



## I Letter from the Director Air France-KLM

**François Robardet** Representative of employees  
and former employee shareholders PS and PNC

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### *The Press Review on Monday...*

#### > When you run an airline, you have to be agile

(source Le Figaro) August 1 - Appointed CEO of Air France-KLM in late summer 2018, after a long social crisis, **Air Canada's former number two gave Le Figaro his first interview**. He defended his first decisions, starting with his choice to renew the fleet of medium-haul aircraft, and detailed his ambitions for Air France- KLM and Transavia.

*The FIGARO. - You have been at the head of Air France-KLM for ten months, with the ambition, like your predecessors, to make it a world leader. How are you doing?*

Ben SMITH. - I agreed to come because **I believe in the potential of both companies, which are internationally recognized**. Air France and KLM are not making the most of their capacities. (...) My priority has been to set up a team that responds in a sustainable way to employees' frustrations and concerns. (...) I have chosen to restore four pillars: trust, respect, transparency and confidentiality (...) **All categories of staff have signed agreements (...). This gives us great stability to develop our business**. In a more transparent environment, better and faster decisions can be made. And when you run an airline, you have to be agile.

*How do you plan to reduce the margin gap between Air France and KLM?*

**Air France's margin in 2018 was only 2%, compared to 9% for KLM, 10% for Lufthansa, 12% for British Airways and 18% for Ryanair.** 2% margin at Air France is not satisfactory. **Five points can be explained by the costs in France. But two points are due to the complexity and inefficiency of the company.** It is up to us to tackle it. For the other five, we should be able to do as in Singapore or Schiphol, where governments support the competitiveness of their airlines. In France, there is no reason why we can't do it.

*You have just announced the purchase of aircraft to renew Air France's medium-haul aircraft. Why the choice of the A220?*

Making a decision to change the ageing fleet is impossible in a situation of social crisis such as the one we experienced a few months ago. Fleet renewal had been postponed several times. And after two or three years, no decision had been made. **The A220-300 was chosen in three months. It favours the new generation of single-aisle vehicles whose design has been developed in recent years.** It is more fuel efficient and therefore emits much less CO<sub>2</sub>. Its noise impact is lower than any other device in this category. It is flexible. It can be used on the domestic, European network. (...)

*What orders will you consider to support Transavia's growth, which has opted for the 737?*

(...) We will not buy a 737 Max for the moment. We will be able to buy used 737 NG. There are thousands of them in the world. KLM already has 50 of them.

*What is your ambition to develop Transavia?*

We will be able to develop Transavia from Orly, but also for example Marseille, Nice, Toulouse, Lyon, Nantes, Bordeaux where low-costs are present. (...)

*The domestic market continues to lose a lot of money. Will you go further to restructure it?*

There is a domestic market in France, and Paris is the leading tourist destination in the European market. Many customers who are not

based in Paris expect us to be their first choice. And thanks to our domestic network, our partners like Delta have access to 50 connections in France. The **restructuring of the domestic network is in progress**. It is not easy. We are losing a lot of money. The TGV is becoming increasingly popular with travellers. This is a unique situation. **Our competitors**, British Airways and Lufthansa, **have completely exited the domestic market. They have been replaced by low-costs. In France, it's different. But we still need to evolve to maintain our presence.** We will not be able to continue to lose money like we are losing today.

*Air transport, particularly for domestic routes, is under fire from environmentalists. How can you answer them?*

**We take our environmental responsibility very seriously.** And our customers are as sensitive to it as our employees. We all want the environmental impact to be reduced. But we are being attacked disproportionately. Yesterday's decision to renew our fleet represents a significant improvement in our environmental impact. **That is the message we are sending to the government. Taxing us means preventing us from investing more in a more environmentally friendly fleet. I am not sure that this measure is a step in the right direction. (...)**

*Why do you no longer believe in the A380?*

It was an interesting design with many innovations. Customers appreciate this silent unit. But we don't have a satisfactory product, especially in business class. The cost of renovating the cabins is one of the reasons for our decision to stop flying them from 2022 onwards. Investing 31 million euros to renovate and 55 million euros for the maintenance of each of the seven devices is not reasonable. **With its four engines, the A380 consumes a lot of fuel, and maintaining such a small fleet is not efficient. In addition, this aircraft provides access to only a limited number of airports and routes. (...)**

**> Air France-KLM improves its results and turns the page on the A380**

(source Les Échos) July 31 - Good news can hide bad news at Air France-KLM. And vice versa. While the **group announced on Wednesday morning rather positive results in the second quarter**, marked by an increase in unit revenue and a decrease in unit costs, **Air France-KLM will have to deal with an asset depreciation of around**

**400 million euros, linked to the exit from the fleet of all its A380s.**

This expense will be spread over different fiscal years from 2019 to 2022, said Benjamin Smith, Executive Director.

Of the ten A380s in service with Air France, five are owned by the company and are therefore recorded in assets (...). They will have been used for only about ten years, half as long as normal. Air France will therefore have to write off these amounts before disposing of them, which will have an **impact on its net income, even if it is only an accounting loss with no cash outflow**, while providing the necessary resources to purchase replacement aircraft. On the other hand, the gradual phase-out of the A380s will enable it to save the approximately €35 million per aircraft that it would have had to pay to renovate the A380 cabins, as well as the maintenance costs for the aircraft's 12 years, estimated at €85 million per aircraft.

**However, this depreciation should not obscure a real improvement in the accounts in the second quarter**, despite an unfavourable European economic situation, with positive prospects for the third quarter. **Unlike Lufthansa and Ryanair, Air France-KLM managed to stop the decline in its unit revenue in the second quarter.** And booking and revenue levels are on a positive trend in the third quarter. The group's quarterly revenue rose 6.4% to more than €7 billion and operating income rose 15.6% to €400 million (+15.6%). However, this last indicator is distorted by the comparison with the second quarter of 2018, which had been strongly impacted by the strikes in series. Compared to the second quarter of 2017, operating income decreased by €95 million.

**The only downside is that the net result for the first half of the year remains clearly in the red, with a loss of €239 million, compared with €158 million for the same period in 2018**, as profits in the second quarter (€81 million) did not offset the poor results in the first. And it is still Air France's operating losses (113 million over the first half) that are driving results, while KLM's profits (202 million) were almost halved over the first half. Nevertheless, the usual strong third quarter earnings should correct the trend.

**However, the gap between Air France and KLM is narrowing. (...)**

**In addition**, Air France seems to have resolved its social problems, with the signing of wage agreements with all categories of staff, in addition to an agreement with Air France pilots on the development of Transavia, announced on Wednesday. **Air France pilots who are members of the AF SNPL have said 78% "yes" to the draft agreement, which removes the limit of 40 aircraft for Transavia France** and also offers more possibilities for Air France's medium-haul fleet. On the KLM side, however, the situation is far from being

resolved, with difficult wage negotiations under way and mistrust of headquarters that has not subsided.

**My comment:** *In the first half of 2019, the Air France-KLM Group recorded mixed results. The Group's operating income decreased by €131 million compared to the first half of 2018.*

*Air France improved its operating income by €51 million, but it should be recalled that Air France strikes cost nearly €330 million.*

*For its part, KLM's operating income fell by more than 180 million euros.*

*There are two main reasons for these results. On the one hand, the cost of fuel is higher than last year. On the other hand, unit revenue fell slightly (-0.4%) due to overcapacity in the medium-haul European market.*

### > **Air France announces the order of 60 Airbus A220-300 aircraft, but for what purpose?**

(source TourMaG) July 31 - (...) "The acquisition of these new A220-300s is perfectly in line with Air France-KLM's overall strategy to modernize and harmonize its fleet," said Benjamin Smith, CEO of the Air France-KLM group.

Less polluting than previous generations (-20%), the **A220-300 is a single-aisle vehicle with a capacity of 100 to 150 seats**. By consuming less fuel, the aircraft will save money and, above all, improve flight efficiency.

And Air France's CEO continued: "**This aircraft guarantees optimal operational and economic efficiency and will allow us to continue to improve our environmental footprint.**"

It is also perfectly adapted to our domestic and European network and will enable Air France to operate more efficiently on its short- and medium-haul network. "» (... )

The A220-300 is simply Bombardier's C-Series. (...) For Airbus, these small aircraft represent a huge market since they will be 7,000 aircraft in the sky in the next 20 years.

**My comment:** *To replace the fifty-one Air France A318s and A319s, several aircraft models could have been suitable: the Boeing 737, already in Transavia's fleet, the A320 Neo and the A220-300 (formerly*

*Bombardier C-Series, recently acquired by Airbus, which considered it better than a possible A318 Neo).*

*The A220-300, with a capacity of 149 seats, was chosen. It has the advantage of being of recent design, (it consumes 20% less than older generation aircraft). Nearly six hundred A220s are on order and eighty are in service, including at our partner Delta Airlines, which has been operating it without problems for almost a year.*

*Air France has ordered sixty firms. The thirty options and thirty purchase rights, intended to replace the A30 and A321, will be exercised in accordance with market developments.*

*The A220 is powered by Pratt & Whitney. AFI KLM E&M maintenance will therefore be able to extend its MRO expertise to Pratt & Whitney engines.*

### **> Air France: Joint venture with Virgin Atlantic**

(source Air Journal) August 5 - The **United States has given its provisional approval to extend the transatlantic joint venture between Air France-KLM and Delta Airlines to Virgin Atlantic.** (...)

This joint venture extended to Virgin Atlantic will replace the existing ones between Europe and the USA on the one hand and between the United Kingdom and the USA on the other hand (...). Protected from antitrust laws, the four airlines will have to report to the DoT annually on their commercial cooperation, and in five years time provide a detailed report on the effects of this expanded joint venture. (...)

**The Transatlantic Marketplace Partnership, estimated at \$13 billion between Europe, the United Kingdom and North America, will offer more than 300 transatlantic flights per day (...).** It should be recalled that at the end of the transaction, which should be completed by the end of the year, Air France-KLM will acquire a 31% stake in Virgin Atlantic for £220 million, currently held by Virgin Group; Virgin Group will retain a 20% stake and the presidency of the British airline, while Delta Air Lines will retain its 49% stake (it also owns 9% of Air France-KLM). (...)

**My comment:** *On the North Atlantic, two joint ventures coexist within the Skyteam alliance: one between Delta Airlines and Air France-KLM (with Alitalia), the other between Delta Airlines and Virgin Atlantic.*

*The US authorities have just agreed to their merger, a few months after the European authorities have done the same.*

### > Financial results: IAG far ahead of Lufthansa and Air France-KLM

(source La Tribune) August 2 - **IAG**, the parent company of British Airways, Iberia, Air Lingus, Vueling and Level, reported **an operating profit of €960 million in the second quarter** (+6.6% compared to last year) (...).

After a difficult first quarter, marked by a 60% drop in its operating profit, (...) driven by transatlantic traffic, (...) IAG is doing much better than its rivals Lufthansa and Air France-KLM. This week, the German group reported an operating profit of €754 million (-25%) while the French group reported an operating profit of €400 million, up 15.6% compared to the same period last year, which had impacted the cost of strikes at Air France by €260 million. **The gap is even more striking in the first half of the year. 1.095 billion euros for IAG compared to 418 million for Lufthansa and 97 million for Air France-KLM.** (...)

Like Air France-KLM, IAG recorded a 1.1% increase in unit revenue in the second quarter (at constant exchange rates). It fell by 1.4% in the first quarter. In particular, it improved significantly on roads to North America (+2.9% after a decline of 2.3% in the first quarter) and significantly reduced its decline in Europe (-1.1% after -5.7%). Unit costs, including fuel, increased by 6.3%, which is also an improvement. The group maintained its forecast of a profit in 2019 equivalent to that of last year (€3.2 billion) and expects an improvement in its unit revenues and non-fuel costs. (...)

**My comment:** *The European majors' half-yearly results have one thing in common: a sharp deterioration in their cargo business.*

*While IAG's results appear to be better than those of Air France-KLM, it is worth recalling that the load differential to which Air France is subject represents more than 800 million euros per year. Otherwise, the Franco-Dutch Group's results would be between those of IAG and those of the Lufthansa Group.*

### > How Lufthansa's fine strategy turned sour

(source Les Échos) July 30 - Two years after the acquisition of Air Berlin, the German Lufthansa continues to pay a high price for its

strategic bet to take over its domestic market from the low-cost countries. **After two earnings warnings** since the beginning of the year, **Europe's leading airline group announced on Tuesday a 70% drop in net profit in the second quarter** to €226 million, with revenues of €9.6 billion, up 4%. And despite the restructuring measures, **its low-cost subsidiary Eurowings continues to lose money and market share**. A rather incongruous situation when it was supposed to boost the group's growth. It should remain in the red until at least 2021. (...)

According to analysts, this should translate into an annual profit that is down by about 25%. (...)

**In 2017, however, everything seemed to be in place to make Lufthansa the undisputed leader in the European sky (...)**. After a long conflict, the group's management had finally reached a lasting agreement with its pilots, paving the way for the development of low-cost activities. In addition, the bankruptcy of Air Berlin offered a unique opportunity to regain control of the medium-haul market, while at the same time strengthening Eurowings' fleet at a good price. (...)  
**But that was without counting on (...)** the **merciless offensive of easyJet and Ryanair in Germany and Austria**, both of whom were determined to fill the empty space left by Air Berlin. (...)

The **group had to cut into Eurowings' offer in order to reduce its losses**, postponing by two years the planned date of its return to balance. As a conqueror, Lufthansa found itself on the defensive and the outcome of the battle remains very uncertain. But the European sky giant is not the only one to suffer, Ryanair and easyJet are also suffering.

### > **Air China flies to Nice, lands on the A350 in Paris**

(source Air Journal) August 2 - This Friday, **Air China is opening a new direct route between Beijing and Nice**, where routes from Shanghai and Guangzhou are announced for next year. At Paris-CDG, it has been deploying an Airbus A350 since Thursday. From August 2, 2019, the Chinese national airline will offer three flights per week between its Beijing base and Nice-Côte d'Azur airport, operated by Airbus A330-200 aircraft that can accommodate 30 passengers in Business class and 207 in Economy. (...) Air China is without competition on this route, the **first between China and a city other than Paris**. (...)

**Air China has also modified its route between Beijing and Paris-CDG**: since yesterday, it has been using (...) an A350-900 that can



accommodate 32 passengers in Business Class, 24 in Premium and 256 in Economy, for a total of 312 seats. (...) **It competes on this route with Air France alone, as Aigle Azur suspended its route from Orly at the end of the winter programme.** (...)

China and France have a bilateral air agreement with flight frequencies that will double by 2020, from 50 to 126 per week per flag; from Paris, Air France offers four CDG routes to China (having suspended Guangzhou at the end of March), and XL Airways France one (to Jinan).

### > **European Commission: aid granted to Ryanair under contracts at Montpellier airport is illegal**

(source Air Journal) 4 August - On Friday 2 August, the **European Commission ordered the** Irish low-cost airline **Ryanair to return €8.5 million in aid to France under** promotion contracts for Montpellier Airport (MPL). For good reason, **this aid is illegal, the European Commission said.** "Our investigation shows that certain payments made by French local authorities to Ryanair to promote Montpellier airport have given Ryanair an unfair and selective advantage over its competitors and harmed other regions and regional airports," explained Margrethe Vestager, European Commissioner for Competition. (...)

***My comment:*** In my letter No. 713, I indicated that 16 French airports served by Ryanair were supported through subsidies.

*In the case of Montpellier, the Commission concluded that "the marketing contracts conferred on Ryanair an unfair and selective advantage over its competitors, that they amounted to unlawful and incompatible aid under the European Union's State aid rules".*

*This is the fourth time in France that Ryanair has been ordered to repay illegal aid. Previously, Pau, Nîmes and Angoulême had been the subject of the same decision.*

### > **Boeing would work on a new flight control system for its 737 MAX**

(source Seattle Times) August 4 - (...) According to some sources close to the file that requested anonymity, **the American aircraft manufacturer is in the process of modifying the software of its 737 MAX's automated flight control system so that it uses a second**

**flight control computer to make it more reliable.** (...) The support of data provided simultaneously by these two flight control computers, instead of just one, will add the redundancy-related security layer that has been sorely lacking in this flight system until now. (...)

Only one computer was used in the past, because Boeing considered its system to be statistically reliable. (...)

**For its part, the European Aviation Regulatory Authority (EASA) has drawn up a detailed list of five major requirements that Boeing must meet before authorising the return to service of the 737 Max.** (...) In addition to the critical failures mentioned above, EASA is concerned about: the potential difficulty for pilots to turn the aircraft's manual trim wheel, the unreliability of Max's angle of attack sensors, inadequate training procedures, and the fact that the automatic jet pilot does not turn off in some emergency situations.

**At this time, it is unclear whether mitigating these vulnerabilities requires a simple update of the 737 MAX flight software or more in-depth changes to the aircraft** itself, given that some industry experts, such as Gregory Travis, an experienced software engineer and an experienced pilot, believe that a software update cannot compensate for the design defects of this aircraft and advocate a complete redesign of the aircraft. At the moment, Boeing seems to prefer the first solution. (...)

## ***Press review Stock market***

### **> Air France: Oddo raises its price target**

(source Zone bourse) August 1st - **Oddo indicates that the 2nd quarter of 2019 finally came out 17% above expectations** in terms of operating income at 400 ME (+16%) for a turnover growth of 6.4%. Following this publication, **Oddo confirms its advice to purchase and raises its target price to 12€.**

The company anticipates a stable unit revenue on the transition to Q3 but points out that long-haul bookings remain on the whole well oriented," says the analysis office.

Oddo believes that the regained flexibility combined with Transavia's expanded role would contribute more than 1% to the group's operating profitability in the short term. (...)

## ***End of the press review***

### **> Follow-up to the referendum on the privatisation of Aéroports de Paris**

The consultation mechanism on the privatisation of the ADP group is open from 13 June to March 2020. To lead to a shared initiative referendum (RIP), it requires the signature of 4.7 million voters.

On the Internet, the consultation is signed on the website [referendum.interieur.gouv.fr](http://referendum.interieur.gouv.fr)

As of August 5, the consultation had collected 600,000 signatures, or 12.7% of the required signatures.

### **> My comment on the evolution of the Air France-KLM share price**

The Air France-KLM share price was 9.828 euros at the end of Monday, August 5. It is up 8.69%.

The average (consensus) of analysts for the AF-KLM share is 10.43 euros.

The barrel of Brent oil (North Sea) is down from \$2 to \$61.

**This indicative information does not in any way constitute an incentive to sell or solicit the purchase of Air France-KLM shares.**

You may react to this press review or provide me with any information or thoughts that may help me to better manage my role as a director of the Air France-KLM group.

**You can ask me, by return, any questions about the Air France-KLM group or employee share ownership....**

See you soon.

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## | François Robardet

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