



WHY AIR FRANCE'S POSITIVE PROFITS ARE BAD NEWS RIGHT NOW

News / Airlines



After a year in which France was shaken by terrorist attacks and Air-France KLM executives had their shirts torn from their backs by employees protesting job cuts, the airline's first annual net profit since 2010 should be cause for celebration.

But being back in the black just makes CEO Alexandre de Juniac's mission to transform the airline's competitiveness more difficult.

De Juniac has yet to get trade union approval for his "Perform 2020" overhaul to help Air France better compete with low-cost rivals in Europe like Ryanair, as well as state-backed long-haul carriers from the Gulf.

Those talks will now take place against a backdrop of improving financial metrics: thanks to lower fuel costs, operating free cash flow (after disposals) may soar to 1 billion euros in 2016, from 606 million euros last year. That should help the airline to trim net debt, which fell more than 20 percent to 4.3 billion euros in 2015.

Labor unions will argue Air-France now doesn't need to cut costs and restructure because the

airline is doing much better. But that argument is wrong: Air-France booked 450 million euros in fuel savings last year — the chief reason why it was able to post a 118 million-euro net profit.

Air-France expects fuel costs to fall a further 27 percent, or 1.7 billion euros, in 2016. That's 400 million euros more than Commerzbank analysts had anticipated.

Because the airline hasn't locked in as big a proportion of its future fuel costs as budget carriers, it can expect a further tailwind next year — as long as oil doesn't rally too much. Air France has hedged about 25 percent of its fuel consumption for 2017, compared with Ryanair's 95 percent.

Still, the unions also need to wake up to what's happening in the market. As Gadfly noted recently, rival airlines are adding capacity in Europe. That will drive down ticket prices, and force carriers to pass on fuel savings to customers.

In addition, Air France is facing dwindling demand in Brazil and Japan (which together account for 10 percent of total capacity) as well as for routes to destinations linked to the oil and gas industry, including many in Africa.

Air-France said it was able to cling on to less than a third of its total fuel savings last year due to falling fares. And it expects that trend to continue in 2016.

Even without an agreement with workers, De Juniac has already had some success in cutting costs: they fell by 0.6 percent last year and the airline is targeting a 1 percent decline in 2016.

But Air France's operating margins remain skimpy compared with competitors: at 3.1 percent it trails Ryanair's 18 percent. And Ryanair is targeting deeper reductions in expenses, too. It wants to cut unit costs before fuel by 2 percent in the current fiscal year.

Air-France's shares jumped as much as 10 percent on Thursday — but until de Juniac convinces his bellicose workers of the need for change, that optimism risks looking misplaced.

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