KATUSA RESEARCH

Independent Investment Research Firm

6 December 2016

How You Can Help Break the Canadian Air Cartel…and Start Flying Like a First-World Citizen

By: Marin Katusa

Tiny bathrooms.

Screaming children.

The snoring guy sitting right next to you.

Airline travel can be a crapshoot for anyone. It's just an unpleasant experience you put up with in order to visit family, do business, or go on vacation.

But for Canadian travelers, it's even worse. We're at the mercy of a Canadian airline cartel that gouges us on price, provides limited choices, and cheats our country's poorest citizens.

It's time for us to speak up. It's time to break the cartel. And it's time for Canadian citizens to get better service at a lower price.

My work as a professional investor takes me all over the world. Over the past ten years, I've taken more than 500 flights, traveling more than one million air miles.

As a frequent traveler based out of Vancouver, I'm in a good position to offer an informed assessment of Canadian airlines. Here's one conclusion with which I'm sure many will agree: Canadian citizens suffer from the complete absence of discount airlines ("low-cost carriers") and the even more cost conscious ultra-low-cost carriers (ULCCs).

You know the ones I'm referring to—companies like Ryanair, JetBlue, Allegiant, Spirit and even bigger low-cost carriers (LCCs) like Southwest Airlines.

The introduction of low-cost carriers has made air travel possible for hundreds of millions of people around the world. It has given people a huge range of choices.

Yet we Canadians don't have the option of flying with a low-cost carrier. Canada is the only G7 country that does not have ultra-low-cost airline service. In Canada, we have only Air Canada and WestJet, which together control approximately 80% of the domestic market. Both companies are doing very well. In fact, they're enjoying record profits. In 2016, pre-tax profit for all Canadian airlines is expected to be around $1.5 billion.

But are those cartel-sized profits coming at the Canadian flyer's expense?

The aviation safety rating firm JACDEC ranks the low-cost carriers and Ultra-Low-Cost Carriers I mentioned above higher than those of American Airlines, Air France, Alaska Airlines, Air China, AeroMexico, Alitalia, and

many other G20 nation airlines. It is proven that safety is NOT compromised with ultra-low-cost carrier (ULCCs) airlines.

Low-cost and ultra-low-cost carriers have a 26% market share of the global air travel market. The have 30% of the “short haul” market (flights of up to 3,000 miles).

Excellent safety records and low prices have allowed ULCCs to flourish everywhere except here in Canada. This has produced some very predictable consequences:

- Canadian travelers face an artificially limited number of choices and pay unnecessarily high prices. The Canadian Airports Council, a lobby group that represents 120 airports, estimates that Canadians are paying, on average, $428 more per round-trip fare than an American would in the U.S., even after taxes, fees and surcharges are factored in.

- Many secondary destinations that could use jet air service are either underserved or not served at all.

- In many cases, cost-conscious customers—including leisure travelers, students, families, and businesspersons—can’t afford the unnecessarily high fares.

- Residents of Canadian border towns and cities with easy U.S. access, especially Toronto and Vancouver/Victoria, are voting with their feet. They frequently drive to the States in order to take advantage of ULCCs available there, thus exporting dollars that would otherwise be spent domestically. In 2012, the Conference Board of Canada estimated that as many as 5 million Canadians do this annually. That number will surely rise in October, when Allegiant begins wooing Ottawa residents by adding cheap Ogdensburg, NY-Orlando flights).

- A significant number of Canadian travelers are simply not flying to trans-border destinations, either because the necessary service is not currently offered, or because it is offered only via an annoying number of stops and connections.

Canada is a huge, geographically diverse country. It’s a leader in banking, resources, and manufacturing. Its citizens are among the most educated in the world. We deserve to have affordable air travel that will connect us to each other, enhance our national unity, and benefit our families and businesses alike.
There is a clear-cut need waiting to be filled here.

Enter *Jetlines*, a company eager to fill it.

Jetlines is a startup ULCC with a business model equivalent to those of its highly successful counterparts in other countries; it aims to sell over 90% of its tickets via its website. *Jetlines* will primarily fly point-to-point routes (i.e., excludes hubs, interline, code-sharing or other commercial passenger feed agreements). It features a world-class management team and Board of Directors, all of whom possess significant experience in the airline industry and a proven ability to raise capital. *Jetlines* is proposing a route structure that will eventually encompass some 200 destinations–including many not presently served–with scheduled, all-jet flights. *Jetlines* will be a national airline, with primary bases at Vancouver and Hamilton International Airports, a secondary base at Winnipeg International, and expansion plans for Atlantic Canada.

In addition to operating flights throughout the country, *Jetlines* will also offer service to locations in the U.S., Mexico, and the Caribbean. *Jetlines*’ motto says it all: *Affordable Airfares with a Passion for Service*.

The company estimates that there are 10 million potential passenger trips per year (or a projected 15% market share) that are currently not flown due to high costs that the average Canadian traveler can’t afford. That will change as *Jetlines* brings a 36% net cost reduction vs. the Canadian airline cartel operators.

Adding this ambitious new provider to the current transportation mix is truly a no-brainer.
But here's the rub: in order to get *Jetlines* off the ground, so to speak, it must raise the money needed to complete licensing and certification, roll out a marketing strategy, and build the necessary IT infrastructure.

Problem is, Canada has a relatively small number of financiers with the expertise and interest in airline investment. So, *Jetlines*must reach out and dip into the international capital pool. The money is there for the taking. However, the company can't access it without clearance from the Canadian government.
That is not a deal breaker. In fact, it could be accomplished in short order, without the passage of any new legislation.

Let me explain…

Under the *Canada Transportation Act*, foreign ownership of an airline is restricted to 25% of voting equity. While the legislation—enacted in order to keep control of Canadian companies firmly in Canadian hands—is well-intentioned, it places a serious roadblock in the path of those who must cast their fundraising net farther and wider.

The Government is aware of this dilemma.

An amendment has already been passed by the Canadian Parliament which would allow for 49% foreign ownership. That would open up the market to vast new sources of capital, while ensuring that the ultimate control of a company remains with Canadians. Unfortunately for *Jetlines*, the amendment requires a federal cabinet decision before it goes into force.

There is a reasonably good chance the change to 49% foreign ownership will be approved by the cabinet following a recommendation by the Minister of Transport. However, this necessary action may not be coming anytime soon. Transport Canada strongly prefers to go through an exhaustive consultation exercise. In addition, time would also be required to develop and roll out the requisite regulatory framework. All of this is projected to take up to 24 months.

Jetlines has already raised the funds required to get the ball rolling. It is committed to raising another C$6 million. Among other things, these funds will allow *Jetlines* to enter into agreements to acquire initial planes and to complete Transport Canada's Air Operator Certificate (AOC) process.

I am backing the Chairman of *Jetlines*, Mark Morabito, in a big way. I have personally written a large check, and plan on being a very large shareholder in what I believe will not only be a great investment, but more importantly, a service that will benefit all Canadians alike. My friends own fancy private jets. I plan on owning a lot of shares in a great ultra-low-cost carrier that serves Canadian citizens.

This, in turn, advances *Jetlines'* efforts to get licensed by the Canadian Transportation Agency (CTA) and vault the final hurdle before commercial launch. The company has already completed Stage I of the CTA's licensing procedure. In order to complete Stage II, it will need, in addition to its AOC, C$27.233 million in working capital to satisfy the financial requirements for a domestic airline license.

That amount of money is simply not available in Canada for a startup airline.

However, some very bright European investors stand ready to participate in this second round of funding, provided that the foreign ownership restriction is raised to 49%. This can happen if the amendment is soon put in place.

But, since the amendment may be delayed too long to help *Jetlines*, there are two suitable alternatives.
One would be for the Governor in Council, upon recommendation by the Minister of Transport, to pass a regulation increasing the foreign ownership limit to 49%.

The other alternative would be for the Minister to issue an exemption order, specific to *Jetlines*,

immediately lifting that ownership ceiling. The Minister has the lawful authority to do this. It would resolve the issue in the timeliest manner. *Jetlines* has lawfully applied for just such an exemption.

Granted, there may be objections raised, especially from you-know-who (the cartel), but *Jetlines* has anticipated and addressed each of them:

1) Question: What about the loss of passengers by Air Canada and WestJet?

Answer: In order to avoid this, Jetlines will focus on under- and non-served markets, and will develop its own clientele among Canadians currently priced out of flying. It will not compete with legacy airlines on the vast majority of its routes. Further, it will have to avoid service to or from Pearson International or Montreal Trudeau Airport, as their high costs would disrupt the ULCC model.

2) Question: What about Indirect Service Providers (ISPs)?

Answer: It has been argued that ISPs—which don't operate any aircraft, but rather market and sell air services—could serve Jetlines' target markets by reselling these contracted services. For example, the recently launched NewLeaf service doesn't own or operate any planes; instead, it contracts out flight services to Flair Air from Kelowna and Enerjet out of Calgary. First, that means two companies have to make a profit instead of one, which makes sustainability highly suspect in a low margin business. Second, while ISPs could benefit some specific-purpose tour operations (e.g., vacation packages), their model would not hold up if they attempted to apply it to flights to secondary markets on a scheduled basis.

3) Question: What about the pitfalls of foreign ownership?

Answer: The worry here is that significant foreign ownership may allow foreign airlines to use their interest to direct Canadian passengers into their own network system(s), as opposed to them being directed to the Air Canada or WestJet networks. This is of special concern with regard to the so-called ME3 airlines (Emirates, Etihad Airways, and Qatar Airways), which are heavily government-subsidized, enabling them to undercut competition on price. Jetlines, however, has pledged to not enter into an agreement with any international carrier to supply feed or connectivity access. Moreover, it not only will not, it cannot. The ULCC model only works when there are no code-sharing, interline or other commercial agreements for passenger feed.

Jobs: Granted an exemption order, *Jetlines* believes it can secure the requisite funding within two months and be in a position to fully launch 4-8 months after that. In its first three years of operation, the company expects to hire or create 1,000 direct new jobs and 4,000 total jobs.

Economic stimulus: By year three, when *Jetlines* expects to have 16 routes (city/pairs), the projected 750,000 added passengers in B.C. alone will generate an estimated gross new passenger economic output of C$560 million.

Local industry support: Once up and flying, *Jetlines* can, under its current business plan, purchase 24 C-Series aircraft from Quebec-based Bombardier. *Jetlines* has done a deep dive on the C-Series with Bombardier's assistance and handed over their findings to the Department of Transport. The C-Series is a winner and would fit well into the *Jetlines* model.

Jetlines could provide significant revenue ($1.9 billion) to Bombardier at a critical time and showcase Canada's flagship aircraft to domestic and international travelers. This potential contract with *Jetlines* for Bombardier would be equal to 50% of the revenue that Bombardier received from Air Canada's most recent order for 45 Bombardier C-Series jets.

This is a win-win for everyone.

This not only benefits Bombardier and its employees, but also benefits the Canadian Federal and Provincial governments, as well as the entire Canadian air transportation sector.

The benefits to adding this ULCC to Canada's airline mix are huge, while the downsides are basically non-existent.

I call on Canada's Minister of Transport to approve *Jetlines'* request for an exemption from the 25% foreign ownership rule, in order to expedite the launch of the company.

Canadian travelers deserve the service *Jetlines* can provide, and they deserve it now. They should not have to wait any longer to enjoy what travelers in other G-7 countries have been enjoying for years. The Canadian air cartel should not be allowed to gouge citizens who struggle to afford high-cost airfares.

If you agree with me, please let your voice be known and contact:

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Also, please carbon copy the following key players:

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Regards,

Marin Katusa