A New Flight Path for Aer Lingus

The Alternative to Selling Our National Airline

SIPTU

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> ***"I'm not just going to click my fingers because some right-wing economists believes we should privatise," the Taoiseach, Bertie Ahern told the Dáil on November 17, 2004. "We're an island nation, heavily dependent on trade, overseas investment and tourism. There are very important strategic issues which have to be satisfactorily resolved."***

The decision by the Government to sell off a majority share-holding in Aer Lingus represents a triumph for the free marketeers in the Cabinet and a victory for ideology over common sense. It is bad for the country, bad for the taxpayer, bad for the workforce and is bad business for Aer Lingus.

If a majority share-holding in Aer Lingus is sold, the country will lose its national flag carrier. It will also lose control over a strategic company that – as the Taoiseach says – is vital to an open, island economy.

In time, Aer Lingus will disappear. The shamrock will be painted over and a national carrier that flies travellers direct from Ireland to major centres throughout Europe and North America will become a feeder airline to a hub such as Heathrow.

Taxpayers will lose the dividends enjoyed from ownership of the company and the Exchequer will not even make a once-off financial killing on the stock market because shares will have to be offered at such a large discount to attract potential investors. At least €100 million could be written off the airline's value.

It doesn't have to be this way.

There is a viable and less costly alternative. It must be explored.

Aer Lingus can remain in public ownership and control and still access the capital it needs for development and fleet replacement. There will be no lost discounts and the Irish people can share in the future gains of the airline. All this can be done rapidly and cheaply if the Government explores all the options.

Promises cannot be fulfilled once a majority share is sold off. Business has no sentiment!

Privatisation is bad for Aer Lingus because new investors will make maximising profit a higher priority than the interests of the airline, the customers and the staff. In a cyclical industry, they will close it down or sell it on at the first down-turn. There is no sentiment in business.

Aer Lingus is currently one of the world's most profitable airlines. It had an operating profit of €107 million in 2004, a high return of 10.6% on turnover and close to its highest ever return of 12% in 2003. **Aer Lingus recorded profit rates higher than virtually all other airlines.**

Its market value is estimated at between €500 million and €950 million. It needs more equity, or capital, to exploit its success. The employees have been prepared to invest in the national carrier – through job cuts and increased productivity but the Government has not. In fact many Aer Lingus staff see the decision to sell as a betrayal of all of their sacrifices and success in rescuing the airline and restoring it to profitability.

Painting over the shamrock

The sight of the Aer Lingus tail fin with its shamrock in distant airports makes Irish people feel they are at home. The Government talks about "golden shares" and protecting the "national interest." But once control is ceded to outside investors, it is only a matter of time before that tail fin is painted over.

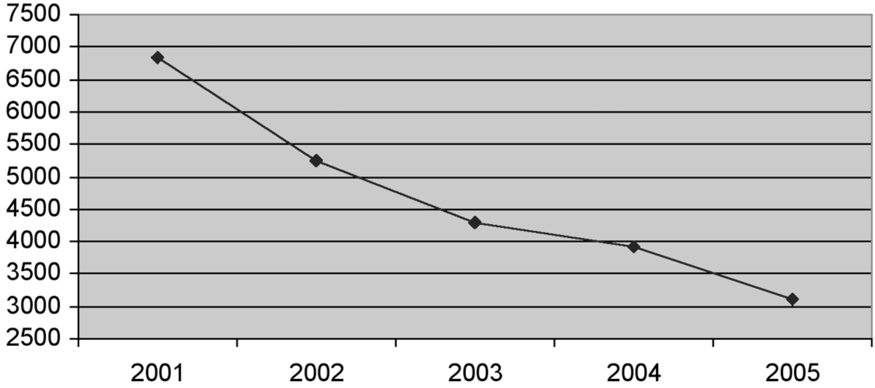
The State may retain a blocking share for a time. But sooner or later it will bow to pressure – as it did with Eircom – and sell out. In the hard world of business a determined take-over, just like Malcom Glazer's at Manchester United, will gain control and Aer Lingus will be saddled with the debts run up by those who borrow to buy it. As a Manchester United fan, Bertie Ahern should take heed of what has happened across the water.

A committed workforce

This does not have to happen. The airline's strong financial performance comes after the worst international crisis in aviation history. The 9/11 terrorist attack in 2001 saw several major US airlines and European national carriers collapse. The survival of Aer Lingus was possible because staff embraced change on a scale never seen before.

Some 2,500 jobs were shed and massive changes in work practices accepted to make operations more cost effective and ensure the airline's survival. When that was done, senior management wanted to cut a further 1,325 jobs. Many staff believed this was a precursor to privatisation. This belief was bolstered by much speculation in the media and underlined even more when senior management figures approached the Government for permission to buy out the company.

Aer Lingus Average Employment 2001-2005



Source: Annual Reports and 2005 estimate.

2001 crisis

Yet from an operational point of view some of these cuts don't stack up. For example, this year, a further 600 jobs are being shed even though the company plans to expand. It has had to hire contract labour to cope with customer demand. Not surprisingly services are suffering.[1]

Yet it is well known that two-thirds of the cost advantages of low-fare airlines come from having superior business processes, such as internet sales and flying aircraft more hours a day, rather than cutting labour costs.[2]

Aer Lingus itself is an example. A high proportion of the €350 million in reductions achieved between 2001 and end 2004 came from non-labour costs such as better aircraft utilisation and the success of its FastPass check-in facility.

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1 "Aer Lingus Passengers Complain," *Irish Times,* May 30, 2005.

2 Booz Allen Hamilton, quoted in the conservative *Economist* magazine, which erroneously states that Southwest Airlines in the US has "the advantage" of a non-unionised workforce. In fact, trade unions have played a key role in the success of Southwest.

Why privatisation?

Why indeed – when no convincing case has been made to support such a drastic and probably irreversible move?

In a growing market, Aer Lingus needs more capital. We accept the need for investment to expand. But we believe that investment should be made in a way which does not cost the tax-payer a fortune or see control of the company lost forever.

The only beneficiaries of privatisation will be a small number of very wealthy and powerfully connected people, as was the case when Eircom was sold. Once again a strategic asset will be sold at a knock-down price and long term investment will be left to the whims of the market.

Does Aer Lingus need equity for expansion?

Yes, although to date nobody has been able to quantify the amount. What is clear is that all of the equity is not needed immediately. Aer Lingus debt levels are very low. New equity can be used to borrow against the cost of buying and leasing new aircraft so that the amount invested can be spread over a number of years and mixed in with borrowings.

A bad time for privatisation

Even commentators who favour privatisation believe the timing is wrong. They point out that the airline has a new chief executive and it will take a couple of years for a new management team to bed down. Oil prices are high and, in a very cyclical industry, all these factors will drive down the Initial Public Offering (IPO) value.

In short, the current turmoil in the airline industry is not conducive to privatisation. A long-term business plan and share-holders who will stick with it are what Aer Lingus and the national interest require.

The hidden costs of privatisation

The Government is thought likely to sell off shares in Aer Lingus through an IPO on the Stock Exchange. But it may decide on a trade sale to another airline, or to sell shares in a block to an investor who will sells them on to another airline at a profit.

However, the Government is expected to opt for an IPO in the hope that it will attract many small investors. It may even structure the sale to ensure small investors receive shares.

But even if this happens, it cannot prevent a subsequent Eircom-type operation where predatory speculators gobble up the shares.

The IPO option is also very expensive for the taxpayer. For example, if Aer Lingus is valued at the relatively low figure of €600 million and 50.1% is sold off, then there will be a loss of around €90 million because of something called the 'double discount.' In privatisations, governments usually offer a discount of up to 15% to ensure all the shares sell.[3]

Where existing share-holders remain involved – as in Ireland, with the Government and Aer Lingus employees retaining 49.9% between them – there is usually a further discount of up to 15%. The total 30% discount would mean a potential loss of around €90 million to the tax-payer.

The loss becomes bigger if the company is valued at a higher price or the Government sells more than 50.1%. For instance, losses arising from discounts would amount to €135 million if the company was worth €750m and 60% was sold off at a 30% discount.

The Heathrow landing slots

The Heathrow slots are worth a lot of money and could be asset-stripped by a new buyer. These slots, which are effectively landing rights, are sold in a "grey market" – even though they are not actually "owned" by the airlines. It is highly unlikely that the Irish Government would be able to separate the slots from Aer Lingus in any transaction.

In fact, Aer Lingus has a lot of slots at Heathrow. It is a very popular airport with business people and other travellers because of its great inter-flight connections. The slots are particularly prized by long haul operators. Qantas paid close to £20 million for two pairs of slots in late 2003 and Virgin Atlantic paid £20 million for four slot pairs. Previously the market valued prime slot pairs at £5 million to £6 million.

If new owners sold off these slots, or allocated them to another part of their operation, Aer Lingus customers could find themselves flying into Stansted and Luton. Commentators who believe that market demand will ensure Aer Lingus keeps its slots, fail to realise that the maximum return on them is by re-allocating them to long-haul routes. Aer Lingus holds onto them because it is the national carrier and is committed to maximising their value for its own hub in Dublin.

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[3] Report to the Department of Transport of Ireland: Evaluation of Ownership Options Regarding Aer Lingus Group plc. October 6, 2004. Dublin, page 39.

Protect and serve: the transatlantic routes, freight and tourism

Ireland needs a long-haul, long-term airline to meet the needs of our island economy. It is not just a matter of national pride – it is a necessity. We need it to keep the vital North Atlantic routes open and bring in US tourists, business people and direct investment. US tourists coming into Shannon are good for local business. They spend €42.50 per head at the airport alone, compared to €6 per head for short-haul travellers from the UK and Europe.

The value of Aer Lingus to the nation was demonstrated after 9/11 when it was the only airline that continued to fly on the North Atlantic.

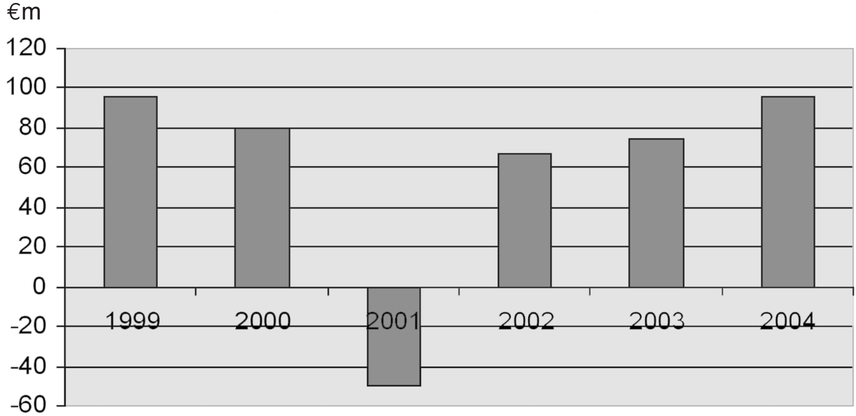
US companies put a high premium on their ability to send executives on a one-stop trip to Irish subsidiaries, allowing them to return to the US on the same, or following day. They place an even higher premium on their ability to move high value product quickly in and out of Ireland.

We also need Aer Lingus to sustain high value air freight services that are essential to our economic growth. Although air freight only accounts for 0.44% of Irish imports and exports by weight, it accounts for 29.4% by value – or €37.3 billion. Air freight is especially important for our high value exports, accounting for almost €25.6 billion worth of goods.

Postal services and the return of human remains from abroad are also key roles performed by our national airline.

On the tourist front, the consequences could be just as severe. Visitors who have to travel from North America to London are more likely to stay in Britain or opt for other short stay destinations such as Paris, rather than Dublin. The number prepared to travel on to Shannon or Cork is likely to be even lower.

AER LINGUS
Operating Profits/Loss



Source: Aer Lingus Annual Reports, 1999-2004

Performing "way better"

Aer Lingus is expected to continue to improve and only needs equity capital to consolidate its position as one of the world's most commercially successful airlines. Cash flow is strong. "Free cash" and liquid assets alone increased by almost €200 million in 2004.

The company has over €800 million in cash, of which €560 million is "free cash." While it owes €400m, most of this is for leasing aircraft. Only €64m is accounted for by bank loans. Aer Lingus even earned €33.5 million in interest last year.

In fact Aer Lingus has never performed as well. Compared to international airlines, its performance has been exceptional in a very difficult environment.

In the US the six big traditional carriers have racked up losses of $21 billion since 2001 – in spite of handouts of $2.1billion from the US government and further subsidies in tax breaks and reduced interest loans from aircraft leasing companies and banks.

In Europe, Sabena and Swissair have gone bust. Olympia is in deep trouble. KLM has been taken over by Air France. Alitalia made a huge operating loss in 2003 – for the fifth year in a row – and the Italian government is seeking EU approval for State aid of €400m. Standing tall amid this private and public failure is Aer Lingus.

As well as performing well financially, Aer Lingus is adding on new European routes from Dublin and wants to expand its network to new long-haul destinations such as South Africa and the Far East. Its fares have been cut substantially, but unlike Ryanair it offers the consumer a balance of service and low fare economy.

We've been here before: lessons of the Eircom privatisation

The Government made a huge mistake privatising Eircom. The only bonus was that the Exchequer made €6.2 billion on its €800 million investment. However, much of this profit money came from the pockets of the same tax-payers who bought over-valued Eircom shares.

A once profitable State-owned utility has been transformed into today's loss-making, under-investing, debt-ridden, private monopoly. Huge debts were run up in the leveraged buyout of Eircom by Wall Street venture capitalists. Most telecom prices are higher now than they would have been without privatisation.

The privatisation of Eircom also resulted in loss of competitiveness to the economy, because of low investment in infrastructure by its new private owners. There is poor access to broadband, download speeds are slow and prices high.

Now, the Government has had to invest over €300 million in grants to new broadband operators after failing to persuade Eircom to provide an adequate service. Regulation of the market is clearly no substitute for State ownership of key utilities and strategic companies.

Do we really want to face a situation in a few years time where we may have to buy Aer Lingus back and slots at Heathrow, or even establish a new airline to ensure adequate aviation links with the rest of the world?

We don't want a 'race to the bottom'

There have been around 3,700 job cuts in Aer Lingus since 2001. The previous management wanted to reduce staff numbers by a further 1,325, although new equity will see business grow. Central to their plan were proposals to "outsource" jobs – effectively sacking staff to be replaced by new workers on contracts with poorer terms.

Such a move would breach Government policy on semi-State companies, including the current national agreement, *Sustaining Progress.*

It would specifically breach commitments given by the Taoiseach, Bertie Ahern, to SIPTU General President, Jack O'Connor, in a letter on March 15, 2004. In relation to the proposed break-up of Aer Rianta and changes in C.I.E, the Taoiseach said:

> *'I confirm that it remains government policy to engage with the trade union movement on all aspects of proposals for change in the State companies. I note your concern on the need for measures to ensure standards of employment are protected and that a "race to the bottom" is avoided. I confirm that we will engage with the trade unions on measures to address these concerns.'*

SIPTU has warned that the Union will resist any attempt by the new management team to pursue a 'race to the bottom' agenda.

New Zealand – back to the future?

When the Government privatised Eircom in 1999, it could at least plead ignorance of the consequences. That excuse does not arise in the case of Aer Lingus because New Zealand – another island economy – provides a case study of the dangers.

In 1988 Air New Zealand was sold to a private sector consortium for NZ$660 million. Unlike the Irish Government in the Eircom sale, their New Zealand counterparts retained a 'Kiwi share' in the national airline that ensured a majority of board members in the privatised company must be New Zealanders. It also put in place measures to protect landing slots abroad to ensure air links were protected for their peripheral island economy.

Despite these safeguards, the drive for profits in the larger Australian and South-East Asian markets led to lopsided growth and ill-advised take-overs of other airlines. By 2000, the former State airline was facing bankruptcy.

Trading in its shares was suspended and some 16,000 people lost their jobs. The company owed NZ$675 million in unpaid salaries and bonuses to staff.

The consequences of the company's collapse for New Zealand were potentially catastrophic. The Government had no option but to buy back 83% of the company for NZ$885 million and write off €1.3 billion in debts. As New Zealand's Deputy Prime Minister Jim Anderton put it in October 2001:

> *As in rail, banking, telecommunications and energy, this Government is having to cope with the problems of a failed economic ideology. New Zealand's economic development and tourism future hinges on maintaining a strong air transport carrier. The primary consideration of the Government in making the decision to invest is the national interest in maintaining an effective flag carrier.*

What are we proposing?

Privatisation of Aer Lingus would be a major strategic error. Under EU competition rules the Government is allowed to invest in Aer Lingus on the same basis as any other investor. However, the Government has decided not to. Therefore, the Union proposes that Aer Lingus should obtain the required equity capital through a State Holding Company.

The Irish Congress of Trade Unions has already proposed[4] that the Government's stake in each of the thirteen commercial State companies – valued at around €7bn - should be transferred from the Department of Finance to a new State Holding Company (SHC). The holding company would be legally owned by a new board of the National Treasury Management Agency (NTMA[5]) called the State Holding Company Investment Board (SHCIB). Economic ownership would, therefore, be held for the benefit of the nation.

Congress has also proposed that additional shares in the SHC – up to 25% – be sold to a group of private pension funds.

The SHC would assess the equity investment proposals of individual companies such as Aer Lingus. Dividends from commercial State companies would be re-invested in the sector. But the SHC would also have access to funds raised through private equity. If the full 25% was taken up this would equal €1.75 billion.

The SHC should be established immediately by the Government. Indeed, there is significant international authority for such a move – since even the conservatively -minded OECD believes SHCs improve the governance of State-owned enterprises.

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4 A New Governance Structure for State Companies, March 2005, Irish Congress of Trade Unions.

5 NTMA has four boards under its stewardship already: NTMA Advisory Board, NPRF Commission, State Claims Agency Policy Committee and National Development Finance Agency. The State Holding Company Investment Board would be the fifth.

It recognises that the State has – and will continue to have – an important role in areas of commercial life through ownership of key companies. The OECD accepts that there are some businesses, such as natural monopolies, that are too important to be left solely in the hands of private interests.

An SHC, along with the Employee Share Ownership Trust, would be a far better share-holding arrangement for Aer Lingus than allowing speculators whose aim is to maximise short-term profits in order to make an Eircom-style killing.

When could this be done?

A draft Bill to establish an SHC could be completed by the end of the summer recess and enacted by year-end. The SHC could be established by January 2006 and it could grant equity to Aer Lingus shortly after. If the Government adopted this approach it could allow Aer Lingus to plan ahead on the basis of increased equity from the SHC.

Conclusion

Economist and former Taoiseach, Garrett FitzGerald, has warned of the high price to be paid if Aer Lingus is privatised. Writing in the *Irish Times,* he condemned the narrow ideologically driven argument in favour of privatisation, and nailed the myth that the State cannot invest in the national carrier.

He also warned that British Airways would be the likely buyer if a majority stake was sold off.

"An island like Ireland, dependent to an almost unique degree on air services for access to and from the rest of the world, has a need for a national airline with a wide remit,"[6] he told readers in words almost identical to those of the Taoiseach in the Dáil last November.

Both of them are right. The Government, representing the community as a whole, must make protection of air transport links a priority for our small, peripheral, island economy. Keeping Aer Lingus in public ownership is a vital part of such a strategy.

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6 FitzGerald, Garrett, *Irish Times,* July 12, 2003.

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