

Financial Aid for Canadian Airlines- A Strategic Approach

December 28, 2020

The coronavirus pandemic has caused aviation demand to take more than a forty year backslide and, as a result, airlines are incurring record losses. Governments have stepped up with broad based short-term business assistance but the airline industry, in particular, is still struggling and asking for more aid to be directed specifically to the airline sector.

In Canada, airlines were not subsidized at all forty years ago, (setting aside the fact that Air Canada was government owned), so why do we need so much help now? The answer is that airlines have responded to the huge growth in travel demand during recent years by acquiring new aircraft, starting new routes, and entrepreneurs, eager to respond to new demand, have started new airlines. This growth in capacity simply cannot be unwound overnight, nor should it be unwound completely because, as a nation, we need to keep our domestic communities connected and we need to keep Canada connected with the rest of the world.

The airline industry has been critical of government(s) for not providing more aid. Canadian carriers who operate internationally have observed that they are operating at a disadvantage to foreign carriers, many of whom are heavily subsidized by their governments and/or operate at a lower cost structures resulting from lower fees and taxes in their countries. Domestically, while there seems to be general acknowledgement that it is in the public interest to ensure that air service to remote and other regional communities is assured, as an industry, we have not been effective in reaching out to government with a unified voice and with a plan to see our way through the pandemic without placing a massive financial burden on taxpayers.

Air North, Yukon's Airline is a small northern airline and while we are most thankful for the financial aid provided to date, we know that we are going to need to operate on a much smaller scale for perhaps years rather than months and we recognize that taxpayers have only a limited ability to fund airline losses. We believe that the burden on taxpayers of providing financial aid to airlines could be minimized and the benefit of financial aid could be enhanced by directing aid to where it is most needed and by structuring aid packages so they assist airlines to operate sustainably on a smaller scale. The logic behind this is simply that current data shows that much of the aid dollars to date have effectively funded excess capacity or empty seats with the result being that the aid has been somewhat ineffective in stemming record industry losses. With excess capacity approaching 50%, it is not reasonable to expect taxpayers to pay airlines to burn jet fuel and wear out airplanes flying empty seats around. It would be far more productive to use subsidy efforts to help all airlines undergo a very necessary temporary contraction so as to ensure that they can operate sustainably with reduced traffic and flying volumes while maintaining essential services and affordable pricing.

To illustrate, in our operation we incurred a pre-subsidy loss in Q2 and Q3 2020 of \$8.6 million on \$21.1 million pre-subsidy revenue and we flew with a 38% load factor (see Supplementary Data). This compares with a \$7.3 million profit on \$51 million revenue and a 68% load factor during the same period last year. We received \$6.6 million in Canada Emergency Wage Subsidy (CEWS) and Northern Essential Air Services (NEAS) subsidy in Q2 and Q3, but the cost of flying at a reduced load factor was \$3.2 million, or almost 50% of the subsidy received. The illustration is even more glaring using Air Canada's published results which showed a \$2.8 billion pre-subsidy loss on \$1.3 billion revenue with a

40% load factor and \$492 million in CEWS relief. We estimate that their cost of excess capacity was \$379 million or 77% of subsidy received.

One might expect that, as a northern carrier providing essential services to northern communities, Air North might be looking for, proportionally, a bigger piece of the “subsidy pie”. In fact, the opposite is true. Because the communities that we fly to rely so heavily on our service, we are able to rely on a “demand floor” that is higher than that in other markets. To illustrate, in Q2 and Q3, our year over year traffic was down by 82%, which is huge, but much less than Air Canada’s traffic, which was down 94%. This translated into a pre-subsidy loss/revenue ratio of 41% for us, which compares with a loss/revenue ratio of 218% for Air Canada. This data suggests that there may be a need for different financial relief strategies in northern domestic, southern domestic, and international markets.

Northern markets are already receiving more focus through the Northern Essential Air Services Program but, going forward, our analysis indicates that, at least in the Yukon market, subsidy dollars could be replaced by conditions associated with airline aid in order to ensure a better outcome for all air carriers as well as for taxpayers. Our ability to maintain essential services in the Yukon market is heavily dependant on the viability of our southern gateway routes, which typically pay for about 85% of our overhead costs. In a healthy economy, competing with mainline air carriers has been a manageable challenge for us, but in a pandemic, it has taken subsidy dollars to help level the playing field. Going forward we feel that policy is a better approach so we have proposed that two conditions be attached to airline financial relief, those being mandatory interline agreements between scheduled air carriers, and a temporary capacity cap on mainline carrier access to northern gateway routes.

The payback for replacing dollars with policy is significant. Our illustrative estimates show (see Supplementary Data) that, by addressing overcapacity either through cooperative agreement or through a leveraged capacity cap, competing air carriers could improve their financial performance by as much as 120% with no impact on taxpayers.

Interline agreements are important because they are nation building. Air service links our nation together and it should be in our national interest to ensure that people and goods can move between any two communities seamlessly. Currently there are 23 independent air carriers in Canada providing service to 189 communities. Only 57 of these communities are served by Air Canada or WestJet, 131 have a population of less than 10,000 and only 49 are served by more than one airline. Of the 313 domestic scheduled air routes in Canada, only 45 are served by more than one air carrier. Of these, 14 are routes where only Air Canada and WestJet compete, 17 are routes where Air Canada and/or WestJet compete with one or all of Flair, Air Transat, and Sunwing, 9 are routes where a regional carrier competes with one or both mainline carriers, and 5 are routes where 2 regional carriers compete. The 9 routes where a regional carrier competes with a mainline carrier include the northern gateway routes between Whitehorse and Vancouver and between Edmonton and Yellowknife.

An interline agreement is a common form of alliance through which airlines work together to achieve mutually beneficial commercial outcomes. Not only can interlines mutually benefit the airlines, but there are some critical benefits to the traveling public as well. These include:

- i) The ability to book flights combining multiple carriers in a single step and on a single ticket;
- ii) The ability to check-in seamlessly for connecting flights;
- iii) The ability for bags to transfer to end destination;

- iv) In the event of a disruption, consumer protection on the connecting flight to a similar standard as if the entire journey was with a single airline.

There are varying degrees of interline agreements, and there are more involved alliances like Capacity Purchase Agreements (CPAs), code shares, and joint ventures (JVs). For example, Air Canada has a prominent CPA with Jazz, Air North has a Code Share with Canadian North, and WestJet attempted to form a JV with Delta; however, this was most recently rejected by the U.S. regulators.

The commercial benefit from an alliance generally stems from allowing each airline to add new destinations or new frequencies on exiting routes to its network, providing the ability to effectively sell more flights without having to incur more flying costs. Depending on the nature of the alliance, airlines can agree to pricing discounts that further create opportunities to stimulate price-sensitive travel demand.

As an illustrative example, a commercial interline between Air North and WestJet, would provide some obvious synergies:

- i) Both airlines could sell Dawson City-Toronto, a route which currently shows up as though no flights exist on most online booking channels;
- ii) WestJet could add Whitehorse-Vancouver to its network without actually flying the route(s);
- iii) WestJet could offer year-round Yukon service without expanding its seasonal summer service which is currently limited to about 16 weeks;
- iv) Air North could add Whitehorse-Toronto (as well as other Yukon to out of Yukon city pairs) to its network without actually flying the route(s);
- v) Both parties could sell more flights and offer more frequencies and connecting opportunities.

Another illustrative example would be a commercial interline between Air North and Air Canada (see Supplementary Data). The illustrative example shows how, in a pandemic influenced competitive market where two air carriers are flying with sub-optimal loads, there would be significant mutual benefit if one carrier reduced capacity and continued to sell at positive margins by purchasing capacity at reduced rates from the other carrier. In the Yukon market, both carriers, the public, and taxpayers could benefit if Air Canada reduced capacity on the Vancouver-Whitehorse route and instead sold sectors on Air North flights and if Air North reduced capacity to secondary gateways like Kelowna, Victoria, Edmonton, Calgary, and Ottawa, and instead sold sectors on Air Canada flights. Each carrier would provide discounted pricing to the other so that overhead margins could be preserved without impacting consumer pricing. Subsidy dollars could be reallocated rather than increased so as to provide benefits to both carriers without driving up prices and without impacting taxpayers. There is true potential for a win-win-win-win scenario which could be induced by negotiated or leveraged market intervention. We estimate that in the current pandemic-influenced Yukon market, capacity rationalization could provide a net gain to each air carrier of close to \$300,000 per month and a net gain of close to \$500,000 per month in a post-pandemic market. Gains of this magnitude are well worth pursuing not only in a pandemic, but at any time in any small market.

While the national airlines may have their own business views on the benefits to them of interlines, the benefits to consumers are indisputable. The consumer protection aspects alone of mandatory interline agreements would raise the bar for the standard of care for air travel in Canada.

It is significant to note that Air Canada lists 105 interline and/or code share partners on their website but only 4 of these partners are Canadian domestic carriers. Similarly, WestJet lists 48 interline and/or code share partners on their website but only 3 of these are Canadian domestic airlines.

The foregoing illustrates that the national airlines in Canada have undertaken to partner with airlines all over the world in order to better connect Canada with other countries, but it would appear that they could do a better job of facilitating community connectivity within Canada. Both Air Canada and WestJet serve larger regional markets through their affiliates or subsidiaries. Air Canada has a CPA with Jazz and also a minority equity interest. Encore is a wholly-owned subsidiary of WestJet. This leaves most of the smallest regional communities and almost all of the remote communities without meaningful access to the national and international air travel network. While the national carriers do list some domestic airlines as partners, these partnerships appear to be extremely narrow in scope and effectively leave many smaller communities disconnected from many of the larger communities in southern Canada simply because many regional airlines are not able to offer competitive connectivity to the national network.

Our research indicates that the few domestic “arms-length” mainline/regional partnerships in the market today are narrow in scope and favour the mainline carrier. For example, Yellowknife-Edmonton is a prime gateway route for Canadian North, but neither Air Canada nor WestJet appear to offer Canadian North flights on this route on any of their booking channels. Canadian North on the other hand does sell connecting flights that combine this route with routes like Edmonton-Toronto, but the pricing is significantly higher than what the national airlines offer when the flight is wholly on their aircraft, so these routes appear to be token. Also, there is a loyalty component with Aeroplan, but the points that can be accumulated favor flying with Air Canada. The only Canadian North route that appears to be offered by the national airlines is Ottawa-Iqaluit, where Canadian North is the only airline operating. While this partnership likely provides some benefit in terms of consumer protection and baggage transfer, it appears to be structured in such a way that consumer choice and access to competitive pricing is not an effective component.

There is both a commercial and a technical component involved in an airline partnership. The commercial component is to agree to the commercial terms and then enter standardized agreements which could be accomplished very quickly, unless there is complex network analysis involved, which would be the case only if the parties wish to unlock detailed strategic synergies. The technical side depends on the IT systems of each company and can involve relatively simple integrations that take a few months or more complex integrations that could take up to 2 years. In our case we have invested millions in the hope of entering alliances with 1 or both of the national airlines, and we are confident that we can implement in a timely manner. Some of the smallest airlines may have difficulty meeting the IT requirements based on their IT systems. The national airlines use large mainstream systems, so the onus is on smaller partners to either invest in these high-cost systems or prove that more affordable systems can integrate or can be made to integrate.

With respect to a mainline capacity cap on gateway routes, it should be noted that mainline carriers do only part of the job in terms of northern Canada. They fly into and out of the north but they do not fly to any regional communities in the north, nor do they transport cargo, employ northerners, facilitate Indigenous investment, or otherwise make a significant contribution to the northern economy or to the social well-being of those who live in Canada’s north. In fact, mainline air carriers represent “leakage”

from the northern economy. The opposite is true for regionally based carriers. We provide a complete suite of services and products from our northern hub in Whitehorse to southern gateway cities as well as to northern regional communities. We are 100% owned by northerners, with approximately one in fifteen Yukoners holding an equity stake, including the Vuntut Gwitchin First Nation, who hold a 49% interest. Our gateway routes typically provide about 85% of our overhead contributions and thus help us to maintain optimal service levels and pricing to our regional communities.

The notion of limiting competition warrants further discussion. Firstly, it should be noted that limiting competition was the norm when air travel demand was low in Canada. The Canadian airline industry was not deregulated until 1987 and the north was not deregulated until 1996. In 1977 when Air North was founded, had we wanted to start a jet service between Whitehorse and Vancouver, we would have been required to make application to the Canadian Transport Committee to demonstrate “public convenience and necessity.” Our application would likely have been denied because, at that time, the market was only producing about 300 passengers per day, which was enough to support Canadian Pacific’s two daily “milk run” flights, one of which stopped in Fort St. John, Fort Nelson, and Watson Lake on the way to Whitehorse. November 2020 produced only 208 daily passengers, and with our recent border lock-down with BC, December is producing only 104 daily passengers to date, yet there are three daily non-stop flights to Vancouver in the market.

The US provides subsidy for thin airline routes through its Essential Air Services Program but only one carrier is subsidized on any route. In Canada we are currently subsidizing competing carriers on several routes and in the Yukon, taxpayers are effectively subsidizing three air carriers to fly the same route.

Competition is important, but it is only one factor in keeping fares low. Airline costs are a much larger influencer of price and, in that respect, the numbers don’t lie. The cost of flying a passenger on a 40% full flight is exactly double the cost of flying a passenger on an 80% full flight (see Supplementary Data) so it is much more important to get capacity right.

The preceding discussion along with the following supporting data provides clear evidence that:

- i) The airline industry in Canada is in serious trouble, and while financial relief provided to date is appreciated, its impact has not reduced losses to sustainable levels;
- ii) Market intervention would provide a means to reallocate subsidy dollars to the markets or routes where they are needed most and would also help air carriers to operate sustainably at reduced traffic and flying volumes;
- iii) A temporary mainline capacity cap on gateway routes should provide some immediate relief to market overcapacity and should ensure that subsidy dollars are used efficiently. Mandatory interline agreements will serve to level the playing field between small regional carriers and large national carriers, thus benefiting both consumers and airlines, reducing the requirement for subsidy and making capacity restrictions no longer necessary.

**Joseph Sparling, President,
Air North, Yukon’s Airline**

Supplementary Data

Year over Year Peer Financial Overview Q2 & Q3

Air Canada Q2-Q3 Results (\$millions)				Air North Q2-Q3 Results (\$millions)				Chorus Aviation Q2-Q3 Results (\$millions)			
	2020	2019	Yr/Yr %		2020	2019	Yr/Yr %		2020	2019	Yr/Yr %
Revenue	\$ 1,284	\$ 10,268	-87%	Revenue	\$ 21.1	\$ 51.0	-59%	Revenue	\$ 381	\$ 684	-44%
Expenses				Expenses				Expenses			
Fuel	\$ 299	\$ 2,337	-87%	Fuel	\$ 2.2	\$ 10.6	-79%	Fuel	\$ -	\$ -	0%
Payroll	\$ 939	\$ 1,569	-40%	Payroll	\$ 7.4	\$ 11.7	-37%	Payroll	\$ 107	\$ 230	-53%
Maintenance	\$ 226	\$ 509	-56%	Maintenance	\$ 5.9	\$ 4.4	34%	Maintenance	\$ 30	\$ 102	-70%
Airport & Nav	\$ 210	\$ 532	-61%	Airport & Nav	\$ 1.2	\$ 3.8	-70%	Airport & Nav	\$ 20	\$ 97	-79%
Pax Meals & supplies	\$ 49	\$ 237	-79%	Pax Meals & supplies	\$ 0.1	\$ 0.8	-81%	Pax Meals & supplies	\$ -	\$ -	0%
Sales Costs	\$ 45	\$ 669	-93%	Sales Costs	\$ 0.3	\$ 1.2	-74%	Sales Costs	\$ -	\$ -	0%
Leases & Rent	\$ 370	\$ 976	-62%	Leases & Rent	\$ -	\$ -	0%	Leases & Rent	\$ -	\$ -	0%
Interest & Fin Cost	\$ 278	\$ 166	67%	Interest & Fin Cost	\$ 0.2	\$ 0.3	-26%	Interest & Fin Cost	\$ 50	\$ 36	38%
Foreign Exchange	-\$ 330	-\$ 144	-129%	Foreign Exchange	\$ 0.0	\$ (0)	-235%	Foreign Exchange	-\$ 33	-\$ 4	-646%
Loss on Asset Disp	\$ -	\$ -	0%	Loss on Asset Disp	\$ -	\$ -	0%	Loss on Asset Disp	\$ 1	-\$ 1	202%
Depreciation	\$ 910	\$ 1,010	-10%	Depreciation	\$ 1.9	\$ 3.0	-37%	Depreciation	\$ 99	\$ 68	46%
Other Expenses	\$ 590	\$ 1,089	-46%	Other Expenses	\$ 3.7	\$ 7.9	-52%	Other Expenses	\$ 55	\$ 79	-30%
Total Expenses	\$ 3,586	\$ 8,950	-60%	Total Expenses	\$ 23.1	\$ 43.7	-47%	Total Expenses	\$ 329	\$ 606	-46%
Income before Tax	\$ (2,302)	\$ 1,318	-275%	Income before Tax	\$ (2.0)	\$ 7.3	-128%	Income before Tax	\$ 52	\$ 78	-33%
Income/Rev	-179%	13%		Income/Rev	-10%	14%		Income/Rev	14%	11%	
Subsidy Received	\$ 492	\$ -		Subsidy Received	\$ 6.6	\$ -		Subsidy Received	\$ 97	\$ -	
Pre-subsidy income	\$ (2,794)	\$ 1,318	-312%	Pre-subsidy income	\$ (8.6)	\$ 7.3	-217%	Pre-subsidy income	\$ (45)	\$ 78	
Pre-subsidy Inc/Rev	-218%	13%		Pre-subsidy Inc/Rev	-41%	14%		Pre-subsidy Inc/Rev	-12%	11%	
Overhead/Rev %	142%	30%		Overhead/Rev %	28%	22%		Overhead/Rev %	45%	26%	
ASM's (millions)	8,192	60,367	-86%	ASM's (millions)	65.5	206.0	-68%	Block Hours	27,223	173,478	-84%
RPM's (millions)	3,300	51,417	-94%	RPM's (millions)	24.9	140.6	-82%	Billable Block Hrs	64,381	175,294	
Load Factor %	40%	85%		Load Factor %	38%	68%		Air Canada Rev est	\$ 283	\$ 566	
Excess cap cost (75%)	\$ 379			Excess capacity cost (75%)	\$ 3.2	\$ 1.8					
Excess cap/subsidy	77%			Excess cap/subsidy	49%						

There are currently three air carriers relevant to the Yukon scheduled service market and they are, Air North, Yukon's Airline, Air Canada, and Chorus Aviation (Jazz), who provide capacity to Air Canada. WestJet provides a seasonal service and are not in the market now. The foregoing data provides a summary of published Q2 and Q3 financial and operating results for all three carriers. Notable observations include:

- i) Air Canada's post-subsidy loss was \$2.3 billion or 179% of revenue. Their pre-subsidy loss was \$2.8 billion or 218% of revenue. They received \$492 million in CEWS subsidy while operating with a load factor of 40%. Their excess capacity cost (75% load factor baseline) is estimated at \$379 million or 77% of subsidy;
- ii) Air North's post-subsidy loss was \$2.0 million or 10% of revenue. Our pre-subsidy loss was \$8.6 million or 41% of revenue. We received \$6.6 million in CEWS and NEAS subsidy while operating with a load factor of 38%. Our excess capacity cost (75% baseline) is estimated at \$3.2 million or 49% of subsidy;
- iii) Chorus showed a \$52 million post-subsidy profit or 14% of revenue. They had a pre-subsidy loss of \$45 million or 12% of revenue. They received \$97 million in CEWS subsidy. Jazz gets paid when they fly so it appears that their biggest issue is reduced flying, which makes it difficult for them to meet overhead expenses. The large gap between billable block hours

and flown block hours was likely a major contributor to the Jazz profit and the Air Canada loss.

The foregoing numbers really speak for themselves. The data provides confirmation of the magnitude of airline industry losses in Canada as a result of the coronavirus pandemic. The data also shows how some air carriers have been impacted more than others and this might suggest that some consideration should be given to a sub-sector specific financial relief strategy which could address the specific needs of northern regional carriers, southern regional carriers, and international carriers. Perhaps most importantly, the data clearly shows that much of the relief dollars to date have effectively funded excess market capacity and this suggests that the requirement for further relief dollars will be reduced and the burden on taxpayers minimized if the government can provide financial relief with associated conditions designed to address market overcapacity.

Capacity Rationalization Illustration- Cooperative or Leveraged

The following data provides a very simplified illustration of the impact of overcapacity and subsidy in a small COVID-19 impacted market. While the data in the illustration is purely hypothetical it is also quite relevant to current dynamics in the Yukon gateway air market.

Daily Capacity Rationalization Illustration- Cooperative or Leveraged			
Pre-Covid Revenue	\$ 70,000	\$ 70,000	\$ 140,000
Current Pandemic Impacted Operations	Carrier #1	Carrier #2	Market Total
# Flights	1	1	2
# Seats	240	240	480
# Passengers	96	96	192
Average Airfare	\$ 200	\$ 200	\$ 200
Flight Revenue	\$ 19,200	\$ 19,200	\$ 38,400
Flight Direct Costs	\$ 18,000	\$ 18,000	\$ 36,000
Flight Margin	\$ 1,200	\$ 1,200	\$ 2,400
Daily Overhead	\$ 20,000	\$ 20,000	\$ 40,000
Pre-Subsidy Net Margin	\$ (18,800)	\$ (18,800)	\$ (37,600)
Subsidy	\$ 11,280	\$ 11,280	\$ 22,560
Post Subsidy Net Margin	\$ (7,520)	\$ (7,520)	\$ (15,040)
Load Factor	40%	40%	40%
Average Direct Cost/pax	\$ 188	\$ 188	\$ 188
Delta Revenue %- Covid impact	-73%	-73%	-73%
Income/Revenue %- pre-subsidy	-98%	-98%	-98%
Income/Revenue %- post-subsidy	-39%	-39%	-39%
Excess Capacity Cost	\$ 9,000	\$ 9,000	\$ 18,000
Excess Capacity/Subsidy %	80%	80%	80%

Financial and operating highlights from the foregoing data include:

- i) Covid-19 has triggered a 73% year over year decline in traffic and revenue and this has resulted in a pre-subsidy loss/revenue ratio of 98%;
- ii) The two carriers are competing for 192 daily passengers and with 480 daily seats in the market, and each carrier is achieving a 40% load factor which is barely sufficient to cover direct operating costs (DOC's). To put this into perspective, the Yukon gateway market is currently producing only about 120 passengers/day. This is clearly not enough to support two, and sometimes three daily flights;
- iii) Direct operating cost (DOC) per passenger is \$188 and poor financial performance creates pressure to increase airfares above the current average of \$200;
- iv) Reduced flying and reduced margins on the flying done makes it pretty much impossible to meet overhead expenses;
- v) The subsidy provided is a big help and improves the loss to revenue ratio from 98% to 39%. Despite the improvement, few airlines could withstand 39% loss to revenue ratio for long;
- vi) Overcapacity cost is estimated at \$9,000 for each carrier, representing 80% of the subsidy received.

The foregoing circumstances are likely illustrative of current dynamics in many Canadian domestic airline markets. Operating results like this are not sustainable and so leave the government with three possible choices:

- i) Do nothing and let the chips fall where they may. Risks associated with this strategy would include the possibility of financial failure of one or several airlines, significant price increases and/or loss of service to communities;
- ii) Increase the amount of financial aid. This would be an effective strategy if the government was prepared to spend significantly more money to help airlines. With all of the other Canadian businesses and individuals looking for help, this strategy would be pretty hard on taxpayers;
- iii) Take steps to ensure that subsidy dollars are utilized more efficiently by ensuring that they are directed to where they are needed most and that they are not used to pay for excess market capacity.

With respect to alternative (iii) above, in our view, the two best options for the government to encourage capacity rationalization are:

- i) To encourage carriers to resolve market capacity issues themselves by making interline agreements mandatory and by temporarily relaxing anti-competitive restrictions in order to allow air carriers to have the type of discussions that need to take place in order to address market overcapacity;
- ii) To temporarily exercise control over market access in order to reduce route overlap. For all intents and purposes, this would amount to a temporary reversion to the regulatory environment that was in place in Canada until 1987, in the case of southern Canada, and until 1996 in the case of northern Canada.

The following data provides an illustration of how the market dynamics in the previous illustration might be cooperatively improved through a carefully structured interline agreement between the carriers.

Cooperative Capacity Rationalization	Carrier #1	Carrier #2	Market Total
# Flights	1	0	1
# Seats	240	0	240
# Passengers	192	96	192
Average Airfare	\$ 175	\$ 200	\$ 275
Flight Revenue	\$ 33,600	\$ 19,200	\$ 52,800
Flight Direct Costs	\$ 18,000	\$ 14,400	\$ 32,400
Flight Margin	\$ 15,600	\$ 4,800	\$ 20,400
Daily Overhead	\$ 20,000	\$ 20,000	\$ 40,000
Pre-Subsidy Net Margin	\$ (4,400)	\$ (15,200)	\$ (19,600)
Load Factor	80%	0%	80%
Average Direct Cost/pax	\$ 94	\$ 94	\$ 113
Delta Revenue %	-52%	-73%	-62%
Reallocate Subsidy- Carrier Benefit	\$ 5,880	\$ 16,680	\$ 22,560
Post Subsidy Net Margin	\$ 1,480	\$ 1,480	\$ 2,960
Delta Carrier Net Margin \$	\$ 9,000	\$ 9,000	\$ 18,000
Delta Carrier Net Margin %	120%	120%	120%
Delta Carrier Subsidy %	-48%	48%	0%

Financial and operating highlights from the foregoing data include:

- i) Carrier #2 continues to sell seats at published fares but routes traffic onto Carrier #1 flights at discounted fares which are less than Carrier #2's previous costs. Carrier #2 achieves an improved operating margin due to reduced costs and Carrier #1 achieves an improved operating margin due to increased traffic and revenue, even though the incremental revenue is at a reduced yield;
- ii) A financial relief program, which is based upon year over year revenue decline would permit a reallocation of the same subsidy dollars, with 48% less to Carrier #1 and 48% more to Carrier #2 with the net result producing a 120% improvement in results for both carriers with no cost increase to taxpayers and no upward pressure on airfares;
- iii) Both airlines have turned significant post-subsidy losses into modest post subsidy profits after full overhead allocation.

The foregoing illustration shows how beneficial capacity rationalization can be at any time, but particularly during a period of low demand. The challenge, of course, is how do we get there? Mandatory interline agreements, financial aid based upon route-by-route year-over-year revenue loss, and temporary relaxation of anti-competitive restrictions would all be useful tools that the government could use to facilitate capacity rationalization.

In the event that air carriers are unwilling or unable to rationalize capacity themselves, the following data provides an illustration of how leveraged capacity rationalization might work.

Leveraged Capacity Rationalization	Carrier #1	Carrier #2	Market Total
# Flights	1	0	1
# Seats	240	0	240
# Passengers	192	0	192
Average Airfare	\$ 200	\$ -	\$ 200
Flight Revenue	\$ 38,400	\$ -	\$ 38,400
Flight Direct Costs	\$ 18,000	\$ -	\$ 18,000
Flight Margin	\$ 20,400	\$ -	\$ 20,400
Daily Overhead	\$ 20,000	\$ 20,000	\$ 40,000
Pre-Subsidy Net Margin	\$ 400	\$ (20,000)	\$ (19,600)
Load Factor	80%	0%	80%
Average Direct Cost/pax	\$ 94	\$ 94	\$ 94
Delta Revenue %	-45%	-100%	-73%
Reallocate Subsidy- Carrier Benefit	\$ 1,080	\$ 21,480	\$ 22,560
Post Subsidy Net Margin	\$ 1,480	\$ 1,480	\$ 2,960
Delta Carrier Net Margin \$	\$ 9,000	\$ 9,000	\$ 18,000
Delta Carrier Net Margin %	120%	120%	120%
Delta Carrier Subsidy %	-90%	90%	0%

Financial and operating highlights from the foregoing data include:

- i) In this illustration, market access is limited to one carrier, just as it would have been forty years ago, when demand was last at today's levels;
- ii) Carrier #1 now has all of the market traffic and has reduced year over year revenue loss from 73% to 45%. Carrier #2 has increased year over year revenue loss from 73% to 100%. The revenue loss-based subsidy program reallocates subsidy with a 90% decrease to Carrier #1 and a 90% increase to Carrier #2;
- iii) The net result is a 120% improvement in net margin for both carriers, turning a significant post-subsidy loss into a modest post-subsidy profit after full allocation of overhead costs;
- iv) There is no upward pressure on airfares in this scenario. This could be guaranteed by requiring price monitoring as a market cap condition.

As in the previous discussion, the numbers really speak for themselves. Finding a way to resolve airline market overcapacity will pay huge dividends for the government, representing taxpayers, and for airlines, who have a responsibility to their shareholders. Airlines will be in need of government help for some time, and so the government should have significant leverage in providing help with associated conditions designed to ensure that subsidy dollars are directed to where they are most needed and are spent efficiently.

Canadian Air Carrier Domestic Scheduled Service Overview

The following data has been extracted from the Sabre Market Intelligence database as well as published air carrier data and provides an overview of the Canadian Domestic Scheduled Air Service Network as of December 2020. This data is further detailed in Air North's supporting data provided to the Commons Standing Committee on Transport, Infrastructure, and Communities dated December 8, 2020.

The data below shows that there are currently 23 individual air carriers providing scheduled air service to a combined total of 299 Canadian communities. As indicated below, there are 189 individual communities receiving scheduled air service, and only some of these communities are served by more than one airline. Air Canada and WestJet, including Jazz and Encore, fly to 82 communities representing 27% of the total number and 42% of the total population. Flair, Air Transat and Sunwing fly to 15 communities representing 5% of the total number and 26% of the total population. Northern Carriers and other regional carriers include 18 airlines flying to 202 communities representing 58% of the total number and 33% of the total population.

Air Carrier Route Summary	# Air Carriers	# Points	%	Population	%
Air Canada & WestJet	2	82	27%	37,409,248	42%
LCC & Sun Dest Carriers	3	15	5%	23,127,374	26%
Northern Carriers	13	169	57%	16,891,614	19%
Other Regional Carriers	5	33	11%	12,517,409	14%
Total	23	299	100%	89,945,645	100%

As shown below, there are 313 domestic routes published in the Sabre database and 33 of these are flown by Air Canada alone, 30 by WestJet alone, 14 by both Air Canada and WestJet, 17 by one or both of Air Canada and WestJet in competition with a low-cost carrier (LCC), a sun destination carrier and/or a regional carrier. Only 9 routes are flown by a regional carrier as well as a mainline carrier and 2 of these routes are the northern gateway routes between Whitehorse and Vancouver and between Yellowknife and Edmonton. The majority of routes, or 65% of the total are flown by 1 regional carrier and 5 routes are flown by 2 regional carriers.

Domestic Route Summary	# Routes	%
AC only	33	11%
WS only	30	10%
Both AC and WS	14	4%
Mainline/LCC/Sun/Reg	17	5%
Regional and Mainline	9	3%
1 Regional Carrier	205	65%
2 Regional Carriers	5	2%
Total	313	100%

As shown below, of the 199 different Canadian communities listed in the Sabre database, 140, or 70% of the total are served by 1 airline only, 49, or 25% of the total are served by 2 or more airlines, and 10, or 5% of the total are shown as having service suspended. The data also shows that only 24 communities, or 12% of the total have a population of greater than 100,000, 44 communities, or 22% of the total have a population of between 10,000 and 100,000, and 131 communities, or 66% of the total have a population of less than 10,000.

Community Service Overview		
	communities #	communities %
1 Carrier Service	140	70%
Multi Carrier Service	49	25%
Service Terminated	10	5%
Total	199	95%

Community Population Overview		
	communities #	communities %
> 100,000	24	12%
< 100,000 and > 10,000	44	22%
< 10,000	131	66%
Total	199	100%

All of the foregoing data underscores the importance of regional air carriers, the importance of service to regional communities, and the value to Canada of taking steps to ensure that regional routes are able to connect with national routes so as to ensure that regional communities and their residents have seamless access to Canada’s larger communities.

Once again, the numbers speak for themselves. The foregoing data illustrates that, while market intervention and differential financial relief may seem like a daunting task and while limiting competition may be a cause of concern for some, the fact is that the Canadian domestic air market is very small. There are a relatively small number of air carriers currently flying a relatively small number of routes to a relatively small number of communities and the majority of routes and communities are already served by only one air carrier. Any instances of less-than-optimal pricing are likely more heavily influenced by traffic volumes which dictate aircraft size and cost of operation than they are by lack of competition.