Proposal for the establishment of a Barbados Air Carrier Aerocentury (ACY)

1. Reason for the Proposal

Background

As one of the major economic and tourism centres of the Eastern Caribbean, there is a strong case for Barbados to possess its own airline in order to serve existing markets, and develop new ones that meet the specific trade, investment, and tourism needs of the country. Further development potential would also be realised by the attainment of FAA Category One status which process would be facilitated by the existence of a national carrier.

Current Situation

Regional airlift into and out of Barbados today is principally provided by LIAT and Caribbean Airlines. Both of these carriers are experiencing severe financial difficulties, and in the case of LIAT this represents a major drain of the resources of the Barbados Treasury in the form of ongoing equity contributions. The level of service provided by LIAT in particular is poor both in terms of quality and quantity, and the financial burden placed on Barbados via its shareholding in LIAT is unlikely to reduce in the short or medium term. In the meantime, Barbados has enjoyed good growth in its intercontinental air service provision in recent years, and needs to sustain and develop this growth through greater critical mass in its regional service provision.

Proposal

That a Barbados Air Carrier (Newco) be established with its own Air Operator's Certificate(AOC) and route licensing authorisation. Newco would effectively replace existing the majority of existing LIAT services throughout the region and would seek to develop new markets.

Continuity of Service

A key objective in the proposal is to ensure continuity of service provision to regional air markets whilst structural changes take place.

2.Approach, methodology and structure for establishment of Newco

Approach

A traditional approach to fleet planning in a start-up airline with a projected requirement of, say, ten aircraft would be to launch initially with 2-3 aircraft and a limited route network, and build thereafter incrementally over a period of 18 months to the final fleet number. Whilst this approach is prudent, it exposes the new entrant to competitive attack, and in this particular case, fails to meet the key objective of continuity of service.

The alternative approach of acquiring, through purchase or lease, a large number of aircraft simultaneously is costly, complex and requires a large number of operating crew to be trained and available long in advance of service commencement.

A third way would be to acquire half the fleet, which in the particular case of Newco could be achieved at minimal cash outlay (see following section on methodolgy), and bring in the balance of the fleet on a short term 'wet lease' basis. In a wet lease arrangement, the lessor provides its own aircraft, crew, maintenance and insurance to the leasing airline (Newco) in return for an hourly rate for services provided. This arrangement avoids the need for Newco making the large investment in aircraft and crew at a single point in time, and enables it to stagger its own incoming aircraft on a one for one replacement of the wet lease aircraft.

Methodology - Fleet

CDB have funded via shareholder governments LIAT's wholly owned ATR42 aircraft. Title of these would pass to the Barbados government either through shareholder agreement or through CDB taking a charge over the aircraft and reassigning them. Barbados would assume title of these aircraft in return for a surrender of their shareholding in LIAT, the respective values of which are broadly equal. These aircraft and the loan obligations would then be assigned to Newco. Prior to the launch of Newco, these aircraft will be leased back to LIAT to ensure continuity of service.

At the same time Newco would enter into a wet lease agreement with a third party provider, who has already been identified and is a Western European AOC holder, for the lease of five aircraft and crew for a period not exceeding 12 months. These aircraft will be delivered to Barbados before the launch of Newco in order to obtain the necessary documentation and crew licensing authority from Barbados Civil Aviation Department (BCAD).

Newco would enter into separate negotiations with aircraft lessors for suitable aircraft to replace the wetleased aircraft. In all likelihood the replacement aircraft would be ATR72s, thus leaving Newco with a final fleet count of five owned ATR42s and five leased ATR72s

Methodology - AOC

As a first step Newco would be incorporated in Barbados with a registered address. A small team of people initially comprising CEO/Accountable Manager, General Counsel and those with specific expertise in Finance, Flight Operations, Maintenance and Commercial would commence work assembling the necessary operational regulatory documentation and commercial and financial infrastructure in order to apply to BCAD for an AOC. This process would normally be expected to take about 3 months. During this time it will be necessary to have obtained an aircraft and crew in order to present an operationally and financially viable airline to BCAD. Whilst it would be possible to use one of the assigned ATR42s for this purpose, this would affect continuity of service, and therefore an alternative option would be to lease an ATR72 which would then form part of the Newco permanent fleet.

On the grant of the Newco AOC, the company would immediately embark on the process of obtaining route licenses, which would be immensely enhanced in a fully cooperative political environment. In such a case, this process is envisaged to take 5-6 months.

Structure

The strategic approach to the structure of Newco would be based on moving a number of historic fixed airline costs to a variable cost basis via outsourcing. This has the benefit of reducing high staff front line and overhead costs, and gives the airline the flexibility to select service providers on the basis of cost and service quality without being tied to long term and ever increasing fixed staff costs.

Areas earmarked for outsourcing would include base maintenance, ground handling, call centre and revenue accounts, all of which are nowadays typically outsourced in many small to medium sized airlines and in almost all low cost carriers. These activities currently employ over 300 staff in LIAT. As a consequence it is envisaged that Newco could operate a fleet of 10 aircraft with just 300-350 permanent staff .Retained activities would include crew and operations, finance, commercial, HR and Legal.

3. Commercial Strategy

Network Development

The strategic approach to Newco's network development would be to capitalise on Barbados' growing importance as the key hub and transfer point in the Eastern Caribbean with additional gateways in Antigua, Port of Spain, and Ogle. This will permit a realignment of the current LIAT network to place greater emphasis on point to point and connecting opportunities in Barbados whilst still retaining key flows in both the north and south of the region. Some of the smaller capacity markets in the north would be served through a franchise partner. Year one of the network plan would reflect this approach with new direct and non-stop routes from Barbados to St Kitts, Barbados to St Maarten, and from Port of Spain to Ogle. Antigua would see the reinstatement of routes to San Juan and Santo Domingo, currently not possible with the smaller LIAT fleet. Year two would see the addition of seven new turboprop routes, whilst year three envisages the introduction of jet capability and a further six medium haul routes. The three year network development plan would be as follows:-

Destinations Served	Year One	Year Two added destinations (turboprop)	Year Three added destinations (jet)
	Anguilla	Aruba	Bogota
	Antigua	Boavista	Fort Lauderdale
	Barbados	Caracas	Havana
	Dominica	Paramaribo	Kingston
	Guadeloupe	Port au Prince	Panama City
	Grenada	Punta Cana	Washington
	Martinique	Tobago	
	Ogle		
	Port of Spain		
	San Juan		
	Santo Domingo		

St Croix		
St Kitts		
St Lucia		
St Maarten		
St Thomas		
St Vincent		
Tortola		

Fleet Development

Market sizes in years one and two of the network development plan dictate 50-70 seat turboprop capacity with an interim fleet in year one of 10 aircraft of both wholly owned and wetlease variants. Year two sees growth in a single type ATR fleet to 12 aircraft, whilst year three adds jet capacity probably in the shape of two class A320-200s. The three year fleet plan would be as follows:-

Aircraft Type	ATR42 - 600(Y)	F50 wetlease(Y)	ATR72-500(Y)	A320-200(J/Y)
Year One	5	5(with phase out)	5(with phase in)	
Year Two	5		7	
Year Three	5		7	3

Distribution, Sales and Marketing, Product

A key requirement to support the hub connection strategy will be a fully distributable reservations system with interline capability to and from intercontinental carriers operating into the region. This means that Newco will have to adopt a major Global Distribution System(GDS) such as Sabre or Amadeus as its host reservation system. Developments over recent years have seen the major GDS providers offer 'lite' versions of their products at a more affordable cost to smaller airlines in order to remain competitive. Newco will also enter into cooperative arrangements with smaller regional carriers in order to extend its distribution reach into markets that demand lower levels of capacity than the ATRs.

In order to deliver its strategic objectives, Newco's market positioning will need to be towards the full service end of the product spectrum with a loyalty program, an enhanced on board product offering and a responsive website with full customer reach and interaction. This does not preclude the ability to take advantage of an ancillary sales revenue stream such as buy on board or second bag fees, which is becoming increasingly common amongst major full service airlines. As the airline moves into medium haul jet operations, the market will demand a two class product.

In keeping with the outsourcing strategy, much of the sales effort will be managed through a Global Sales Agency and a third party call centre with just a small core of directly employed sales people.

4. Year 1 indicative P&L (US$m)

Operating Revenue	
Passenger	110.0
Other	5.0
Total	**115.0**
Operating Costs	
Staff	18.5
Fuel	16.7
Maintenance	14.8
Aircraft Ownership	14.8
Ground Handling	13.0
Cost of Sale	9.3
Overhead Costs	13.0
Financing Costs	5.0
Total	**105.1**
Net Profit	**9.9**

5. Funding requirements

On a projected timescale of 9 months from incorporation of Newco to launch, total anticipated funding requirements of **US$29m** would be as follows:-

Month	Activity	Funding requirement (US$)
0-3	Company incorporation, Premises, initial staff Wetlease commitment fee ATR72 lease deposit GDS commitment fee	1m 0.5m 0.5m 0.5m
3-6	Staff recruitment and salary costs. Route licence and station set-up costs	3.5m
6-9	Staff salary and station set up costs. Other marketing costs Wetlease deposit costs	3.5m 2.0m
Launch	Working capital at 2 months operating costs	17.5m

6. Cooperative approach to the establishment of Newco

This paper proposes the replacement of LIAT with a new entity based in Barbados, and unencumbered by the costs and legacy characteristics of LIAT. Many key aspects of the establishment of Newco would be immeasurably easier to achieve in a cooperative rather than a competitive environment. Continuity of air service, the route licensing process, and a seamless transfer of booked inventory are three obvious examples where a cooperative approach would be in the interests of Newco.

In order to have a balance of opportunity in this process, and being mindful of job retention, Newco might wish to consider offers of employment to former LIAT staff, albeit on new terms and conditions. Other opportunities lie in the retention of LIAT's existing ground handling operations in Dominica, St Lucia, Grenada and St Vincent which could tender services to Newco. A major opportunity would be the establishment, as a separate business, of a Maintenance, Repair and Overhaul facility (MRO) in Antigua. With suitable hangar space potentially being available and an existing skilled workforce, there is a sound case for establishing such a facility in Antigua.

This balance of opportunity would also have the significant added benefit of reducing the liabilities which would be left in LIAT if the company ceased to operate as an airline. Previous estimates of closure costs for LIAT have been in the order of EC$300m or US$111m. In the scenario described above, total liabilities are estimated at half this cost, and of this, it is assumed that there would be latitude for write-off, deferral or re-negotiation. The current liabilities as of Nov 2014 are as follows:-

	US$
Short term borrowings	10.7
Unearned transportation revenue (paid but not travelled)	8.7
Accounts payable and general accruals	9.9
Airport and government charges	20.7
Staff salary provision and vacation leave	3.7
IATA Clearing House and other	2.0
TOTAL	**55.7**

7. Conclusion

Regional aviation in the Caribbean is a topic that has exercised minds for decades and has been the subject of countless academic, financial and politically led studies. Indeed, two such studies are currently underway. The two main players in the region, LIAT and Caribbean Airlines, are both heavily loss making, have been the recipients of large capital injections over the years, but remain caught up in a legacy structure and culture in which there seems little prospect of improvement. It is likely that they will both continue to represent a drain on their government shareholder treasuries, who can ill afford to continue to pour money into these airlines. Their prospects are such that they are highly unlikely to attract any private investment, and the travelling public remain dissatisfied with the service that is provided.

The mechanism of Chapter 11 bankruptcy protection which has enabled the majority of U.S. legacy carriers to completely restructure their businesses is not available to airlines in the Caribbean. Nor is the luxury of a total recapitalisation and the time to reinvent the business. A slow, painful, and costly collapse or a fresh start appear to be the only logical options available.

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