



Short Case 49

IAG'S ACQUISITION OF AIR EUROPA: POSSIBILITIES AND RISKS

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On November 4, 2019, Globalia, the main Spanish tourism group to which the airline Air Europa belongs, and the Spanish-British group, International Airlines Group (hereinafter IAG) to which airlines like Iberia, British Airways, Aer Lingus, Vueling and Level belong, signed an agreement whereby Iberia would acquire the entire issued share capital of Air Europa for 1 billion euros in cash. Air Europa, according to the initial conditions set out in the operation that would be integrated into the Iberia Group as an autonomous revenue center, but keeping its own brand. In this way, the Iberia Group would become, if the 2018 air traffic figures were maintained, the one with the most passengers transported within Spain ahead of the Irish airline Ryanair with more than 50 million, compared to 46,8 million of the latter. Likewise, IAG would have under its control 4 of the 6 most important airlines in terms of number of passengers in Spain (Iberia, Iberia Express, Vueling and Air Europa). With this operation, IAG would try to lead the routes between Europe and America, as Air Europa has 24 transatlantic routes with South America and the Caribbean and with the United States in North America, being able to convert the Madrid-Barajas Adolfo Suárez airport (main headquarters of Iberia) into an important Hub in Europe that could compete with powerful Hubs of the old continent such as Paris Charles de Gaulle, London Heathrow, Frankfurt or Amsterdam.

Furthermore, it is convenient to underline the synergies derived from the acquisition, which are quantitatively estimated at between 1 and 1,4 billion euros during the 5 years following the operation. It is worth highlighting the potential synergies in terms of income and costs from general and administrative expenses, handling, sales, distribution, scale effect, or from the use of resources and centralized systems in the IAG common services platform, also pointing out the advantages that a broader platform could provide for the different brands that make up the group. In this sense, as established in the Annual Report and Accounts (2019, p. 33): "The IAG Platform allows IAG operating companies to access centers of excellence, quality resources and systems that, as an independent organization, it would be difficult to achieve". Specifically, they would highlight synergies such as the integration of Air Europa into the IAG Avios Loyalty Program, shared codes within the group, the alignment of commercial policies, the integration of Air Europa into IAG joint businesses, or the integration into the Iberia Hub structure at Madrid-Barajas Adolfo Suárez airport.

However, the agreement would not be exempt from certain initial obstacles foreseen, such as the position of the Spanish National Commission of Markets and Competition and the European Commission, taking into account that, as a result of the operation, IAG airlines would have a quota of passengers exceeding 70% in Aena's Spanish airports, or the possibility of a hard Brexit with the doubts generated about the Spanish-British character of Iberia that would be transferred to Air Europa. However, to these already predicted obstacles, a third barrier was incorporated that was not part of this planning, and that is undoubtedly the most relevant of all. It is about the health crisis with unpredictable consequences derived from the Covid-19 virus pandemic in the world.

In this context, no international airline could expect the consequences derived from this acute health, economic crisis that has affected the planet in 2020, stopping the growth expectations of the world





tourism industry, and therefore affecting the whole of airlines, facing the worst crisis in their history. In the case of IAG, in the first semester of 2020 it lost 3,806 billion euros, and in the third quarter 1,3 billion euros, the latter being an 83% drop in revenue compared to the same period of 2019, year in which resulted in benefits of 1,425 billion euros. In addition, in the last quarter of 2020, a balance between income and expenses will not be achieved either, estimating that IAG's capacity will not exceed 30% compared to 2019. Given this situation, IAG has had to resort to an expansion capital of 2,741 billion euros in October 2020 to strengthen its liquidity position. Air Europa, for its part, estimates losses of around 400 million euros in 2020, with Globalia being in a critical financial situation with negative projections of 600 million euros for the entire group in 2020. In this sense, Globalia requested in September 2020, a rescue of 400 million euros to the SEPI Fund for the recapitalization of strategic companies, being accepted on October 28, 2020 for 75 million euros more than expected (475 million). However, it has to be pointed out that when the rescue exceeds 250 million euros, it must also be approved by the European Union.

All these aspects directly affect the conditions of the initial agreement between the two companies, with the market establishing a reduction in the valuation of the operation, reaching around 500 million euros. Despite this circumstance, both companies have shown their willingness to ratify the agreement again. IAG due to the still relevant implications of the operation at a strategic and economic level, proposing a restructuring of the agreement reached on November 4, 2019, which would affect a substantial reduction in its price (there is a clause in the signed agreement that allows renegotiating the price), and the financing needs of Air Europa's business. And Globalia, due to the fragile financial situation that the tourist group maintains, knowing that the survival of the airline in the medium and long term depends on its sale to a larger group.

IAG's deadline is May 2021 to culminate the deal and receive the final approval from the European Commission. Otherwise, it will have to compensate Globalia with 40 million euros. However, its forecasts are to conclude the operation between the fourth quarter of 2020 and the beginning of 2021. Despite this, factors such as an even more abrupt loss of value of Air Europa, the probability of a bankruptcy of Globalia due to the delicate financial balance that maintains the tourist group, or even other circumstances that do not depend on the activity of the company such as the real possibility of a hard Brexit without an agreement between the United Kingdom and the European Union or an even more negative and prolonged evolution of the Covid-19 pandemic in the world that could affect in a deeper way to the tourism industry, may mark the future viability of the agreement. In this way, a fact to highlight is that the International Air Transport Association (IATA) predicts that the recovery of air traffic levels prior to the Covid-19 pandemic will not be reached until 2024, an aspect that will influence the income statements of companies of the sector, thus affecting their different corporate strategies.

Question: Indicate and critically analyse the main motives and risks of the operation for the involved companies.

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