Air Canada’s Renewed Partnership with Montreal

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Over the last weeks, I’ve given several speeches across the country and looking over this sea of familiar faces at the Canadian Club, it feels good to be home. But of course, this is also Air Canada’s home town, something that is sometimes overlooked. I hope to convince you today that, in fact, as many have suggested, Air Canada est de retour ici à Montréal – “et en force”.

Our headquarters are, and have always been, based here in Montreal. And in addition to being one of the largest employers in the city, employing some 7,000 people in the Montreal area alone we are the 13th largest airline in the world.

We carried over 32 million passengers last year and nearly six million flew with us to and from Montreal. We operated nearly 94,000 flights during 2009 into and out of the Montreal airport. From here we fly to more than 60 destinations in Canada, the U.S. and around the world. Today I want to talk about unique opportunities for Air Canada and Montreal. Our own way to “Own the Podium” and be a real driver of economic growth for our airport, our community and our province.

First, though, I want to update you on the Air Canada story. The last two years have been difficult for our industry as a whole. Airlines are always the first to go in and the last to come out of a recession. Especially an airline such as Air Canada, which relies heavily on business travelers and premium traffic. The International Air Transport Association estimates that last year
our industry collectively lost more than $11 billion as traffic fell 3.5 per cent. Giovanni Bisignani, the head of IATA, called 2009 the worst year ever for the industry in terms of lost traffic.

For our part, we did relatively well. Air Canada’s revenue performance compared favourably with that of our North American peers. In fact, we outperformed most carriers in terms of both yield and unit Revenue. Moreover, we managed capacity effectively. In 2009 we flew our planes with a system-wide load factor of nearly 81% on average, versus just over 75% for the industry as a whole.

But at the start of last year we encountered a series of interconnected events that threatened our very survival, which I propose to quickly recap for you.

Most of you know the global airline industry suffered a severe whiplash as fuel soared to US$147 a barrel (and at some points, jet fuel exceeded $180 a barrel) and then fell back to $40 during 2008. While Air Canada was partially hedged, the fuel spike added some $866 million in unexpected costs and severely weakened our balance sheet going into 2009. This overlapped with the onset of the very deep global recession that stubbornly persisted throughout that year.

With the economic downturn, like other legacy carriers, we suffered significant losses in 2008 that carried over into 2009. Our cash position was severely depleted, putting us in danger of slipping below the covenants of our credit card processors and other lenders. Moreover, the combination of a 40% drop in equity markets in 2008, coupled with historically low long-term
government bond rates, created, at least on paper, a massive pension fund
deficit of nearly $3 billion which would have saddled us with unmanageable
pension deficit funding payments. And layered on top of this was the expiry
of all of Air Canada’s major collective agreements last summer.

We had a firm deadline for all of this to be resolved – in one way or another
– by the end of July 2009. And I was appointed CEO at the beginning of
April – in fact on April Fool’s Day.

Just as with a Rubik’s cube we began working all sides of the problem at
once. Yet there would be no progress unless all 6 sides of the cube were
solved. Depleted liquidity. High cost structure. Supplier arrangements.
Credit card processor covenants. Expiring collective agreements.
Unmanageable pension deficit.

Early on we got lenders and credit card processors to relax their cash
requirements, albeit conditional on some permanent funding coming in.

One-by-one we reached settlements and contract extensions with our unions
on a cost neutral basis. Also conditional on each other’s arrangements and
on certain cost savings from others. Conditional too on funding and on a
pension deal from the Government. We got suppliers and partners to rework
and improve rates to be more market competitive or to extend their
contracts, so that we could show we were tackling the rest of our cost
structure. The colors of the Cube were starting to align.
Based on the progress we made with Labour, the Government of Canada ratified a joint company-union agreement to reschedule our pension deficit payments, through a change to the pension funding regulations.

Meanwhile we were also actively improving our customer offering, our services, our products and our policies. We were meaningfully re-engaging with our customers and the travel trade, as well as with our partners within Star Alliance.

With these arrangements in place, we announced – on July 29, 2009, two days before the mandatory deadline - that we had raised more than $1 billion from a diverse group that included our major shareholder, several key business partners and other lenders and stakeholders.

We had lived to fight another day – and in the process showed that Air Canada, this 72 year old former Crown Corporation, with 26,000 employees, 25,000 retirees, 7 unions and a long and remarkable history -- could be creative, could be nimble, could be flexible - when it needed to.

The earliest indication that our rebound was real and starting to be understood by the investment community came in October when we announced an equity financing of $260 million. Had someone suggested to me when I started in April that we might be in a position to raise equity by October, I would have summarily dispatched them to the World Anti-Doping Agency, ahead of the Olympic rush, for hallucinogenic drug testing.
This year, with our financial situation stabilized, we are focusing on a more fundamental transformation to sustainably rebuild for the future. I am very proud of what we achieved last year but real progress can only be measured when the transformation is permanent.

The first element is our Cost Transformation Program (CTP) aimed at achieving $500 million in annual cost and revenue improvements by 2011. We have already made significant progress toward this goal and surpassed our 2009 target by 40 per cent. Importantly, we are doing this without compromising the customer experience.

Transformation has to be about much more than cost reduction. It means technology. It means different processes. It means new products. It means innovation and creativity.

This is why we must also transform the way we engage with our customers, particularly our premium business travellers. We are doing this through industry leading products. Through new communication tools.

Through face-to-face meetings with our top tier customers that afford us the chance to both listen and improve. And through a more engaged front-line employee workforce that intends to show what we can do. I know that no one owes us a living – we are not entitled to your business – we must earn it.

Our Lie-flat suites in Business Class lead the industry. Our top of the line in-flight entertainment system of the back of each seat show films that are still in theatres. Our Maple Leaf Lounges and our Concierge Program make the
airport experience significantly more pleasant for our most frequent travelers. Our partnership with Aeroplan consistently has amongst the highest ranking of airline rewards programs worldwide, offering the most attractive tier qualification thresholds and redemption terms and benefits. We were also the first North American airline to introduce popular new IT services for customers in the form of Apple and Blackberry applications with automatic flight notification and rebooking tools.

These provide information in real-time, the way customers want to receive it. Baggage self-tagging is also growing in popularity as a self service option for customers. The underlying philosophy is that if we are easy to use, then we should be easy to choose. Moreover, we will look to further develop our customer social networking and marketing tools through proactive direct offers and communications to our regular customers, continuing to build on their trust, loyalty and engagement.

Conversely, we have admitted straight up where certain irritants were getting in the way of progress and removed them. We eliminated the call centre fee. We relaxed the Standby rules for travel on Rapidair to Ottawa and Toronto. We increased the availability of Aeroplan reward seats. We allowed small pets back in the cabin. We improved our Super Elite members’ access to revenue seats. And we reached out to the travel trade community to restore commissions on some of our lower fare categories. I fully expect our travel trade and other partners and suppliers to make money off of us -- if they can enhance our offering, contribute to our transformation and help to make us more profitable.
While this is still very much a work in progress - more like the 5000 meter speed skating relay than the individualistic 500 meter short track, I was extremely pleased late last year when the most frequent travelers in the industry, including our own customers, recognized what we have achieved. In late 2009, we won a series of prestigious awards from international magazines that are, in effect, the Academy Awards of our industry, based on extensive surveys of many different carriers.

And this, despite the enormous challenges to our very survival we faced last year.

Business Traveler Magazine, with 500,000 readers, and ten editions published globally, gave Air Canada more awards than any other carrier in the world last year: including

- the Best Flight Attendants in North America;
- the Best In-flight Services in North America;
- the Best Business Class among North American carriers;
- and that Air Canada is the Best North American Airline for International Travel.

A survey of 25,000 readers of the equally respected Global Traveler magazine found Air Canada to be the Best Airline in Canada and the Best Airline in North America.
We do not get it right 100% of the time. But these surveys suggest that we *do* get it right *most* of the time. And for that I have to thank the great work of our employees who go “above and beyond” and make the extraordinary effort during both regular and irregular operations. In the flight deck. In the cabin. In the airport. On the ramp. In the hangar. Or on the phone.

Thirdly, the transformation will require overcoming what I consider our greatest challenge: changing the culture at Air Canada. This must happen both in terms of how customers see us and how we behave as a company. This is the most important aspect of our transformation - a corporate culture provides the foundation and sets the tone for everything that you do.

Given the shackles of age and legacy, some think this transformation is not achievable. But this leopard is determined to change its spots.

With the right drivers – both in terms of people and tools - Air Canada will absolutely become a more entrepreneurial and nimble company. A big company that behaves more like a small company with simpler processes. A place where employees act as if they are owners. Empowered. Able to make decisions. A place with a “Just Do It” culture. Where things happen much more quickly without countless committees and white papers. A place where managers become leaders. Where employees are ambassadors for the Air Canada brand and everything good that it represents. An airline which customers will consistently choose over others.

The Olympics in Vancouver provided us an excellent opportunity to see if our culture change goal is indeed gaining traction. As Official Airline of the
Games and Canada’s national flag carrier, we were well aware of the very high expectations for our airline. We planned for nearly a year to accommodate the rush of customers and the teams with their outsized equipment. On March 1, the day following the Closing ceremony, always the heaviest travel day, Air Canada boarded well over half the volume of all passengers traveling through Vancouver, which was more than double the highest volumes seen in Vancouver on any given day.

This included athletes. VIPs. Heads of state and European Royalty. Media, and over 22,000 bags on 155 flights. All with near textbook perfection. All with an amazingly engaged, on-the-ball, empowered and very welcoming employee workforce, displaying with immense pride everything good about Canada and Air Canada.

Despite the enormous volumes, there were virtually no wait times. No irregular operations. No cancellations. Virtually no missed connections, no denied boardings, few misplaced bags. Air Canada at its absolute best. We received great feedback from IOC members who travel to Olympic Games worldwide, telling us that their Vancouver airport departure experience was their best ever. We are working just as hard to ensure similar success with the Paralympics now underway. And we are looking to entrench that Vancouver experience throughout our operations – in effect, to pollinate the excellence we witnessed so that it becomes contagious.

More poignantly, I witnessed first hand another example of this “just do it” spirit early last month in our Haitian relief effort which I know touched many people right here in Montreal.
Our employees swiftly volunteered to launch relief flights to Haiti. In the weeks following the disaster Air Canada delivered nearly 200 tonnes of cargo – consisting of lifesaving items such as medicine, water, IV fluid, rice and food, diapers and tents. We flew in aid workers, hospital volunteers, government personnel, police and security people. And we evacuated more than 700 people, including many orphaned children. One flight carried a three-month-old baby and a 114-year-old woman.

I personally accompanied a flight that brought back 60 children who had already been pre-approved for adoption in Canada. And frankly, I was overwhelmed. By the effort of the cargo and ramp crews. By the massive logistics of the organizers and aid groups. By the concern of Air Canada employees who raised money, bought supplies and volunteered to operate the flight or serve as caregivers for children coming to new homes in Canada.

I was humbled by the many heroes in this company and have never been prouder of our airline or our employees.

The fourth element of our transformation entails building on our position as one of the world’s leading international carriers. Canada is 36th in terms of population among the world’s countries yet Air Canada is the 13th largest airline in the world, punching well above its weight category.

We therefore plan to take advantage of Canada’s excellent geographic position, vast network underpinned by an array of bilateral authorities to fly
to other countries, and the relationships we have with other carriers, particularly those of the Star Alliance.
Perhaps some of you have seen our Olympic TV commercials that in addition to cheering our athletes on, focus on the global aspect of our business. Titled ‘Go Far”, the ads were shot on location in Argentina, China, England and Alberta. They celebrate Canadians who go far in their travels and in their lives. We looked to create the aspiration to everything Air Canada represents- we transport Canadians everywhere and bring the world to our door. We connect Canada and the World.

Our goal is to build an international powerhouse. And to ensure that Montreal rightly occupies the place that it should.

Montréal International and Caribbean Routes
Spring 2009
As one of our three Canadian hubs, Montreal is obviously a cornerstone of this strategy. And despite our system-wide capacity reductions in 2009, consistent with capacity cuts in the industry, we are still adding to Montreal. Since last year we have already added or announced new service from Montreal to Geneva, Rome, Brussels, Athens and Barcelona to strengthen our European flagship routes of London, Paris and Frankfurt.

And apart from these new European routes, we also added year-round service to Martinique and this winter new flights to Samana in the Dominican Republic and Puerto Vallarta in Mexico.
Finally, we also added Houston and Fort Myers to our Montreal-North American network. Houston will figure prominently as a connection point given our new partnership with Continental Airlines, as it moved over to join our Star Alliance from the Sky Team alliance last October.
Therefore, given that three of our four major new international destinations will be served from Montreal, I trust it is clear that we very much want to revitalize Montreal as a true North American gateway to the mutual benefit of the airport, the community and Air Canada. Our success is this community’s success.

However, we cannot do this alone and in order for us to thrive, it takes a commitment to partnership. Our industry is inter-dependant on so many players – more so than most businesses you may be familiar with -- not the
least of which are the airport authority and the business community, the City of Montreal, the Province of Quebec and the Government of Canada and its various departments.

Air Canada has a tremendous partner in Aéroport de Montreal. I’d like to commend Jim Cherry, President and Chief Executive at ADM, and his team, for the excellent work that has been done in redeveloping Montreal- Trudeau Airport in a financially responsible manner. Most recently they opened the new and expanded U.S. departures facility – I might add which looks outstanding and was delivered on budget. This will particularly help us to grow connecting traffic to and from the US through Montreal. Airports have to be extremely conscious of the impact their development has on carriers, especially the main hub carrier, who may have committed substantial sums to the success of the hub in question. And ADM well understands this.

Montrealers can be very proud of our airport -- it is becoming truly first rate. However, let’s do something more meaningful about giving it the road and transit access a city of this size, stature and potential deserves. The new shuttle service just recently announced is a good initiative. But we still have a long way to go to be within shouting distance of “competitive” on this front. Recently, when I was in Vancouver, I had the opportunity to take the amazingly comfortable Canada Line Skytrain from the airport. I was downtown in 15 minutes in a fast, clean, brand new Metro-style train.
Imagine how welcome such a development would be here -- a swift ride to and from the airport, unhindered by the perpetual repairs on the Décarie Expressway, Dorval Circle or Highway 20. I am not suggesting that such a project be funded off the backs of passengers again through an Airport Improvement Fee. A project of this size would require all levels of government to participate. The City, the Province and the Federal government have to commit to building a better hub. With the necessary infrastructure to assist this city and its airport achieve its full potential. If a case can be made for funding the Grand Prix and the consequential several days of economic benefits, an even stronger case can be made for funding rapid transit access and real infrastructure development for our airport.

Since 2004 we have increased our Montreal capacity by over 18% while our traffic was up 25%. This means more business for everybody.

But what I really want to focus on today is the opportunity for further growth in Montreal.

I say this because now that the airport has been redeveloped, it is clear Montreal is not getting its share of traffic compared to other cities. In 2008, Montreal, with a population of 3.8 million had 12.8 million passengers go through its airport.

In contrast, Atlanta with a 4.5 million population had 90.1 million passengers, Dallas-Fort Worth with a population of 4.8 million had 57.1 million passengers, and Amsterdam, population 2.3 million, had 47.4 million passengers.
Admittedly, factors such as geography and the passenger catchment area account for some of this discrepancy. But the essential fact remains—Montreal has the potential for much more traffic— and not necessarily at the expense of Toronto.

We cannot revisit history – Toronto became the country’s main air transportation hub following the political uncertainty in Quebec and the federal government’s unfortunate experiment with Mirabel Airport. That cannot be undone.
While growth for Montreal will largely hinge on the state of the economy and demand, the key driver of Montreal’s expansion as a more important hub will be through channeling connecting traffic through the airport.

Already, fully one-third of Air Canada passengers into and out of Montreal are connecting passengers, whose travels originate elsewhere. And we think we can connect a lot more traffic through Montreal between the U.S. and Europe, the Middle East and Africa.

At present, Air Canada has about 35 per cent of the Canada-Europe market and 29 per cent of the Canada-Middle East Market, which is pretty good given the number of carriers flying these routes.

But we only have five per cent of the Canada-Africa market which does present a unique opportunity for Montreal. Moreover between the U.S. and Europe, the Middle East and Africa, our share is only one or two per cent.

Given the more than 308 million people living in the U.S., by winning only a couple of extra percentage points of market share from the U.S. on these routes, we could potentially connect millions more through Canadian airports, including Montreal- Trudeau. And this is something we think we can do because of all the advantages I mentioned previously. One of the newest fleets in North America. The Lie Flat suites in Business Class. In-flight entertainment on the back of every seat. The Aeroplan program. Having been voted the Best North American Airline for International Travel. That will certainly help with business travelers who already have to connect at a U.S. hub to get to their destination.
So how do we do this?

First, we will further build on our relationships with other carriers in the Star Alliance.

Air Canada was a founding member of Star more than 10 years ago and today the alliance is the largest in the world with 26 member carriers. The alliance enables us to hand off passengers to one another, which effectively expands each member’s network while broadening travel options for our customers.

To give you an example of how this helps Montreal, late last year Brussels Airlines joined Star Alliance. At the same time we announced a new route from Montreal to our new partner’s hub in Brussels. So already we’ve added one new route.

But where we expect to get even more benefit is from the connections that Brussels Airlines will open up. It operates extensively in Africa. As I noted, we currently capture only about five per cent of traffic between Canada and Africa but now we have a convenient, one-stop connecting point in Brussels that will make Air Canada a more attractive travel option to and from destinations such as Abidjan, Dakar and Douala.

Another way we expect to drive connections is with the creation of what we call Atlantic Plus-Plus, a unique revenue-sharing agreement with Lufthansa, Continental and United. We have formed a special transatlantic joint venture
with these three Star Alliance partners in what is the largest international air transport market in the world. It enables us to sell seats on each other’s flights over the Atlantic creating a vast potential market for each of us. The objective is what we call metal neutrality.

Montreal is already starting to see gains from this. Our Montreal-Houston service with connections to Continental’s vast hub is a direct result. And we anticipate we will be able to capture more global flow through Montreal as this partnership matures.

Having these types of arrangements in place, however, does not automatically ensure traffic will grow. Montreal has to be a competitive hub because many other airports are actively and aggressively vying for our traffic, especially our connecting traffic.

This route map gives us a realistic view of the true potential for Montreal as a gateway.
Now I need to be clear that we are not ready to launch service to these destinations. With the exception of Lyons and Nice, we don’t even have the bilateral rights yet to start service. But we do know there exists a market for non-stop service to these destinations that would be best served from Montreal rather than Toronto or elsewhere. At the top of the list is Lebanon given that Montreal has the largest Lebanese Canadian community in the country and Ottawa, nearby, is not far behind. For this reason, Air Canada and ADM both strongly support an air services agreement with Lebanon.
We are and have always been very supportive of the liberalization of the skies and we have always held our own. But in any trade agreement there must be mutual benefits to both countries for the liberalization to work. Some of you are probably aware of the recent controversy involving Emirates Airlines. Air Canada and many in the aviation industry, including many secondary hub airports, do not support an expanded bilateral agreement with the UAE at this time.
The reason is simple. There is already more than enough capacity to carry all the people who want to travel in either direction between Canada and the UAE.

Emirates’ real aim is to dump its excess capacity resulting from too many wide-body aircraft commitments, including A-380s, into the Canadian market, just as it has elsewhere in the world. As a state-owned carrier with access to virtually unlimited capital, it would siphon passengers from other carriers who are making connections en route and connect them through its Dubai hub instead. As airlines flying internationally from Canada rely on connecting passengers to fill their flights, the loss of these passengers would lead to reduced service and eventually to the elimination of some direct service to European destinations from secondary hubs. This would ultimately mean fewer choices for travellers, not more as Emirates argues.

The growth of airports such as Montreal, that rely heavily on connecting traffic would be stunted. Rather than hubs, they would shrink to stubs at the end of a spoke leading only to Dubai. Instead of “Owning the Podium”, in this case, the hub podium, Canada would be cheerfully surrendering it.
The other reason I have been particularly exorcised over the Emirates tactics is that the UAE has tried to link the Open Skies debate to Canada’s continued access to the Camp Mirage military base in the UAE that is used for our country’s operations in Afghanistan. How’s that for no state involvement in their affairs?

As you can see from the route map on the screen, the real opportunity for Montreal is indeed through connecting traffic. Of course, once we get this traffic we must insure that Montreal is a convenient hub to connect through. We have taken the first steps with the new U.S. transborder facility and the upgraded baggage system. Next we will need the road and train link infrastructure as mentioned.

But processes too must be improved, notably in the area of security, check-in and customer flow. For Montreal to win as a hub of choice for a passenger merely connecting -- it must be easy, clear, crisp and efficient to get through the airport.

To this end, we welcome the recent federal government announcement that it intends to undertake a full review of security processes, which often account for most airport bottlenecks.

Another impediment to Montreal’s competitiveness as a hub is direct and indirect taxes. At present, Canadian airlines are severely disadvantaged in
this area due to the government fees and charges that are added onto tickets. There is GST, QST and other provincial taxes. The recently hiked security surcharge. Federal and often provincial fuel excise taxes. Airport improvement fees and navigation charges, etc, etc

The most outrageous of them all is federal airport rent, collected by airports on behalf of the Government -- something no other industrialized country collects. Although Canada privatized its airports in 1992, Ottawa continues to collect more than $300 million annually in rent for these facilities. This year, ADM’s ground rent is going up by 70 percent from $21.5M in 2009 to $36.7M. This is outrageous.
Some may think that collecting this rent may help solve the federal deficit but instead, it chokes economic development and is an anti-stimulus measure. And the feds are not the only level of government that look at aviation as a cash cow. In Montreal, payments in lieu of taxes or PILT to the municipality are the largest of any airport in Canada. In 2010 ADM’s PILT will increase by almost 20 percent to $42.5M from $36M in 2009. Consequently, carriers landing at Canadian airports and their passengers face higher costs. Air Canada pays about $1,000 more on average (or double its US peers) to land a 146-seat Airbus A320 in Montreal than what it costs at major U.S. airports. And the effect is amplified by the fact we land here more than any other airline. These costs are passed on to passengers in the form of higher ticket prices, putting us at a disadvantage to other carriers, particularly those flying out of nearby border airports in the U.S. The imbalance is significant and over time, this will be one of the main drivers determining which cities we will help develop as meaningful hubs and where we invest our scarce resources.

We need broader support for fairer, more rational treatment for the air transport system. That is the only way for the aviation industry to deliver on its true potential for your community and indeed the country.

We are working with airports to address these cost imbalances and in some cases have partnered with the airport and the community it serves to launch new services. The newly launched Calgary-Tokyo service is a great example of what can happen when airports and government cooperate with us. Calgary, backed by the province of Alberta wanted a non-stop service to Asia now. Starting up a new non-stop route between Alberta and Asia in this
fragile economy represents a big risk for us. We could not and made it clear we would not start up the route **without** tangible support to develop the new service. The Province and the Airport Authority stepped up to the plate and convinced us it was a risk worth taking. The first flight starts at the end of the month.

This case illustrates that Alberta and Calgary understand that our industry is a major catalyst for economic growth.

Air Canada currently spends a total of more than $1.5 billion annually in Quebec, including $600 million in payroll-related expenses in Montreal. Our contribution to the Quebec economy amounts to approximately $5 billion in incremental economic activity in the province. So we are an extremely important economic driver for Quebec.

Air transportation facilitates business and social transactions and increases economic activity and opportunity. Clearly, it contributes to the economic growth of the greater Montreal area and all of Quebec. As globalization continues to take hold, the competitiveness of industry increasingly relies on airports and the aviation infrastructure. With rising passenger and cargo traffic and infrastructure improvements at airports globally, the importance of airports as economic catalysts will only increase in the future. Montreal should not be left behind.

So, to conclude. Despite the enormity of the challenges, we got through last year. We extended our collective agreements. We rescheduled our pension deficit payments. We raised nearly $1.4 billion of capital. We were awarded
the Best Airline in North America. We played a key role in making the logistics and operations of the Vancouver Games a success. We have a young fleet and an industry-leading product. Our growth in Montreal has been steady even through the economic downturn including new international routes to Geneva, Brussels, Athens and Barcelona.

Provided we have the support and interest of this community and the various levels of government we will do our part to further build and develop a vibrant Atlantic hub here in Montreal, connecting passengers throughout Air Canada’s global network.

Montreal can absolutely become a major North American gateway capturing global flow by connecting North America with Europe, Africa and other parts of La Francophonie. This represents true economic opportunity for our airport, our community, our province and our country.

It has been a pleasure to speak with you this afternoon. I personally look forward to sharing many more years of success with the Montreal and Quebec business community – and finding ways to build on each other’s strengths.

Thank you