

T2RL'S First View is our rapid analysis of breaking news. It helps provide perspective, putting the facts in the context of our wider and deeper knowledge of the market.

LAN / TAM Merger Will Dominate its Region

T2R Staff

The Facts

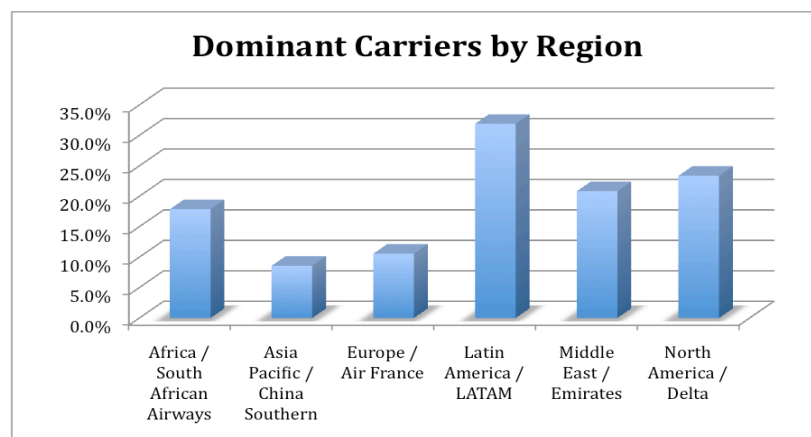
TAM and LAN, the largest and third-largest carriers in Latin America (measured by passengers boarded) have announced that they are to merge. They expect formalities to be completed during 2011 and that the combination will produce \$400 million of "real and achievable synergies". The merger will follow the example of recent European transactions such as Air France / KLM and British Airways / Iberia with each airline maintaining its own brand and operations for the foreseeable future.

The Analysis

In 2009 LAN and TAM boarded 57 million passengers between them with TAM accounting for 31 million and LAN 26 million. TAM had higher revenues, both in aggregate and per passenger boarded, and was significantly more profitable. In 2010 to date however TAM has fallen into losses while LAN continues to make significant profits. On any terms these are both very successful airlines within their region.

One of the recurring themes in the airline business of recent years is a strong move towards consolidation, including cross-border mergers of the type that would have been difficult if not impossible until recent years. Mergers have led to the creation of mega groupings of airlines in Europe and North America but none of these has achieved the same dominance of its regional market as the new LAN/TAM grouping, which is to be known as LATAM.

The following chart shows the airlines with the largest number of passengers boarded in each of the major regions of the world and the proportion of that region's passengers that they carry.



Even allowing for the fact that Delta should soon be overtaken by United as the biggest carrier in North America it is clear that with almost a third of all Latin American passengers, LATAM will have the highest degree of regional domination of any airline in the world.

All of which makes the new airline group a major prize for the global alliances and for suppliers of all kinds of service. Currently TAM and LAN belong to competing alliances and buy their commercial IT systems from competing suppliers.

LAN is in the process of migrating from Amadeus's reservations system, which it uses alongside Iberia's Inventory and DCS, to a comprehensive service from Sabre. TAM migrated from Sabre to Amadeus at the beginning of this year. The scene is set for a major confrontation between the two market-leading PSS suppliers with the prize being dominance of the market in South America for a decade at least.

On the alliance front LAN is a long-standing member of oneworld while TAM joined Star Alliance just this year. The merger announcement indicated that no decision has yet been taken on alliance strategy but it is inevitable that the combined airline will eventually come down in one camp or the other.

The Speculation

The new parent company will be headed by Enrique Cueto, currently CEO of LAN. This might give an indication that LAN thinking will take the lead as the new entity evolves. Certainly LAN's membership of oneworld since 1999 should have allowed it to derive more significant alliance benefits than TAM has been able to achieve in its few months in Star. The loss of TAM would be a blow to the Star Alliance since it has already been through the cycle of losing its Latin American representative with the demise of Varig. There are few potential replacements available. Despite some recent additions to its business model Gol is still predominantly a point to point domestic carrier in Brazil and the only other medium-large airlines in South America are Avianca and Aerolineas Argentinas, neither of which would offer the same sort of network coverage as LAN and TAM.

On the PSS front it may be possible for the two airlines to maintain separate systems for at least a couple of years but eventually they will want to consolidate. If LAN management remains in the ascendency then it is likely that Sabre will win that particular race.