aircraft compared with the more established markets of Europe and North America, there is significant growth in this region. It still excites me today as much as it did when I arrived here 16 years ago.”

Hong Kong’s new tax regime for aircraft lessors

After more than four years of effort by the Working Group on Transportation of Hong Kong’s Economic Development Commission, Hong Kong’s tax legislation for aircraft financing and leasing business was passed into law on July 7.

Under the concessionary tax regime, the assessable profits from prescribed activities by a qualifying aircraft lessor and a qualifying aircraft leasing manager are subject to profit tax of 8.5%.

The assessable profits of the aircraft lessor are calculated at 20% on the net lease rental payments excluding depreciation allowances. The changes in Hong Kong legislation offer a dedicated concessionary tax regime to aircraft lessors as well as aircraft leasing managers considering entry into the aviation leasing market in the region.

The tax treaty network also is a critical factor for aircraft lessors and Hong Kong is behind other leasing centres on this front. The Hong Kong Special Administrative Region (SAR) government is committed to working towards extending its tax treaty network and intends to provide more industry training given the potential growth of the aviation industry.

Given Hong Kong’s proximity to Mainland China and its similar culture and language, aircraft lessors based in the SAR have the advantage of understanding the sentiments of the growing aviation market. The introduction of the concessionary tax regime is a key step in the right direction.

Around 93% of respondents to a PwC survey in February this year said they were confident Hong Kong would become a promising regional aircraft leasing hub and supported the government initiative.

PwC understands several aviation investors have expressed interest and have commenced to plan their aircraft financing and leasing business in Hong Kong, which signals a promising future for aircraft financing and leasing in the SAR.

* PwC Asset Finance and Leasing Tax partner, Clarence KF Leung
New Harbin carrier strikes out for the world

It has only one plane and is owned by a local Chinese jeweler but that is not holding back Harbin’s Longjiang Airlines. It plans to be flying 40 aircraft by 2021, including seven A330s on routes to Sydney, London Heathrow and Los Angeles.

Dominic Lalk reports from Harbin

Longjiang Airlines (LJ Airlines) sole airline route is a daily 2,900 kms Harbin-Hefei-Zhuhai A321 triangular service commenced after receiving its air operator’s certificate (AOC) from the Civil Aviation Administration of China (CAAC) in February.

The new carrier is 98% owned by Harbin Xiangyu Co., a gold and jewellery company and has registered initial capital of 800 million yuan ($130 million).

The airline’s president and legal representative is Zhang Yuming, whose jewelry company owns 98% of LJ Airlines. But the carrier’s day-to-day business is run by LJ’s board director, Li Xiang, and vice-president, Jia Tiesheng. Both Liang and Jia were formerly members of Air China’s senior management. Jia was in charge of alliances and international partner relations and was one of the signatories to the Air China-Lufthansa Sino-Europe joint venture.

When Orient Aviation visited Jia, Li and Liang in Harbin in August, the airline’s planned second aircraft remained grounded after China Aircraft Leasing Group (CALC) served LJ with a termination notice in June that alleged the very young airline had failed to fulfil certain terms and conditions of contracts signed last year for the second A321. LJ bought the A321 flying Harbin-Zhuhai from bankrupt airberlin.

LJ confirmed to Orient Aviation there was a “controversy with CALC” because of an unspecified “deposit issue” and that it is considering legal action against CALC for misrepresentation. At press time, the two parties had not settled their dispute. CALC confirmed to Orient Aviation that following issues with the first lease it had cancelled LJ’s second lease contract.

LJ’s Harbin-Hefei-Zhuhai route is outperforming forecasts. From February to September, it carried approximately 100,000 passengers and achieved an average load factor of 80%. The aircraft arrived in a single-class configuration in Harbin after its short stint with airberlin, but it has been reconfigured to include eight lie-flat first class seats that sell for 8,000 yuan (US$1,200) per round trip. Uptake is good, LJ vice-president Jia said.

At domestic Mainland carriers, aircraft cabins are only fitted with domestic first – generally equivalent to business class elsewhere in the world – and economy seats. LJ serves meals in both domestic first class as well as economy class. Catering is provided by China Southern Airlines, the largest carrier at Harbin’s Taiping International Airport.

Zhuhai was picked as the inaugural destination, CEO Liang explained, because the airline was “bullish on the growth potential of the route as the Hong Kong-Zhuhai-Macau Bridge is about to open and it will take only 40 minutes to drive from Zhuhai to Hong Kong”.

LJ’s goal is to be Heilongjiang Province’s flag carrier. It plans to increase its fleet by six aircraft this year after taking delivery of an additional A321 and four A320s. In 2018, it intends to acquire another seven A320s, followed by seven more A320s in 2019 and, more interestingly, two A330s, one each in November and December, in the same year.

In 2020, seven additional A320s and two extra A330s will arrive at the fleet. In 2021, there will be six A320 and three A330 deliveries to the airline.

LJ will only install first class on the A321s operating to
southern China, while the A320s will be fitted with a single-class layout for 180 passengers. The A330s will have 260 seats, including 18-24 flat beds.

The first A330 is due at LJ in November 2019. For now, it planned to launch a two to three times a week Harbin-Sydney route with the long-haul jet, followed by an A330 service to Singapore a month later. Li and Jia told your correspondent that Australia was the favourite vacation spot for people from Heilongjiang.

In 2020, LJ has the goal of inaugurating A330 services first to San Francisco, followed by Melbourne, and then London-Heathrow, Paris and Los Angeles in 2021. Tokyo, Seoul and Ho Chi Minh City routes will commence next year.

Domestically, LJ will have 36 routes by 2021, including multiple daily flights to Beijing, Shanghai and Guangzhou.

It has ambitions to carry four million passengers that year after building secondary hubs in Nanning and Xian and launching a frequent flyer programme.

LJ needs to improve its distribution. At the time of our visit, most sales were made through the indirect channel. The airline is rolling out a mobile app and WeChat booking and it is opening more ticket offices. In 2018, it forecasts 80% of sales will go through its direct channels.

The carrier is expected to face stiff competition in the first years of operation given the number of airlines opening in China and across the region. HNA Group is preparing to launch Heilongjiang Airlines, also to be based at Harbin Taiping International Airport, but like elsewhere on the Mainland the growth of new carriers is being hampered by acute pilot and slot shortages.

Taiping International Airport is undergoing major expansion that will include a new runway, a 163,000 square metre terminal and 43 new aprons. By 2020, the airport will accommodate 22 million passengers, up from 16 million last year.

The Airport, formerly known as Yanjiagang Airport, opened in 1979. The airfield is located approximately 37 kilometres southwest of downtown Harbin. It is the largest airport in north-eastern China.

In 2015, Harbin implemented a 72-hour visa-free transit scheme, allowing visitors from 51 countries to enter Harbin for up to three days without a visa. Yet Harbin remains relatively isolated on the airline route map. While it boasts an extensive domestic network, the airport is lacking international connectivity.

The only scheduled international services are Seoul (Asiana Airlines), Taipei (EVA Airways), Vladivostok (Aurora Airlines, China Southern and Sichuan Airlines, as well as Bangkok, Macau and Nagoya (Spring Airlines). Lion Air operates charter flights to Denpasar and South Korea’s Eastar Jet offers charters to Cheongju. Singapore's Scoot has announced Singapore-Harbin from December 1.

"We expect Harbin will be one of the ten major gateways for international travel from China going forward. At the moment, we don't have any long-haul flights from Harbin, but that will change in the future."

Jia Tiesheng
Longjiang Airlines vice president
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Mainland airline juggernaut powers across the globe

Increasingly affluent Mainlanders are driving the monumental growth of China’s passenger traffic. Chinese carriers are looking beyond the Open Skies agreements of old as their global market share explodes.

By Tom Ballantyne

Recient equity links between U.S. and Chinese airlines may speed up moves to seal a long-awaited new Open Skies agreement between the two nations.

If a breakthrough agreement is achieved, it would allow the partnerships formed to apply for anti-trust immunity to coordinate networks and pricing across the Pacific.

Chinese carriers have been on an unprecedented global expansion drive, offering low fares on long-haul routes that is putting severe pressure on competing western carriers. At press time, return economy flights between Los Angeles and Shanghai were being offered at US$722 by Hainan Airlines and $880 by China Southern Airlines. Delta’s lowest price for the route is $920.

China’s biggest carrier, China Southern Airlines, is offering Sydney to London return, via Guangzhou, for $1,420 and China Eastern Airlines is charging $1,539. In contrast, Qantas Airways’s cheapest fare is $1,717, Emirates Airline’s is $1,807 and Cathay Pacific Airways $2,147 from Australia to the UK capital.

China Southern also has been selling flights from Sydney to Seoul, via Guangzhou, for $588.30, more than one third cheaper than flying direct with Qantas to South Korea.

Flying from London to Hanoi, also via Guangzhou, costs $830 with China Southern and $1,216.50 on British Airways.

Earlier this year, China finalized a landmark Open Skies agreement with Australia and late last year agreed to a new bilateral with the UK. The China-UK agreement allowed China to increase its flights to Britain from 40 to 100 a week.

Chinese regulators are allocating 28 of the 60 additional flights to second-tier airlines, including Hainan Airlines and Tianjin Airlines, which already own traffic rights for service into the UK. Other carriers who want to launch flights between the two countries will also be approved.

However, in the case of the U.S., Open Skies discussions have stalled for months, primarily because major Chinese gateways are already congested and there are insufficient slots to meet demand.

Analysts calculate that in 2019, Beijing and Washington could finally sign a new Open Skies agreement. The reason? The first phase of Beijing’s second airport, at Daxing, will open in 2019 followed soon afterwards by a new satellite terminal at Shanghai’s Pudong Airport.

The availability of more slots at China’s two busiest airports will help solve a longstanding belief in the industry that Chinese airlines receive preferential treatment in slot allocations in their home territory.

The CAPA consultancy said it was an “open secret” that slot allocation in China was protectionist, was not transparent and did not follow International Air Transport Association (IATA) slot guidelines. “There are well cited examples of U.S. airlines being unable to secure Chinese slots, most recently American Airlines trying for a new Los Angeles-Beijing route and United Airlines for a second daily San Francisco-Shanghai Pudong service,” it said.

“The problems are not new. American Airlines had a well-publicized incident when attempting to secure slots for its Chicago-Beijing service. It had to cancel the launch at the last minute and only received slots much later. At the same time as these incidents, Chinese airlines

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NEWS BACKGROUNDER
have secured new slots."

The situation is changing. American Airlines has spent $200 million for 2.76% of China Southern and Delta has paid $450 million for 3.55% of China Eastern. While no equity is involved, United Airlines this year signed a deal with Air China to improve connections and enhance frequent flyer benefits between the airlines.

This new eagerness on the part of Chinese carriers to seek closer ties with western airlines is not confined to U.S. carriers. Hainan Airlines has bought 13% of Virgin Australia for $114 million and China Eastern recently announced it would acquire 10% of the Air France-KLM Group for about $440 million. China Eastern, Delta and Air France-KLM are members of the SkyTeam alliance.

China Eastern believed these investments would speed up its global expansion. Having partner carriers in three continents would build closer commercial ties, through equity deals and market cooperation agreements, between the three airlines.

"The three of us are all renowned international airlines with a history of cooperation, which lays a solid foundation for this strategic investment," said the chairman of China Eastern, Liu Shaoyang.

"We will also start cooperation in resource-sharing and e-commerce. The goal is to enhance our internationalization in terms of competitiveness and brand," said the carrier's chief marketing officer, Dong Bo.

Air China, said analysts, does not feel close to United Airlines, which has the highest presence of its own metal in the Chinese market. "Air China questions whether United actually wants Open Skies. There is unlikely to be any government deal without the support of Air China, the flag carrier, and a major airline that enjoys a close relationship with the regulator," CAPA wrote in a recent analysis.

A decade ago, U.S.-China Open Skies was regarded as standalone market liberalization, irrespective of partnerships. But now U.S.-China Open Skies is intertwined with the prospect of establishing joint ventures with antitrust immunity, CAPA said.

Chinese airlines are increasingly forming joint ventures, informed by the recognition that the future China-U.S. market is huge and the strategies of 10 years ago no longer apply.

Historically, U.S. airlines have dominated routes between China and North America. In 2011, the Chinese airline seat share of the market, excluding Hawaii and Pacific Islands, reached a decade low when Mainland carriers accounted for only 37% of U.S.-China seats and 36% of U.S.-China flights. In 2015, Chinese airlines overtook their U.S. rivals. This year Mainland carriers account for 61% of seats and 57% of flights between China and the U.S.

In the meantime, the fare dumping by Chinese carriers in international markets is continuing to hurt their competitors. OAG airline data has reported the average one way fare on flights between China and four of the largest Western European countries - France, Germany, the Netherlands and the UK - was $538 in March this year, although there were wide variations in price between airlines.

But it’s not all up, up and away. Two months ago, United Airlines announced it would close its three times a week San Francisco-Hangzhou service in October because of weakness in the China market. "In every market we serve, we continuously review and measure demand and performance," said a United Airlines spokesman. "After careful analysis, we have determined this route is not meeting our expectations and is not economically sustainable."

A U.S.-China Open Skies deal would certainly turn around such decisions. With anti-trust immunity and a more extensive joint venture with Air China, United could return to Hangzhou at low cost and at low risk.

Whatever the outcome, there is no sign Chinese expansion will slow. International air routes into China jumped 35%, to 660, last year, the Civil Aviation Administration of China has reported.

With manufacturers forecasting Chinese airlines will need up to 6,810 new planes in the next two decades to meet Mainland passenger demand, there is no doubt a large proportion of those aircraft will be plying routes that cross China’s borders. ■
HOST CLOSER TO PREMIUM GUESTS

Norbert Kettner, Managing Director, Vienna Tourist Board

Having hosted over 14.9 million overnight stays in 2016, Vienna is not only considered to be an international magnet for tourism, art and culture, but also a global player in its capacity as a conference location. Almost 80% of Vienna’s conference visitors arrive by plane. It is for this reason that Vienna Airport is a key strategic partner for the Vienna Tourist Board, as both are hospitable, global, smart and premium.
ATTUNED TO THE MARKET

Launched from the ashes of a failing full service carrier four years ago, HK Express has ridden the upward curve in a market hungry for quality low-cost carriers. Slot availability has curbed expansion, but the carrier is circumventing the constraint and expanding, CEO Andrew Cowen, told chief correspondent, Tom Ballantyne, in Hong Kong.

Photos: Graham Uden
You would think that an airline boss trying to grow his business at an airport and in a region clogged by congestion and slot shortages would be pulling his hair out, but Andrew Cowen, the CEO of Hong Kong-headquartered budget carrier, HK Express, is far from fazed by the situation. He is bent on expanding the budget carrier regardless of the region’s operational limitations. And his intentions are not all talk, a situation made clear by the airline’s latest statistics. Close to 345,000 passengers flew on the carrier in July, which was a 38.8% increase over the same month in 2016. In the past 12 months, HK Express has grown by 22.6%, and carried nearly 3.4 million customers.

The results were achieved despite slot constraints at its home base and severe air traffic congestion along China’s coastal airways into Hong Kong. Hong Kong International Airport’s (HKIA) $18 billion third runway, approved last year, will not be fully operational until 2024, which meant that HK Express could not fly to 30 or 40 destinations in Mainland China that it would like to serve for quite a while yet.

Yet Cowen stressed: “Hong Kong airport is working with the Civil Aviation Department. They are very alert to the difficulties airlines have in securing slots. Naturally, they want to support growth at the airport. They are working very hard. There’s no question about that. There is a program of action underway to increase capacity at the airport’s existing two runways.

“That said, there is certainly a great desire on our side for that third runway to be built and for the full three-runway system to be operational.”

The operating circumstances in Hong Kong make HK Express’s ever improving results impressive. Ultimately majority owned by China’s HNA Group, the airline that was transformed from full service carrier, Hong Kong Express, to an LCC punches above its weight.

It started flying with three A320-200s and now operates an all Airbus fleet of 12 A320-200s, four A321-200s and
three A320neo. It has nine A320neo and eight A321-200s in its order book. It flies to 26 destinations in nine countries, including nine airports in Japan, making it the airline with the largest number of flights between the two countries.

Also in its network are South Korea, Taiwan, Thailand, Vietnam, Cambodia, the Philippines and the Western Pacific island of Saipan, Kunming and Ningbo and charter flights to Baotou and Lanzhou.

Cowen rejected any suggestions that HK Express’s growth in China has been curtailed by the fact its HNA-owned sister airline, full service Hong Kong Airlines, has a large network on the Mainland.

Destinations across China are available to the airline’s passengers through its partners in the world’s first budget Alliance, U-Fly Alliance, he said. U-Fly Alliance members are Lucky Air, Urumqi Air and West Air in China and South Korean budget carrier, Eastar Jet.

“I should highlight what the U-Fly Alliance is all about. We all understand that when it comes to air services between Hong Kong and China the key competition is the Mainland Chinese carriers coming the other way and bringing many Mainland China visitors to Hong Kong,” he said.

“This means you are competing with Mainland carriers for sales on the ground in China. That’s very hard to do when you have a limited number of frequencies and you are only flying to Hong Kong and so on.

“This was one of the rationales for establishing U-Fly. By partnering with Yunnan’s Lucky Air, Urumqi Air and Chongqing’s West Air as well as Eastar Jet - and hopefully more airlines in the future - effectively we are partnering with airlines that have very strong positions in their local markets.

“They have very high brand awareness and extensive networks. So the U-Fly Alliance is a relatively low risk way for us to access the quite complex and certainly very competitive China market.

“We can offer those destinations via interlining with our partners. Its early days, but we truly think: ‘let’s lay the foundations now and we’ll get the benefits in time’.”

As for overlapping with Hong Kong Airlines, he said: “Obviously, there is some overlap, but I prefer to say it is not so much overlap but more about offering a broader choice of brand and products in that particular market.

“For example, both carriers fly to Tokyo Narita. In our mind it’s a simple execution of a twin brand strategy, so generally our approach is: ‘let’s work to spread our footprint more broadly because there is half the world’s population within five hours flying time of Hong Kong’.”

Tying together the U-Fly Alliance arrangements has taken longer than anticipated, Cowen said, with delays mostly about the technical challenges. “In the case of Lucky, we are interlining across HK Express’ Navitaire reservation system and TravelSky,” he said.

“As you might expect, there was a lot of complexity. We had hoped to move faster, but we are solving technological

Infrastructure – both airports and air traffic control – remained HK Express’s biggest challenge “by some way”, but Cowen is not complaining. Full marks and three gold stars to the planners in this part of the world who are able to move forward faster than elsewhere. Unfortunately, it is still not as fast as travel is growing. It’s a constraint that makes forward planning difficult.”

Andrew Cowen
Director and CEO HK Express
issues we think will return a lot of dividends.

“You have to start somewhere. That is why, when we stand back, we can see we have gained access to a very complicated China market in a low-risk, pretty inexpensive way. We have partnered with some very strong LCCs. We are solving technological challenges and then, as growth continues, hopefully we will reap the dividends of that.” HK Express was preparing to go live on Lucky Air’s network at press time.

Another recent development Cowen is keenly anticipating is the value of the partnership between Virgin Australia, which is now flying to Hong Kong, to HNA Group carriers including Hainan Airlines, Hong Kong Airlines and HK Express.

“We have had a number of preliminary discussions with Virgin Australia,” said Cowen. “It is one of the critical steps in allowing us to complete all our interline arrangements, which are fairly well advanced. We think there is a great opportunity.”

He sees Australians and their families flying to Hong Kong with full service Virgin Australia and then taking advantage of his LCC to make side trips to China, Japan, Vietnam or other destinations.

He also sees travelers from the carrier’s secondary Japanese destinations, rather than backtracking to catch flights to Australia from Tokyo, travelling on HK Express to Hong Kong to connect with Virgin flights. “That’s where we think there is a really great opportunity,” he said.

In the meantime, there have been some challenges in building the HK Express fleet. It is flying three highly efficient, fuel-saving A320neos and had planned to have another two of the type in its fleet in 2017.

Cowen refused to take the aircraft because of well publicized reliability issues with their Pratt & Whitney engines. “We have been in negotiations with Pratt & Whitney about that and I am happy to say we are receiving very good support from them. They are making a very significant effort to address the engine’s issues,” he said.

The delivery delays have meant plans to remove two non-standard A320s, equipped with CFM engines, from the fleet, have changed. “In the early years of an LCC, it is quite normal to have a mix of aircraft that is not as standardized as you would like. We have been taking advantage of those neo and A321 deliveries to simplify our fleet.”

While the airline wanted to standardize its fleet, he said, it also had to make sure enough aircraft were kept on hand for market expansion. “This circles back to slots. It’s a bit of a juggling act between [scheduling] our aircraft deliveries and making exit plans for aircraft to enable that standardization. We have to be in a good position to grab slots when they come up.” However the fleet management plan is resolved Cowen said the carrier should have 24 to 26 aircraft by year-end.

Future aircraft orders remain an open question. Cowen said: “We are reasonably happy with the commitments we have. To go beyond them is premature. It is still a few years to the third runway and there is not enough clarity about slot availability [once the third runway opens],” he said.

“It does not make sense to order three aircraft or 13. If you’re going to do an order, do it properly: 30, 40 or 50. We are comfortable the demand is there, but until the infrastructure has caught up with that demand, it’s a bit risky [to acquire more aircraft].

“Then, you have to overlay the general competitive environment, the economic situation and the political situation when making the decision. Putting all this together, we are very happy with the commitments we have made and think ‘let’s be a little bit cautious’.”

Further ahead, HK Express may order wide body aircraft. “It’s an open question for us,” said Cowen. “In no way are we saying no to that, but only that it is a little early for us.

“The A321 has given us an extra 50 seats per slot pair, or around 27% more seats, which is nice growth without consuming slots. In the A321 (230 seats), we have an economy cabin that is not much smaller than most full service A330 operations. They have something like 240 to 260 or maybe 280 seats.

“To have a very cheap aircraft at more or less the same capacity, while being taught how to grow in aircraft size, hopefully puts us in a position in a few years to be confident we can comfortably fill wide bodies.”

Network-wise, the next major event for the carrier will be the planned launch of flights to Guam, via Japan’s Nagoya, in October. The LCC used to operate a direct Hong Kong-Guam service, but cancelled it last year because of soft demand and high costs.

“Coming off Hong Kong – Guam was not to come off forever. We decided to suspend the service because we are always under pressure to optimize the use of our slots. I don’t want to say we go in, out, shake it all about. We don’t operate like that. We are very serious about any market we enter. We want to stay there for the long term,” he said.
number of outbound travelers from Hong Kong, the airline is working hard to attract more inbound passengers. “The fact we fly so much to Japan means we are establishing a reasonable degree of awareness of HK Express in Japan,” he said.

“This allows us to grow our proportion of sales at that end of the route. It’s a means of spreading our net wider and not having all our eggs in one basket.”

The carrier has been building a series of associated businesses and offerings that have enhanced the overall product. They include reward-U, a frequent flyer program that offers an efficient “any seat redemption” process to members with no blackout dates.

Started a year ago, it has more than one million members. U-FLY Holidays, still small but growing, sells holiday packages. The carrier also has a free corporate membership club; a program to attract small business travelers. It offers increased flexibility, convenience and value for money for their HK Express tickets.

“Most of these things are orientated to the leisure traveler, the family traveler, the price-sensitive traveler. I want to highlight the fact that we have invested a lot in our small business product, U-Biz. People tend to think of Hong Kong as a place of big corporates, but some 95% of businesses are actually SMEs (small to medium enterprises),” he said.

“Small businesses are price sensitive. We are seeing great growth in passengers taking advantage of that offering. We remain very determinedly to be low fare, low cost and very technology enabled - but not too fancy about technology. We want passengers to be able to do business with us easily. Travelling on an LCC does not mean you are not going to get good service.”

A practised LCC hand

South Africa-born Cowen has a wealth of experience in aviation. He started his career at British Airways in 1989, eventually managing the airline’s financial affairs at its American business unit in New York before he was promoted to Head of Strategy for BA’s low-cost carrier, Go. He was a member of the group that negotiated a management buy-out of the LCC that the participants later sold at a profit to Easyjet.

A graduate of City University, London, Cowen is a qualified chartered management accountant whose experience includes management roles at low-cost carriers in Britain, the Middle East, Vietnam, the Philippines and Japan. Before he took on HK Express, he guided the establishment of Japanese LCC, Peach Aviation, an Osaka-based joint venture initially owned by Japanese and Hong Kong interests, to launch.

From 2005 and 2009, he was CEO of Saudi Arabia’s Sama Airlines where he was the leader of the start-up team that put the carrier into operation. In 2009, he moved to Kuwait’s Jazeera Airlines as acting CEO before turning his attention to the Asia-Pacific.
Going nowhere on the capacity treadmill

Srilankan Airlines CEO, Suren Ratwatte, has taken on the job of rebuilding SriLankan Airlines, but his efforts could be in vain as Gulf carriers saturate his home market with capacity and cheap fares he can never match.

By Tom Ballantyne

Srilankan Airlines CEO, Captain Suren Ratwatte says there is only one word to describe the Gulf carriers’ collective capacity attack on his home market - “ridiculous”.

Since Sri Lanka’s 25-year civil war ended in 2009, Ratwatte told Orient Aviation at a Sydney CAPA conference, the number of seats into the country’s international airport had jumped by 86% as the economy recovered from the domestic conflict and tourists to the island country increased.

“That is good,” he said. “It means more people flying in. But who added that capacity? It’s pretty obvious. It’s the Gulf carriers. If you take the increase in seats by the Gulf carriers alone it’s 155%. This is twice the additional capacity of all other carriers flying into the country, including Sri Lanka’s national carrier.


“They have six times as much capacity as we do in the same market. You can see where this is going. Where do all these passengers go? Only 32% of passengers on flights to the UAE actually disembark in the UAE. The remaining 68% go everywhere else. Given the fare structure of airlines today you know he who has the deeper pockets is going to win.

“Here is an interesting statistic. Approximately 44% of passengers on Sydney -Singapore flights are going to Singapore, whereas only 4% of passengers on Sydney-Doha flights are going to Doha. The remaining 96% are going elsewhere.”

Essentially, Middle Eastern airlines and some other carriers are draining the traffic from the notionally representative carriers onto their airlines, said Ratwatte. “The whole idea of a bilateral agreement is a joke. It does not apply anymore. These guys come in with deep pockets – and great service I must add – and they dilute yields to the point where the business

If I had no financial constraints I would be happy to take five narrow bodies annually for the next couple of years because the Indian market is huge and I need to cash in on it before anybody else does

Captain Suren Ratwatte
Srilankan Airlines CEO
becomes non-viable," he said. “The Europe to Sri Lanka average fare more than halved between 2013 and 2016, which is not a sustainable yield. You cannot continue to operate as a normal airline unless someone else is making up the difference.”

What happens in the end? “In 2012, we went to a whole bunch of countries: Heathrow, two destinations in Italy, Paris, Frankfurt, Zurich and Moscow. The numbers were reasonably healthy. Today, my European route network is one destination - London. I could not operate [anywhere else] without bleeding to death,” he said.

Ratwatte is a pilot of 30 years with more than 18,000 flight hours on aircraft including the B777 and the A380. He took charge at SriLankan in late 2015 and has the mammoth task of turning around the flag carrier.

The news is not all bad he told Orient Aviation. He foresaw profits for SriLankan in the fiscal year to March 2018 despite the carrier’s net loss of $15.1 million in the 12 months to March this year.

“We have beaten our revenue forecast for each month of the current financial year. Our big problem is our cost base. If we can reduce that we will be profitable by the end of the financial year,” he said.

An added challenge for the SriLankan CEO is the government’s intention to privatize the carrier. Emirates, which sold a 43.6% holding in the airline in 2008, has denied it is an interested buyer second time around.

“Emirates have other challenges at the moment,” said Ratwatte. “There are other carriers interested, but probably an outside investment group is a more likely buyer. To be honest, I don’t have a lot of say, but I try to guide the government in the right direction on the issue.

“I would like to see us as a 100% private airline. I do not think governments should run airlines in this day and age. It does not make any sense at all. But it is a big mental shift on the part of the government to disinvest completely so let’s see how it goes. But certainly, we need the capital and it doesn’t make sense for a country like Sri Lanka to invest state capital in an airline.”

Ratwatte is waiting for the Sri Lankan government to approve his restructuring plan. The primary barrier to the carrier’s growth is available capital and he believed the government had to “act quickly” to advance restructuring process.

“We have had the inability to cash in on our captive market in South Asia. If we don’t act quickly, we will be left behind as ever increasing capacity from the Gulf and India is added to the market. We will lose market share,” he said.

Ratwatte’s strategy has “a little bit of downsizing” of staff and includes a network rationalization and a debt resolution plan. “Debt is our biggest problem. It’s all government debt so the government has undertaken to sort it out. There will be tinkering around the edges and I will have a much better bottom line,” he said.

The airline flies to 40 international destinations, but the network substantially favours the subcontinent. “We are the dominant carrier into India. We have more destinations in India than any other foreign airline. We intend to build on that.”

It operates an all Airbus fleet of eight A320s, four A321s and 13 A330s, including two recently delivered A320neo and one A321neo. Three more A321neos are due to arrive by March next year.

“If we a draw a 1,000 mile circle around Colombo, key destinations include Hyderabad and the Maldives. They are in our natural market with 300 million people. The South Asian market still offers plenty of room for growth;” he said.

The carrier recently announced it would start Sri Lanka-Melbourne in October. China is an obvious growth market. SriLankan flies daily to Guangzhou and five times a week each to Shanghai and Beijing. “I’d like to go daily [to Shanghai and Beijing], but there are no slots,” he said.

“We also fly to Kunming. We are struggling a little with it so we are looking at that one very closely. It’s almost all leisure traffic and therefore very seasonal.”

Ratwatte holds both Bachelor and post graduate degrees from Embry Riddle Aeronautical University and is a Fellow of the Royal Aeronautical Society. He is well known in the field of aviation human factors and has published several research papers on the subject. Before he took on SriLankan he was Human Factors Manager at Emirates.

But his past employment at the Gulf carrier does not stop him bemoaning the “vicious cycle” his former employee and other Gulf carriers have sparked in his market.

“It never ends and airlines like mine, with limited access to capital and limited financial support from government, are going to find that it is almost impossible to compete,” he said.

“Historically we have been a capacity-driven business model. If others add capacity and you don’t, you are left behind so you add capacity. Then your seat factors drop and you add more capacity. You are running around just to fill these flights. Irrespective of how good your service is, it does not matter. It’s a purely price driven market. As you keep adding capacity you keep driving down the price. I don’t know where it ends.”

“...I would like to see us as a 100% private airline. I do not think governments should run airlines in this day and age. It does not make any sense at all. But it is a big mental shift on the part of the government to disinvest completely so let’s see how it goes. But certainly, we need the capital and it doesn’t make sense for a country like Sri Lanka to invest state capital in an airline...”
MAB boss forecasts a golden decade for airlines

By Tom Ballantyne

Malaysia Airlines group managing director, Peter Bellew, may only be midway through his transformation of the carrier, but he has absolutely no doubt about the profits ahead for Asia-Pacific airlines.

“Golden Decade” is ahead for airlines, the group managing director of Malaysia Airlines, Peter Bellew, predicted at Sydney conference last month and added the cost of fuel will be even lower than it is today.

“The massive investment in renewable energy by banking giants such as Goldman Sachs and Morgan Stanley, other investment banks and sovereign governments will result in a sea change in the price of oil,” he said.

“Around late 2019 or in 2020 we will reach an inflection point with the usage of oil. Renewables will be coming on stream in big, big, big numbers and that will lead us in the next decade to oil stabilizing at around $30 to $35 a barrel.”

The low fuel price would have an impact on the construction costs of aircraft. Lower fuel costs and lower fuel by-product costs would make it cheaper to manufacture composites and therefore cheaper to produce aircraft, he said.

Bellew, a self-confessed technology geek who spoke at CAPA’s Sydney conference last month said the first mobile enabled phone, the Nokia 7110, was revealed to the world in 2000.

“By 2010 European carrier, Vueling, was the first airline to have full mobile check-in. These things happen so fast. As an industry, we need to keep up with technological change. If we don’t, we are going to have our bread and butter stolen by the technology companies,” he said.

“The market is going to play into our hands. Even if we do nothing there are a billion people in the world today with passports. In a short number of years there will be 1.7 billion people with passports.

“That’s 700 million more people who want to travel compared with today. It is breathtaking to me to see the growth in the number of people from China that travel and to see where they travel, how often they travel and what they do when they get there.”

He believed airlines outside China have been very poor about developing websites and skilled staff to address this market. “The small number of airlines getting their acts together about China’s potential will make a lot of money. My personal experience has been that the Chinese are very open to carriers from around the world operating in their market as long as you show them some proper respect,” he said.

“At a time when everybody else is starting to skim people for these things – luggage, food, entertainment and credit card use - we’re not going to do that. We want to regain our position in the next couple of years as a quality five-star carrier dealing with business people.”

Peter Bellew
Malaysia Airlines Berhad group managing director
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APEX tickets. They don’t have the legacy thinking we have. “They want to buy a seat on their mobile phone in a minute and not be caught up in the complexity we generally have in the transaction.”

Bellew also believed the artificial intelligence that is being applied to the development of autonomous cars would progress to aircraft in the next decade. “I don’t think we will see one pilot aircraft, but I do think the manning of aircraft with four pilots on some long-haul aircraft will go down to three or two,” he said.

“Over flight costs will be reduced because of rapid advances in performance based navigation. There will be much shorter routes into and out of airports and on final approach. There will be more airspace because there will be more efficient use of airspace.

“In maintenance, we are starting to see the earliest, earliest benefits of technology. The two principal manufacturers are much, much better at using the data streams coming off aircraft to carry out predictive analysis of maintenance requirements. Modern aircraft, generally, are more reliable. All these factors will lead to a golden decade of opportunity for airlines to start making some money.”

He said that some of the airlines he has visited in recent months have their customer service run by Chat Box. “It’s very, very effective. Chat Box can process a customer’s query seven times faster than a human and there’s a lot less attitude,” he said. Chatbox is a digital messaging platform that enables collaboration between businesses and their customers.

“I’ve been a geek and a hacker since I was very young and I am already seeing, because I’m plugged into so many new technologies, airlines sending me predictive messages and booking engines telling me you are going here on this date, this is the flight you should be taking. That’s going to happen. Voice services are going to become very common.”

“I’ve no doubt there are many people who have a negative perception of us because of what happened. But the brand, I believe, has recovered very well in pretty much all marketplaces. You don’t get load factors of over 80% if there’s something wrong with your brand,” he said. “In the month of last December, we hit a network wide load factor of 90%. That was the highest load factor of any full service carrier in the world last December so there is nothing wrong with the brand. The brand is strong.”

Bellew is committed to preserving the airline’s status as a full service carrier and has reversed decisions by his predecessors to increase business through the internet and away from travel agents. He also has axed plans to unbundle fares and said the airline would not be charging extra for bags, food, entertainment or credit card use.

Last month, he revealed he is working with Northern Ireland’s Thompson Aero Seating on a customized flat-bed configuration, with direct aisle access from every seat, for the premium cabins of his incoming fleet of 10 B737 MAX 10s. ■
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Airbus names China innovation centre boss

Airbus has appointed Luo Gang as CEO of its planned innovation centre in China, but said it would not announce the location of its research and development facility until later in the year.

A Tianjin University electrical engineering graduate with an MBA from London Business School, Gang spent three years developing Uber China until it was sold to Chinese entrepreneur, Didi Chuxing last year. He also worked for UK retail forecasting firm, Rangespan, which was bought by Google.

Gang, who will report to Airbus CTO Paul Eremenko, will establish the China innovation centre by year end. “China is a powerhouse of innovation now and has a strong and complete ecosystem, including hardware, software and artificial intelligence. Extending this knowledge to aerospace will advance manufacturing” he said.

The goal of the new centre is to define the future of flight by identifying the next big transformation in aerospace, said Airbus in a statement that announced Gang’s appointment. ■

Boeing and GAMECO sign agreements with Hong Kong research centre

The Aviation Services Research Centre (ASRC) at Hong Kong Polytechnic University has signed a Letter of Intent with Guangzhou Aircraft Maintenance Engineering Company Ltd (GAMECO) to join the ASRC. The Hong Kong university also agreed to continue a joint program of collaboration with Boeing. The ASRC enters a new phase in its development this month with the opening of a research centre that will address, among its projects, automated damage inspection and assessment, aircraft surface preparation and inspection and new smart operating solutions for the aircraft MRO industry. ■

Honeywell joins with ARI to advance aircraft solutions

Honeywell Aerospace’s wholly owned subsidiary, China Aircraft Disassembly Centre (Hong Kong) Ltd and Aircraft Recycling International (ARI) have signed a Memorandum of Understanding to investigate co-expansion of aircraft maintenance and dismantling at ARI’s China Aircraft Disassembly Centre (CADC) in Harbin, northern China. ARI deputy chief executive officer and chief operating officer, Christina Ng, said: “ARI has accumulated a wealth of experience in used aircraft solutions, including aircraft dismantling technology, aircraft asset management and business operations. ARI’s aircraft recycling platforms, UAM in the U.S. and CADC in Harbin, can service global demand for mid-to-late life aircraft asset management.”

Honeywell Aerospace Asia Pacific president, Steven Lien, said: “There are big opportunities in the region’s MRO market, which is expected to grow at six per cent a year. In the Asia-Pacific, Honeywell has seven aftermarket service sites. By partnering with ARI, Honeywell is improving our operating and repair capabilities to provide local customers with better support.

There is surging demand for fleet MRO in China and the trend is expected to continue, said ARI. Combined with UAM, a leading U.S. global aviation service provider that ARI acquired in March, CADC in Harbin will soon commence operations as a global platform for mid-to-old life aircraft solutions.

Honeywell is a Fortune 100 company that provides products and services for commercial, defence and space aircraft. ■

Spairliners joint venture appoints new sales boss

Spairliners, which provides aircraft component care packages for the A380 and Embraer E-Jet family, recently named Cornelius Dalm to succeed Fabrice Dumas as head of sales and marketing at the AFI KLM E&M/Lufthansa Technik joint venture. Headquartered in Hamburg, the company’s customers include Qantas Airways and Malaysia Airlines Berhad. Dalm spent five years at Lufthansa Technik where he was most recently head of contract management in the corporate sales division. ■

Boeing to establish in-house avionics division

Boeing will build and operate its own Boeing Avionics Unit that will expand the company’s portfolio into the equipping of commercial and military jets. The decision will provide greater competition for two giants of aerospace electronic systems, Rockwell Collins and Honeywell International Inc.

Boeing said last month the new business, which will employ 600 staff by 2019, has been established in consultation with suppliers. It will be headed by a senior Boeing defence leader, Allan Brown, who will report to Boeing CTO, Greg Hyslop. ■

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TRAINING

**Singapore Airlines and CAE set up Singapore training joint venture**

Singapore Airlines (SIA) and flight training specialist, CAE, signed a Memorandum of Understanding (MoU) in August to establish a joint venture pilot training facility in Singapore. The partners initially will focus on simulator training for Boeing airplanes, supporting SIA Group airlines and third party training for other airlines in the region.

SIA will shift four of its full flight Boeing simulators to the new centre, which will be housed in the Singapore Airlines Training Centre adjacent to Changi Airport. The courses will include a full range of initial type rating and recurrent training programs for Boeing’s 737 MAX, 747, 777 and 787 aircraft.

SIA already operates a training joint venture with Airbus in Singapore, the Airbus Asia Training Centre. ■

**FlightSafety International announces introductory course for aspiring pilots**

International aviation training company and supplier of full flight simulators, New York headquartered FlightSafety International, last month announced its new Integrated Growth and Achievement Preparation Program that is open to all students, both domestically and internationally, who entering the company’s academy in Florida.

Manager of the FlightSafety Academy, Nancy Ritter, said the program is designed to be undertaken by students before they start their formal pilot training. “This unique new initiative will help prepare those entering the academy for the rigours of training and the disciplines required for a career as a professional pilot,” she said.

Among the program’s modules are: ground school pre-study, STEM review, managing training deadlines, interacting with instructors, cockpit technology and health and wellness. “Our goal is to provide the knowledge and skills needed to become excellent first officers and captains. This pre-study program clearly demonstrates our commitment to provide training of the highest quality and reinforces our position as a world leader in ab initio training,” Ritter said.

The Florida academy at Vero Beach has a fleet of close to 90 training aircraft and a staff of 70 flight instructors based on a 30-acre campus that can accommodate 300 residents.

It provides 1.4 million hours of training each year and operates 90 training aircraft and a staff of 70 flight instructors based on a 30-acre campus that can accommodate 300 residents. Among the program’s modules are: ground school pre-study, STEM review, managing training deadlines, interacting with instructors, cockpit technology and health and wellness.

“If our goal is to provide the knowledge and skills needed to become excellent first officers and captains, this pre-study program clearly demonstrates our commitment to provide training of the highest quality and reinforces our position as a world leader in ab initio training,” Ritter said.

FlightSafety International announced its new Integrated Growth and Achievement (IGA) Program for aspiring pilots. The program is designed to provide students with a solid foundation in the disciplines required for a career as a professional pilot. The academy in Florida is open to all students, both domestically and internationally.

SIA already operates a training joint venture with Airbus in Singapore, the Airbus Asia Training Centre. ■

**BRIEFLY…**

AAR, a global aftermarket solutions company that employs 5,000 people worldwide, has opened a supply chain hub in Shanghai. The new warehouse will stock new airframe and engine components from OEMs including Eaton, Unison, UTAS, Meggit and Lord, “which will fulfill the needs of just about every type of aircraft operating in China today”, said AAR senior vice president OEM aftermarket solutions, Eric Young. AAR recently opened a similar warehouse facility in Dubai.

Air Lease Corporation (ALC) has finalized an order for more than 250 CFM Leap-1B engines, to power its new five B737 MAX 7s and seven –MAX 8s. Deliveries are scheduled to begin from 2022. ALC specializes in buying new commercial aircraft to lease to airline customers. The LEAP engine family has 18 airline customers operating 85 airliners worldwide.

Boeing Shanghai Aviation Services Co. Ltd recently signed its first contract with China’s SF Airlines Co. Ltd for maintenance, including C Checks, of the air freight and parcel express group of classic B737 and B767-300 freighters. Launched in 2009, SF Airlines operates a 39 aircraft fleet of B767s, B757s and B737s. Boeing Shanghai is a joint venture between Boeing, Shanghai Airport Authorities and China Eastern Airlines.

China’s COMAC selected Mobil Jet Oil to support the maiden flight of its C919 mid size jet. Powered by CFM Leap 1-C engines, the C919 used Mobil Jet Oil II synthetic gas lubricant for the 79 minute test flight out of Shanghai Pudong airport earlier this year. Exxon jet oil is used in more than 50 per cent of all aircraft in operation.

Aviation consultancy, IBA, has set up a new freighter advisory division within the parent group that will be led by head of freighter advisory, Moshe Haimovich. IBA CEO, Phil Seymour, said freight business had surged this year with airlines based in the Asia-Pacific and Europe accounting for two-thirds of the annual increase in freight volumes in 2017. The remainder was equally divided between North American and Gulf carriers.

Munich Airport’s operating company, FMG, has established a 100%-owned subsidiary, Munich Airport International GmbH, for the handling of the consulting, airport management and training divisions of the parent company. Past customers of FMG have included Bangkok and New Delhi airports. FMG consultancies in progress include a partnership with Singapore’s Changi Airport and projects at airports in Muscat, Riyadh and Taif in the Middle East.

Sabre Corporation has announced a global distribution partnership with Himalaya Airlines, a Nepalese carrier that intends to add 15 aircraft to its fleet. The company distribution will put the Kathamandu headquartered carrier before 425,00 travel agents globally via Sabre’s global distribution system.
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LOW-COST CARRIER REPORT: THE WINNERS AND THE LOSERS IN THE ASIA-PACIFIC

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