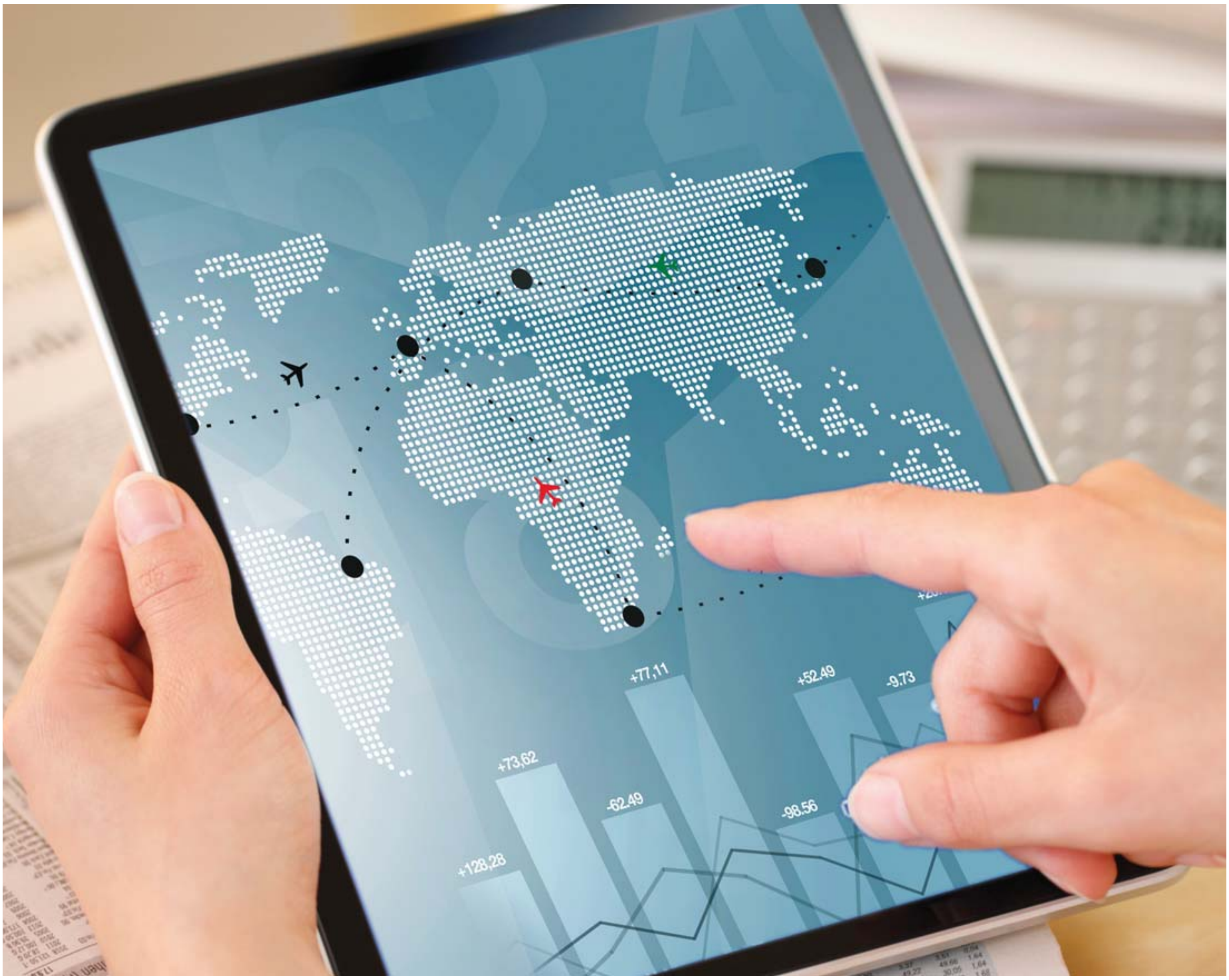
MAY - JUNE 2013
KPMG LLP (UK)

Transport Perspectives



This edition of Transport Perspectives focuses on two key trends in the transport sector.

Roberta Carter and Heinrich Kleine review key **integration and separation** issues airlines face in an era of increasing consolidation.

Big Data has had growing media interest in recent months. Eddie Short looks at what transport companies can do to achieve greater insight and value from big data and analytics capabilities.

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Managing integration and separation

Roberta Carter, Partner – Transactions
Heinrich Kleine, Assistant Manager – Integration

The airline industry has seen a wave of divestments, mergers, joint ventures and alliances in recent years. But are they delivering value? This article explores the inherent challenges and key integration and separation issues for each of these strategic responses.

Mergers

The most integrated two airlines can become is when they enter into a merger and act as one[1]. Recent years have seen an increase in large mergers such as the tie-up between LAN Airlines with TAM, United Airlines with Continental and, more recently, US Airways with American Airlines. Europe is also going through a phase of consolidation driven by International Airlines Group (British Airways with Iberia), Lufthansa Group (now owner of Swiss and Austrian Airlines) and Air France-KLM.

When entering into a merger, the overall business operating model and level of integration needs to be clear at the onset – will it be a full operational merger, or will there be multiple airlines operating separately but sharing key head office and central functions? From an integration perspective, getting the level, approach and pace of integration right is the primary driver of success. The size of an acquisition clearly needs to be considered but does not change the five key issues which any airline merger must address.

Common ground agreement

Airline integrations are very complex as they combine in a unique way technical challenges, regulatory restrictions and dependencies on people. The clearly defined work processes are prone to significant disruption (flight cancellations, delays, etc.) and financial impacts (continued negative cash flow), if the integration is not based on a compelling strategic rationale, obvious synergy opportunities and very clear guiding principles. Guiding principles, such as minimum disruption to customers and safe and secure operations at all times, help to align both parties and set the ground rules for the overall integration programme.

Speed

Even if a full operational integration is not envisaged, it is important to act quickly to implement even a reduced level of integration. Most airline integrations see a brief period of goodwill from customers, suppliers and employees which is a key opportunity to communicate integration plans and begin implementing key changes. After this initial period, any further integration or change will be very difficult to implement. Very often the acquired airline is also in financial distress. It is therefore essential to implement as many changes as possible early on with very clear and concise messages. For example, the integration of bmi mainline into British Airways was driven by aggressive timelines in order to reduce the ongoing losses that bmi was incurring. This included the transition of all staff, re-issuing all passenger tickets, extraction from Star Alliance, transfer of all international stations and aircraft operating certificates (AOCs) to British Airways control.

Control over synergies

Synergies in airline transactions can be significant, from cross-sales to maintenance costs and back office operations. Negative impacts such as loss of airport slots due to competition rulings also need to be considered. Transforming the initial synergy assessments into realistic implementation plans with clear management ownership (and reward for delivery) as well as benefits tracking is key to success.

1 KPMG, 2013 Airline Disclosures Handbook, http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Pages/airline-disclosures-handbook-2013.aspx


DO NOT USE WHEN RADAR ON
COMPASS CALIBRATION
RADIO ON
RESET PROPS
ENGINE FIRE INSTRUCTIONS
1 POWER LEVER - IDLE
2 PROP LEVER - FEATHER
3 FUEL LEVER - OFF
4 FUEL EMERGENCY - OFF
5 FIRE PULL HANDLE - PULL
6 BOOST PUMP - OFF
LEFT ENGINE
TEST
RIGHT ENGINE
FIRE PULL
FIRE PULL
FIRE DETECTION
TORQUE PRESS
TORQUE PRESS
PROP RPM
PROP RPM
FUEL FLOW
OIL TEMP
T5
T5
OIL PRESS
IND TEST
STDBY BOOST PUMP EMER FWD
SQUELCH
FREQ
CHAN
TEST
FREQUENCY
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209.0
ADF
OFF
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FUEL QUANTITY
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Common culture and key talent
Airlines tend to have very strong cultures and are often part of the national identity. Integrations need to recognise these differences and work around them during the transition period. Ensuring that the shared culture is clearly defined early on with a plan to implement it quickly will help to avoid the loss of key talent. Another important factor is the influence of unions which is traditionally strong in this industry. Clear and integrated performance and reward mechanisms such as determining seniority levels are necessary to minimise the risk of disruption caused by potential strike action.

Passenger disruption
To avoid passenger disruption, airlines need to pay close attention to the passenger experience. Typical areas of focus include integration of frequent flyer programmes (lounge access, earning and spending frequent flyer points), customer communication when schedule changes occur, control over the onboard experience (catering, in-flight entertainment) as well as having workarounds and additional resources available during times of changeovers. Achieving control of passenger operations quickly is essential to enable flexibility in the use of combined networks as well as flows of revenue.

Strategic alliances and joint ventures

Contrary to the popular view that strategic alliances suffer from a high level of dissatisfaction and are often not found to be successful,[2] many airlines are exploring alliances to remain flexible in times of economic uncertainty. Such alliances are designed to offer benefits to the customer (in terms of increased choice) and to the airline: more efficient use of capacity, scheduling and a "metal-neutral" approach to joint sales, while staying within regulatory constraints including foreign ownership limits[3]. Joint Venture Agreements (JVAs) reduce the complexity of large scale mergers and are relatively easy to dissolve. However, they still require a clear focus and an answer to the following typical issues:

- Aligning key operational conditions such as flight sharing routes and profit sharing mechanisms. This should happen early on the process.
- Whilst less stringent in terms of regulatory requirements, JVAs need to obtain Anti-Trust Immunity which can prove challenging.
- Clear governance and performance evaluation mechanisms are required to enable measuring the JVAs success.
- JVAs are often limited to a short- or medium-term period and require a clear exit strategy to be in place.

Divestments – often part of larger acquisitions

Whilst we have not seen a significant increase in large airline divestments in recent months, separations are often part of a larger acquisition. For instance, bmi regional was sold to Sector Aviation Holdings as part of the British Airways/ bmi tie-up. Successfully divesting an airline largely depends on maintaining

2 Hubbard, N. (2013, p. 4, p. 11) Conquering Global Markets: Secrets from the world's most successful multinationals. Palgrave Macmillan.
3 KPMG, 2013 Airline Disclosures Handbook, p. 14

its operational integrity and finding the "right" buyer.

Finding the right buyer
Airlines need to closely evaluate all potential buyers as competition regulation, foreign ownership cap and access to route rights is often based on nationality and can therefore restrict the available options[4].

Define the assets to be transferred
If the assets to be divested are not a separate operating unit and the best potential buyers are not operators, the seller must clearly define a package which can survive as a stand-alone airline. This includes the transfer of aircraft (e.g. leasing contracts), operating certificates, airport slots, route access rights and the required flight and cabin crew to operate those flights. Along with defining the costs, the seller needs to determine the financial impact of the divestment. That includes potential dissynergies caused by losing certain profitable route combinations, the cost of separating the operational unit and stranded cost such as retained functions and operations from the sold entity.

Maintain operational integrity
Suppliers (e.g. fuel suppliers or handling agents) are often reluctant to support a divestment when the potential buyer is a small player or does not have the required expertise. In those cases the seller needs to consider providing certain guarantees or using a subcontracting model.

Facilitate alliance exit and terminate other agreements (e.g. codeshare)
Most airlines are part of a wider alliance group (e.g. **one**world, Star Alliance, SkyTeam). If the buyer is a member of a separate alliance then an alliance exit strategy should be drawn up. Typical activities include changing access policies and halting the accrual of frequent flyer miles. In addition, codesharing agreements need to be cancelled with the exception of specific routes as agreed by both parties.

Support the transition period
In most separations, the buyer will not be able to fully operate the acquired airline as the required infrastructure might not yet be in place. This often applies to functions which have previously been shared with the overall selling group, for example, back-office services such as Finance or IT. To facilitate the transition, buyer and seller often agree that the seller will continue providing those services as part of a Transitional Service Agreement.

No matter what type of transaction or operational model is pursued, a strong and clear rationale for the deal and approach to integration and/ or separation is required. Both rely on swift execution requiring very thorough planning and strong, clear communications to avoid disruption.

4 KPMG, 2013 Airline Disclosures Handbook, p. 14

Big Data

Eddie Short, Partner - Advisory

Market analysts predict that companies will be spending upwards of USD60 billion per year on big data and analytics capabilities. With information becoming the 'power resource' of the 21st century, many organizations are starting to develop how to best use data to inform their decision making. While investment in technology is certainly critical, it is how businesses are using data investments to create value and insight that will ultimately help improve shareholder value.

Data is only as good as what you do with it. Recent Sloan MIT and McKinsey research[1] demonstrated this, showing that 'top performing organisations use analytics five times more than lower performers'. While there are myriad of analytical tools that can be leveraged, a recent study indicated that more than 70% of CEOs and CMOs are underprepared to manage the explosion of data and 'lack true insight'. In addition, two-thirds of executives feel that the quality of and timely access to data is poor and inconsistent.

How is this relevant in transport?

In the world of transport more and more legacy infrastructure is becoming internet connected (or instrumented). Not only CCTV, but packet level data on networks, rail signalling equipment, road traffic signals and air traffic control information in all their different formats (audio, video, structured and unstructured text) can be tagged and aggregated to create very valuable information, in real time where and when necessary.

With all of these instrumented devices the demands of data traffic exponentially increase, as typically all of the instruments are interconnected. From there it becomes critical to have the means to drive insights and intelligence from this mass of data.

Transport operators are already active in the Big Data space.

Airports and airlines have been leaders in provision of information

PASSUR Aerospace operates its RightETA system from more than 155 airports across the USA. Every 4.6 seconds it collects a wide range of information about every plane that it 'sees'[2]. This yields a huge and constant flood of digital data and the company keeps all the data it has gathered over time, so it has an immense body of multidimensional information spanning more than a decade, allowing sophisticated analysis and pattern matching. PASSUR believes that enabling an airline to know when its planes are going to land and plan accordingly is worth several million dollars a year at each airport. It is a simple formula: using big data can lead to better predictions, and better predictions yield better decisions. This enables airports and airlines to make better scheduling decisions.

So what can you do about it?

Typical areas where business benefits are delivered include increased productivity, margins, and revenues, and reduced labour costs. However, as the Sloan MIT and McKinsey study has shown, the areas of greatest opportunity are not necessarily in cost reduction and efficiency, but rather are focused on ensuring that the core purpose will create breakaway growth opportunities.

There are clearly many different analytics needs. These we characterise as core, remedial and ancillary.

Core

Core analytics capabilities are central to an organisation meeting its stated strategy, for example optimising on-time arrivals and scheduling, and knowing your customer. Core analytics require significant investment and best in class solutions to allow businesses to remain several steps ahead of their customers, suppliers and the competition.

In recent years, organisations have made significant investments on ERP systems which have enabled significant cost savings through better process management and shared services. IBM –MIT Sloan[3] research shows that many organisations have achieved mastery or leadership in the operational and financial areas; however, the areas of strategy, HR and customer are not receiving the same level of attention.

Organisations establish strong core capabilities to support their strategy. Tesco, for example, has at least 45 pieces of data attached to every product it sells[4]. Analysis of this data has informed a number of key decisions for the company in recent years such as the launches of Tesco.com, its financial services arm and its entry into non-food

1 Big data: The next frontier for innovation, competition, and productivity; June 2011; http://www.mckinsey.com/insights/business_technology/big_data_the_next_frontier_for_innovation
2 http://blogs.hbr.org/cs/2012/09/big_datas_management_revolutio.html
3 The New Intelligent Enterprise, a joint MIT Sloan Management Review and IBM Institute of Business Value analytics research partnership. Massachusetts Institute of Technology, 2011.
4 Consumer Currents: Issues Driving Consumer Organisations, KPMG, 2012

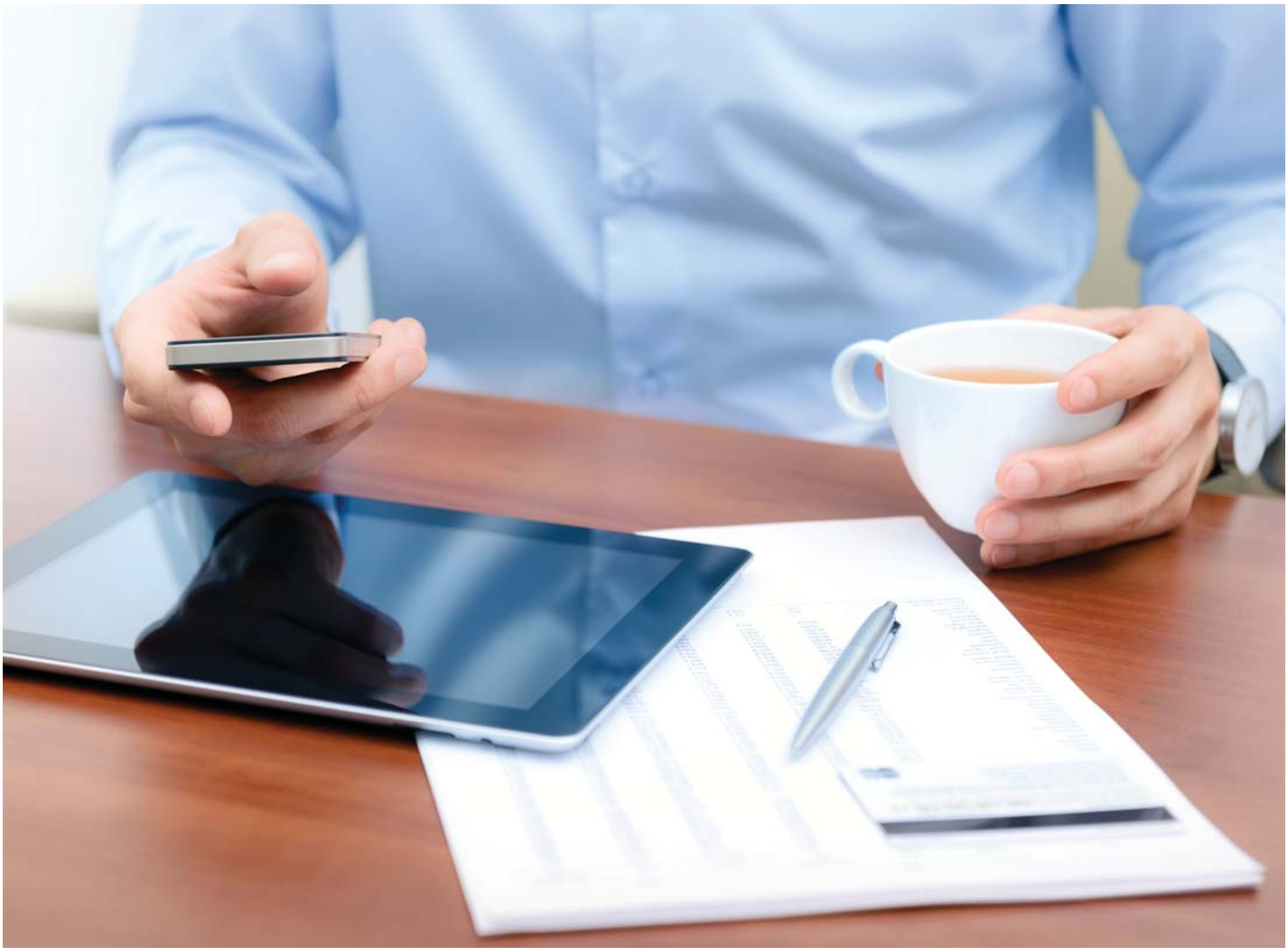
categories such as clothing; both contributing factors to the increase in UK market share amongst its competitors. This data analysis of consumer spend and travel patterns could prove just as valuable for an airline or train operating company making strategic investment or divestment decisions or implementing revenue management or fare pricing strategies.

Remedial
These include capabilities an organisation can draw upon in case of a major business problem or external event, for example a major road accident or airport outages caused by extreme weather events. Research has indicated that those with a disciplined approach to analytics overall tend to recover much more rapidly than their peers who rely on 'gut feel' and intuition. Most airlines and train operators are already leveraging Twitter and other social media outlets to communicate with their passengers around delays and issues. Building on this, Remedial analytics can be used to provide flexible and agile routing and rerouting when there is a significant problem isolated to a specific area, for example, engineering work on rail tracks, train stations, or roads. This can enable people to make connections they might otherwise miss.

Ancillary
Analytics which are not core to the business' overall objectives are known as ancillary analytics. Most often, these relate to indicators and data that are important to the organisation but do not provide an immediate competitive advantage.

Organisations should have a governance structure which balances the investment between core, remedial and ancillary analytics.

What is vital is to have a Data and Analytics Strategy – not something that stands alone, but rather shows how the capabilities deployed across the organisation will better enable the business to meet its strategic and operational goals, delivering on the most important value elements of the business, but also ensuring you have the right insights to protect yourself if things go wrong!



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RR Donnelley | RRD-282199 | May 2013.