

Coronavirus: Air France reduces capacity in Europe



| Letter from the Air France-KLM Director

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Monday's Press Review

> **Coronavirus: Air France reduces capacity in Europe**

(source Air Journal) March 9 - The airline company **Air France announced yesterday a 30% reduction in capacity between France and northern Italy**, where the toll of the Covid-19 epidemic has reached 366 deaths and more than 7365 contaminated and nearly a quarter of the population has been placed under quarantine. **Towards the rest of Europe, the reduction concerns 20% of the capacities.** (...)

Announced on 8 March 2020, the new reduction in capacity at the French national airline's transalpine neighbour will be carried out without any suspension of lines. (...)

Air France is now offering its customers the possibility of postponing (...) free of charge their flight tickets on its entire network, for all journeys booked before 31 March. (...)

Air France-KLM had already estimated the financial impact of the epidemic at between 150 and 200 million euros by April. In a letter sent to employees published yesterday by La Tribune, Air France CEO Anne Rigail warns that this impact will be "more significant": "(...) Uncertainty as to its evolution and consequences leads us to anticipate all scenarios". According to her, the **priority is for Air France to "preserve its cash flow"**: "We are in an economic emergency situation which may remind us of previous crises, such as that of 11 September 2001, or the global financial crisis of 2008".

The Franco-Dutch group had already announced a tightening of its belt with the postponement or cancellation of non-operating expenses and investment projects. On the employment front, the continued hiring freeze for all services not directly linked to operations" announced by Air France Chief Financial Officer Steven Zaat will be accompanied, according to Anne Rigail, by **proposals for "measures to reduce working hours on a voluntary basis"**, for example by anticipating paid holidays, taking unpaid leave, using acquired rights or **"part-time or alternating work". Part-time work is also "under consideration".**

***My comment:** In the last few days I have received many messages from readers of this letter. All these messages are a testimony to your concern.*

The flight crews have been telling me about planes that are low on fuel. The staff in charge of schedules report constant adjustments.

Call centre staff report their dismay. They spend most of their time no longer selling tickets but informing customers and making refunds or, in most cases, postponing trips.

I would like to reassure you as much as possible. The Air France-KLM Group is tackling this crisis in a better situation than in previous crises (stock market crisis in 2008, SARS crisis in 2013). All teams are working hard to limit the impact of this epidemic on customers and Group employees as much as possible.

> Aldermen say no to the rapid growth of Amsterdam Schiphol Airport

(source Het Financieele Dagblad translated with Deepl) 9 March - A large number of municipalities around Schiphol are opposed to the government's plan to gradually increase the airport to reach 540,000 flights per year by 2021. (...)

Neighbouring municipalities describe the increase in the number of movements as "undesirable" and "out of the question" for the time being. According to them, the current number of take-offs and landings (up to 500 000 per year) is already causing too much environmental and noise pollution for the inhabitants. The balance in this region is lost," says Herbert Raat, alderman of the VVD in Amstelveen.

For many municipalities, the possible growth of Schiphol can only be envisaged from 2023 onwards and only if the nuisance for the inhabitants is "clearly" reduced. In that year, the reclassification of Dutch airspace must be completed. This should result in higher

approach routes, fewer detours and, ultimately, a reduction in inconvenience.

The FD study comes at a politically precarious time. **Minister of Aviation**, Cora van Nieuwenhuizen, will **probably present her long-awaited plans for the future of Schiphol this spring**. In recent months, the VVD minister has been under heavy pressure from the airport and the main KLM user.

CEOs Dick Benschop (Schiphol) and Pieter Elbers (KLM) are asking the government for a quick clarification. For years Schiphol has reached the ceiling of half a million flight movements per year. This ceiling will apply until the end of this year. Benschop and Elbers believe that moderate growth is needed to ensure that Schiphol remains an airport with many direct flights. Only in this way will the airport be able to continue to compete with Frankfurt and Paris airports. (...)

The municipalities are asking the Cabinet to take decisions at last. (...)

My comment: *The removal of the ceiling on aircraft movements at Schiphol has been under discussion for two years now.*

If a decision is not taken within the next few weeks, it is likely to be postponed until after the next Dutch elections in March 2021.

This makes it difficult for KLM to develop a long-term strategy.

> **Covid-19: The \$46 barrel does not benefit Air France**

(source: Déplacements Pros) 9 March - With oil at less than US\$46 a barrel (Brent crude oil price on 8/3/2020), companies are experiencing huge shortfalls. This is due to "Hedging", a purchasing technique that allows fuel prices to be "smoothed out".

In Europe, airlines negotiate fuel with refiners and then lock in a volume and then a price over fixed periods and amounts. This is called "Hedging". This purchasing technique allows airlines to set a so-called hedging value and thus buy visibility on the most important item of their expenses. In this strategy, nothing happens randomly, because commitments are capital. Making a mistake means paying more for fuel than a competitor, and the penalty is irrevocable, because in a hyper-competitive market, it is impossible to recover by raising ticket prices. The effect of a miscalculation is immediate and immeasurable.

With the unexpected fall in oil prices (Coronavirus = lower demand. Geopolitical struggle between Russia and Saudi Arabia...), European companies find themselves paying for fuel not at the current rate, but at the negotiated rate, i.e. the cover value. This is how the Air France-

KLM group is facing a shortfall which, if oil stabilizes at a value close to US\$45 per barrel, could reach a billion dollars.

The reason for this loss in relation to the hedge value is due to the fact that **Air France-KLM has covered 65% of the fuel requirements expected for 2020 at around USD 65 per barrel** (reference: Brent price in mid-February).

For Air France-KLM, fuel represents around 23% of operating costs. In 2019, the Group spent US\$6.2 billion. Without the pricing of the hedge value this amount could have been reduced to USD 4.5 billion. But who could have predicted such a fall?

As a reminder, 8 years ago, the barrel rose to 128.4 US dollars and then fell back to 27.10 US dollars in January 2016. With such variations, we understand the interest of Hedging.

The purchasing strategy therefore depends on the analysis of thousands of parameters, the hedge value and the volume purchased. If the analysis is fine and correlated by the market, the result can be interesting. For example, **in 2019, Air France-KLM generated hedging gains of \$50 million.** (...)

***My comment:** In highly competitive geographic areas, it is very difficult for airlines to pass on fuel increases in ticket prices. This is particularly the case in Europe.*

This is why the major European airlines use the hedging mechanism.

Their official coverage levels are between 60% and 70% for the current year. The effects are therefore similar from one airline to another. Given the current level of oil prices, the fuel bill of European airlines (after taking hedging into account) should be lower in 2020 than in 2019.

Conversely, when market concentration is high (North America), there is no need to resort to this system. US airlines generally manage to pass on three quarters of fuel price increases in the price of tickets.

> Coronavirus: Lufthansa would consider asking Berlin for help

(source: Le Figaro with Reuters) March 8 - The airline Deutsche **Lufthansa is seeking government aid to deal with the coronavirus epidemic that is** causing a drop in demand and threatens to curb air

traffic for several months, the Bloomberg agency reported on Sunday. **The German carrier is considering short-time working**, it said in an e-mail to Bloomberg. This measure would be part of a scheme, known in German as "Kurzarbeit", which involves the government compensating lost wages when companies are forced to temporarily stop working, the agency explained.

Restrictions by some countries on flights from Germany are having a "huge" impact on Lufthansa's bookings, airline CEO Carsten Spohr said in an internal memo to employees obtained by Bloomberg. **"We have to assume that it may be months before we see the first signs of stability,"** he said in the memo recorded on Friday.

***My comment:** The Lufthansa Group, weakened by the difficult takeover of Air Berlin, was the first in Europe to take far-reaching measures: it has just announced that it has grounded more than 150 aircraft.*

> Coronavirus and lack of liquidity: British airline Flybe throws in the towel

(source AFP) 5 March - **The British airline Flybe ceased operations on Thursday after already escaping bankruptcy several times in the past year**, as the coronavirus epidemic that has plummeted world air traffic dealt it a fatal blow. (...)

Europe's largest regional airline had already escaped bankruptcy in mid-January thanks to a fiscal boost from the government of Boris Johnson, which agreed to defer tax payments, and after another rescue last year by the Connect Airways consortium. (...)

The company, which employed some 2,400 people and was headquartered in Exeter (southwest England), carried about 8 million passengers a year to 170 European destinations.

It is the latest major bankruptcy in the British transport sector, after Monarch in 2017 and tour operator Thomas Cook in 2019. (...) Flybe was the main carrier at airports such as Aberdeen, Manchester and Southampton. Belfast airport is one of the worst affected, with 81% of its flights being handled by the defunct airline. (...)

After the rescue plan announced in January, Flybe's competitors, Ryanair and IAG, the parent company of British Airways, however, rebelled against what they considered to be anti-competitive and illegal subsidies.

In view of the worsening of Flybe's finances, the executive has chosen to throw in the towel this time, and says it is also looking

into the possibility of restoring services not already provided by other airlines. (...)

My comment: *If the outbreak lasts a few weeks, other airlines could see their difficulties worsen.*

In Europe, Alitalia and Norwegian Airlines are already in the red. Elsewhere, companies with a strong Asian clientele (Air India, Malaysia Airlines, South African Airways, Kenya Airways, Thai Airways and Etihad Airways) are now the most exposed.

> Agreement between Volotea and IAG to facilitate the acquisition of Air Europa

(source actu-aero) 7 March - The Spanish low-cost airline **Volotea announces that it has reached an agreement with the International Airlines Group (IAG)** in which Iberia would sell several routes and slots at Spanish airports to **Volotea in order to** recreate competition on Spanish territory and thus facilitate the European Commission's (EC) approval of the purchase of Air Europa.

Iberia proposed Volotea as a preliminary agreement or "Fix-it-first remedy", so that **after Iberia's acquisition of Air Europa, Volotea would start operating those routes where the EC (European Commission) might consider the entry of a new competitor necessary.** This "win-win" agreement, which has yet to be approved by the EC, should enable Volotea to strengthen its presence in Spain and the IAG Group to unblock the dossier for the €1 billion acquisition of Air Europa announced in November 2019.

If the EC approves this proposal, Volotea would significantly strengthen its growth in Spain with the opening of 2 to 4 new bases and increase its connectivity to **rank among the top five airlines operating in Spain.** The increase in routes and slots would also boost connectivity between the Autonomous Communities, in particular the Canary and Balearic Islands, but also Galicia, the Basque Country and Asturias, with a positive impact on the size of the fleet and the airline's workforce. In Spain, Volotea operates 92 routes and carried 1.4 million passengers in 2019.

My comment: *By entering into an agreement with Volotea, an agreement which only covers Spanish domestic routes, the IAG Group anticipates the remarks of the competition authorities.*

It remains for the competition authorities to assess whether the

takeover of Air Europa by Iberia distorts competition on the South Atlantic network.

> **Etiha**d in the red for the 4th consecutive year

(source Le Figaro with AFP) 5 March - Abu Dhabi-based **Etiha**d announced Thursday that it will lose 870 million dollars for 2019, its fourth consecutive year in the red, saying its current restructuring plan still has "some way to go". This figure also reveals a decrease in the company's losses, with high operating costs and in full restructuring since the end of 2017. **Etiha**d had already relatively limited the scrap to 1.28 billion dollars in 2018 compared to 1.52 billion a year earlier. (...)

Etiha

d has (...) asked its ground personnel to consider bringing their year-end paid holidays forward to April, due to lower demand. (...)

Etiha

d has invested heavily in carriers around the world, including Alitalia, Air Berlin, Air Seychelles, Virgin Australia and India's Jet Airways. **Created in 2003 by the oil-rich emirate of Abu Dhabi, Etiha**d also faces stiff competition, mainly from its Gulf rivals, the Emirates of Dubai and Doha-based Qatar Airways. (...)

At the end of last year, the carrier had a fleet of 95 passenger aircraft, serving some 76 destinations worldwide. Etiha

d carried 17.5 million passengers last year, up from 17.8 million in 2018. **Its revenues in 2019 fell to \$5.6 billion from \$5.9 billion the previous year, well below the \$9 billion posted in 2015 before the crisis began.**

***My comment:** Not only has Etiha*d Airways been accumulating losses for 5 years, but over the same period its turnover has fallen by 40%.

Does the smallest of the Gulf's airlines still have a future by remaining independent?

> **Ryanair** releases €6.7 million in mid-flight for the benefit of Nîmes metropolitan airport

(source: Objectif Gard) 3 March - (...) **Nîmes métropole will be able to recover the trifle of €6.7 million, a sum deposited since 2015 in a blocked account with a Parisian notary, following the dispute between the European Commission and Ryanair.** (...)

The Irish airline company has in fact just notified the judges that it is withdrawing its appeal before the European court against the legality of the European Commission's decision of 23 July 2014. On that date, the Commission had considered that certain agreements between Ryanair and the manager of Nîmes airport (...) constituted 'State aid measures

granted by the joint trade union for the benefit of Ryanair'. To put it **plainly: there is no question of Ryanair's airlines being subsidised by the local authorities.**

At the time, the European Commission ordered France "to be reimbursed these sums with interest". Weary, Ryanair appealed against the legality of this decision before the European Union court. And the €6.7 million or so was, by mutual agreement, blocked in an account. (...)

This order once again highlights the fragility of the model of indirect subsidies to low-cost companies. If it can be perceived as an opportunity to make a figure in terms of passengers in the short or medium term, it remains a costly strategy to be seriously weighed against the economic spin-offs for the territory. (...)

> Aid to Béziers airport and Ryanair in the crosshairs of Brussels

(source Capital) 2 March - **The European Union is conducting an investigation to determine whether aid from the French public authorities to Béziers airport (south), as well as agreements between this airport and Ryanair, were in compliance with European competition law.**

The EU on Monday opened an investigation into Béziers airport and Ryanair for alleged distortions of competition. **From 2007 to today, operators at Béziers airport have received operating aid from several regional and local public authorities, which are under the scrutiny of the European Commission.** The Commission - which has received a complaint from an undisclosed third party - has decided to launch an in-depth investigation into this aid as it may be incompatible with EU competition law.

Public aid is always subject to very strict monitoring by the European executive, as it can give an undue advantage to a company to the detriment of its rivals and therefore distort competition in the Union. They are in principle prohibited but there may be derogations. Also in the European Commission's sights: the airport services and marketing agreements concluded between the Irish airline Ryanair and the operators of Béziers airport during the same period. (...)

My comment: *The airport of Béziers is added to the already extensive list of French airports pinpointed by the European Commission: Montpellier, Nîmes, Pau and Angoulême.*

All these airports have illegally paid subsidies to Ryanair. It is up to the

local elected representatives to put an end to these practices, without waiting for a possible conviction.

> **New blow for Boeing: FAA may require rewiring of all 737 MAX!**

(source La Tribune) March 9 - New blow in sight for Boeing. Two days after the alarming congressional statement that the 737 MAX was "fundamentally defective," the FAA (Federal Aviation Administration), **the US civil aviation authority, is considering**, according to the Wall Street Journal, **requiring the American aircraft manufacturer to move some electrical wiring on all 737 MAX** before giving the green light to return the aircraft to service.

This decision would apply to the nearly 800 aircraft already produced, half of which were already delivered to airlines before they were grounded in March 2019 following the Ethiopian Airline crash (157 deaths), and the other half that Boeing has built since that date. For the FAA, the way in which certain cables are laid out would not comply with safety standards designed to avoid short circuits, the American newspaper explains. "In extreme circumstances, a wiring problem could lead to flight control systems pulling the nose of the aircraft down sharply," as in the two fatal accidents involving 737 MAX aircraft belonging to Lion Air and then Ethiopian Airlines, the daily writes. In both accidents, the MCAS stall protection system was involved. (...)

A few days before the commemoration of the Ethiopian Airlines tragedy, the elected members of the US House of Representatives concluded, in a preliminary report unveiled Friday, that the 737 MAX was a "fundamentally defective and dangerous" aircraft, which demonstrated the need to reform the laws and regulations relating to the certification of airliners.

My comment: *There is a principle in aeronautics called redundancy. This means that any function of the aircraft must be able to be performed by several different systems.*

However, the MCAS system, involved in the two accidents involving the 737 MAX, uses only one probe to activate. Experts agree that the installation of a second probe, connected to the MCAS, is essential to ensure the integrity of this system.

The installation of this second probe will also require a rewiring of the 737 MAX.

> **Coronavirus: IATA calls for relaxation of slot allocation rules**

(source Air & Cosmos) 4 March - The **International Transport Association (IATA) wishes in particular to suspend the rule requiring airlines to use 80% of slots in order to retain them from one year to the next. In**

view of the effects of the coronavirus on air transport bookings, and the need for airlines to reduce their flight plans to adapt to this, the International Air Transport Association (IATA) has contacted regulators to suspend the slot allocation rules immediately and for the whole of the 2020 season.

"About 43% of passengers depart from one of the more than 200 coordinated airports worldwide," IATA says. **"In theory, the slot allocation rules require airlines to operate at least 80% of the allocated slots under normal circumstances** (editor's note: the so-called 'grandfather' or 'use it or lose it' rule). Failure to obey this rule means that the airline loses its rights to the slot for the next equivalent season. **In exceptional circumstances, regulators may relax this rule.** The coronavirus has had a severe impact on air traffic," adds IATA. (...)

"Given these extraordinary circumstances as a result of a public health emergency, the collective assessment of the airline industry is that the application of the 80% rule is inappropriate during the current season. (...)

***My comment:** For several days now, European governments have been asked to take a decision on this issue. In the meantime, companies are flying almost empty planes to avoid losing slots.*

> **Coronavirus: 900 companies have applied for short-time work**

(source AFP) 8 March - **Some 900 companies affected by the spread of the new coronavirus have applied for short-time** working for about 15,000 employees, Labour Minister Muriel Pénicaud said on Sunday, adding that the figure had more than doubled in just a few days.

"It concerns 15,000 employees, it may seem a lot but it is out of 20 million employees," said Pénicaud on BFMTV, for whom "we should not generalize" because "there are many sectors that are not affected. On Thursday, she had already mentioned 400 companies that had applied to benefit from this scheme, which aims to "maintain employment" in the event of a drop in activity. "It represents 52 million

euros for the moment, we have a third which has already been granted, for the others it is being examined, we are doing this within a short period of time," the minister said.

The virus mainly affects the tourism, events, catering, hotel and catering industry and, "in part, the transport sector", she said.

"Economic life is a bit damaged in some sectors. We have to be realistic: we are going to have a partial slowdown in growth, but we are doing everything we can to preserve it," she added. (...)

My comment: *If the progress of the epidemic does not slow down rapidly, it is likely that short-time working (the new name for short-time unemployment) will become widespread within the affected sectors. Air France could then be affected.*

Stock exchange press review ...

> Coronavirus and oil crash: Monday of anxiety in the markets

(source AFP) March 9 at 12:51 - A tide of red on the stock market screens: the markets were in free fall on Monday, suffering a double shock, that of the collapse of oil and a state of alert to the new coronavirus in Italy, a bad omen for the rest of Europe and world growth.

Investors had already been burned in recent weeks by the spread of the coronavirus and now added to the stress is the **black gold**, which on **Monday experienced its worst fall since the first Gulf War in 1991, collapsing by more than 30% in Asia.** (...)

At issue is Saudi Arabia's decision to adopt a scorched earth policy by drastically lowering the price of its black gold, after last weekend's failed negotiations with Russia. (...)

Another shock: Italy took drastic measures on Sunday with the quarantine of a quarter of its territory, including its economic lung, which stretches from Milan to Venice. **"The fear is that Italy could prefigure the health situation in the rest of Europe in the coming days,"** Larroutourou said.

The markets are now clinging to the hope of a coordinated response from both central banks and governments in terms of both monetary and fiscal policies.

Several billions have already been released in the US and Italy to respond to this unprecedented health crisis, Germany has announced measures, but market participants note that these plans lack ambition

and coordination. (...)

The impact of the coronavirus on the growth of the French economy will be "several tenths of points of GDP" (gross domestic product), warned Monday the Minister of Economy Bruno Le Maire.

Germany, which according to the economists is one of the most vulnerable countries, because of its very strongly exporting economy, has just announced some support measures, but without revealing the vigorous recovery plan that the experts were hoping for.

As for Japan, it is headed straight for a recession, characterized by a contraction in GDP for at least two quarters in a row. This would be the first time since 2015.

"It is still a little early to anticipate a global recession" but, according to the experts at broker Aurel BGC, the markets "undoubtedly need to anticipate the worst before stabilizing".

My comment: You have to go back to 1991 to find such a situation again. This gives an idea of the importance of the current crisis.

A small hint of optimism: the return of good weather should help curb the epidemic.

End of the press review

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

The consultation process on the privatisation of the ADP Group is open from 13 June 2019 until 12 March 2020. It requires the signatures of 4.7 million voters in order to lead to a referendum of shared initiative (RIP).

On the Internet, the consultation can be signed on the site referendum.interieur.gouv.fr

By 9 March, the consultation had collected 1,130,000 signatures, i.e. 23.95% of the signatures required.

My comment: There are 3 days left to sign the request for a referendum on the privatization of Aéroports de Paris.

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

The Air France-KLM share is at 5.178 euros at the close of trading on Monday 9 March. It fell by -18.71%. Announcements concerning the coronavirus epidemic have caused the share price to fall for all the players in the air transport sector. At the beginning of the coronavirus epidemic, it was at 9.93 euros.

The average (the consensus) of analysts for the AF-KLM share is down to 11.03 euros.

The barrel of Brent oil (North Sea) is in freefall, from \$16 to \$36. When the coronavirus outbreak started, it was \$69. That's the biggest drop since 1991.

This indicative information in no way constitutes an invitation to sell or a solicitation to buy Air France-KLM shares.

You can react to this press review or provide me with any information or thoughts that will help me better carry out my duties as a director of the Air France-KLM Group.

You can ask me, by return, any question relating to the Air France-KLM group or employee shareholding...

I'll see you soon.

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| François Robardet

Director Air France-KLM representing employee shareholders PNC and PS.

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