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FEATURED Q&A

What Does the Avianca-Taca Merger Mean for the Airline Industry?

Q Colombian airline Avianca and El Salvador-based carrier Taca on Oct. 7 announced plans to merge, creating one of the region's largest airline groups. Under the plan, Avianca's parent company Synergy will have a two-thirds stake in the new company while Taca's shareholders will hold the remainder. What will the merger mean for the companies involved and their customers? How does it affect the rest of Latin America's airline industry? What does it say about the industry's health?

A Bob Booth, chairman of AvGroup in Miami: "The joint venture is a major step for both airlines, which will be controlled by a holding company (holdco) based in the Bahamas. The important issue is that both airlines will continue to operate their own brands and will be able to compete, head to head, not only with the largest airlines in the region (i.e., Tam, Lan, Gol/Varig) but also with the U.S. airlines which serve the region. By having a basic common fleet of NG A320 family aircraft, it will save money on maintenance and new acquisitions. It will also be able to expand its existing capacity in the region, beginning with domestic in Colombia and Peru as well as regional and long-haul flights to the United States and Europe. With annual revenues estimated at \$3 billion, the combined airlines are a major factor in Latin America, the fastest growing airline market in the world. What it means is that the two air-

lines, operating jointly, will save money, increase their presence, be able to compete more effectively and, most importantly, become very profitable in the process. They also may pursue an initial public offering, which would be a major move with significant benefits. Its impact on other airlines is similar to what happened with Lan as it became a multi-country network—and what it means is that some kind of consolidation is going to happen in the region. Finally, it is a positive sign for the health of the industry in Latin America. The markets

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Lower House of Mexico's Congress Passes Tax Increases

Mexico's Chamber of Deputies on Wednesday approved a toned-down version of a tax increase package proposed by President Felipe Calderon. The measure now heads to the Senate. See story on page 2.

File Photo: Mexican Government.

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NEWS BRIEFS

Brazilian Government May Increase Stake in Petrobras

Brazil's government may increase its stake in **Petrobras** because minority shareholders of the state-controlled oil company will most likely not completely subscribe to the company's share offer, Dow Jones reported Wednesday, citing Finance Minister Guido Mantega. The offer is part of the government's plan to provide the company with enough capital to develop offshore pre-salt oil reserves. The government and its affiliates currently hold 57.6 percent of Petrobras' voting shares. In related news, Petrobras said earlier this week it is planning a multi-tranche benchmark dollar bond issue.

Wireless Provider NII Holdings Reports Q3 Profits Up 35 Percent

Virginia-based **NII Holdings**, the company that runs the Nextel brand in Latin America, surprised markets today with third-quarter profits that rose 35 percent despite the global economic downturn. The company added 329,000 net subscribers to its network during the third quarter, bringing its subscriber base to more than 7 million, Dow Jones reported. The company's shares are up 78 percent this year.

Brazil Plans New Nuclear Power Plant by 2019

The Brazilian government plans to build a new nuclear power generation plant in the Northeast of the country, EFE news agency reported Wednesday. The president of state-owned **Eletronuclear**, Othon Luiz Pinheiro, told congress members Wednesday that the new plant would be located on the Atlantic coast between Salvador and Recife, and could become operational by 2019. No cost details were disclosed in the report.

Political News

U.S. Revokes Visas of More Members of De Facto Honduran Government

The United States government has canceled the visas of more members and supporters of the administration of de facto Honduran President Roberto Micheletti, Reuters reported Wednesday. The cancellations are part of the U.S. effort to pressure the de facto government to bring an end to the political crisis that has wracked Honduras since the June 28 coup against



Micheletti

File Photo: Honduran Government.

President Manuel Zelaya, who has been taking refuge at the Brazilian Embassy in Tegucigalpa for the past month. "This action is a reflection of the seriousness and urgency with which the U.S. government takes the need for the de facto regime to reach an agreement with President Zelaya to restore the democratic order," said State Department spokesman Charles Luoma-Overstreet. The United States previously revoked the visas of Micheletti and other members of his government. Luoma-Overstreet would not specify which Hondurans' visas were canceled in the latest round.

Economic News

Lower House of Mexico's Congress Approves Fiscal Reform Package

The lower house of Mexico's Congress on Wednesday approved a watered-down version of President Felipe Calderon's fiscal reforms. The package includes an increase in the country's value-added tax, which excludes food and medicine, to 16 percent from 15 percent. The reforms also include an increase in the income tax rate for high-earners to 30 from 28 percent. Calderon originally called for a new 2 percent sales tax on all goods and services, but that proposal was struck from the version the Chamber of Deputies passed.

The vote had been scheduled for Tuesday in the lower house, but it was pushed to the following day after opposition legislators protested the tax increases, Bloomberg News reported. Lawmakers from the Party of the Democratic

The reforms include increases in the country's value-added tax and income tax for high earners.

Revolution and the Workers' Party covered the chamber's podium with signs blasting Calderon, the legislation and the Institutional Revolutionary Party, or PRI. The PRI, which has the most members of any party in the Chamber of Deputies, had sought changes to Calderon's original proposal, including the elimination of the new 2 percent tax. The measure now faces debate in the Senate, which is expected to vote on it by Oct. 30. [Editor's note: See related Q&A in the Sept. 22 [issue](#) of the *Advisor*.]

Company News

Ecopetrol's Net Income Drops 72 Percent in Third Quarter

Net income for Colombia's state-controlled oil company **Ecopetrol** fell 72 percent on lower crude oil prices, the company said Wednesday, according to Bloomberg News. In addition, a stronger Colombian peso hurt the value of the company's investments overseas. The Bogota-based company's net income declined to 1.11 trillion pesos (\$US 578 million) from 3.91 trillion pesos in last year's third quarter. Ecopetrol's revenue fell 13 percent to 8.9 trillion pesos, in comparison with 10.2 trillion pesos a year ago. In the third quarter, the company proceeded with a \$60 million investment plan, which aims to nearly double production to 1 million barrels of crude daily by 2015. The price of crude is down approximately 45 percent since its peak of \$147 a barrel in July of last year.

Featured Q&A*Continued from page 1*

are growing and need more service throughout the region."

A **Stephen Trent, director for Latin America infrastructure, aerospace and transportation at Citi Investment Research in New York:** "While we see the proposed Avianca-Grupo Taca merger as good for the profitability of the region's commercial passenger business, we also see the possibility of more intense cargo compe-

“We see the possibility of more intense cargo competition.”

— *Stephen Trent*

tion. The merger will not have much impact on Copa. In its Tocumen airport hub, the number of Copa's competitors would shrink by one (and as neither Avianca nor Grupo Taca are Panamanian entities, the combined carrier's landing/airspace rights in Panama should remain limited). Also, the merger will probably not have much of an impact on Lan, which is consistent with our comments on Copa. On the cargo front, however, we see some possibility that the combined carrier becomes more nimble, not only through its integration of Colombia's Tampa Cargo, but also as the airline's fleet renewal plan progresses. We could see an increase in cargo flows in the 'bellies' of passenger aircraft—which could eventually put the carrier in more direct competition with Lan Cargo. On top of that, we also recognize Synergy's option to acquire VarigLog. Both Lan Airlines and Copa might actually benefit (somewhat), medium-term, as a result of the potential for a net-reduction in the region's available seat kilometers. According to the companies, the combined entity could have pro-forma revenues of close to \$3 billion, a total fleet of

more than 100 aircraft, and operations out of four hubs: Bogota, Lima, San Salvador and San Jose."

A **Francisco Alvarez-Demalde, partner at Riverwood Capital in New York:** "I believe that consolidation in the region will continue and might even accelerate in the years to come. Appropriate partnerships or acquisitions will benefit involved airlines in terms of economies of scale, complementary networks and efficiencies. Air travel penetration is still low in Latin America in comparison with developed regions, and I believe that several large players will end up growing into offering better connectivity between large and small cities in each of the countries, as well as better interregional travel alternatives. There will be growth in the medium and long haul as the macroeconomic growth continues, driven by higher demand for business travel and the growth of the middle class, as well as growth in the short-haul or regional air-

“The benefits of scale from this consolidation process will translate into better offerings and service for the passengers.”

— *Francisco Alvarez-Demalde*

lines, driven by the need for better connectivity. Larger airlines with a broader geographic presence and service offering will be able to take advantage of this trend, and offer a better and sustainable service. At the end of the day, the benefits of scale from this consolidation process will translate into better offerings and service for the passengers."

The Advisor welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.

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