



If Russians would fly

SkyExpress maintains that it is Russia's first, and up until recently, only, low-cost carrier (LCC). **Marina Bukalova**, the start-up's CEO is confident that the relatively young airline can tap the massive potential in the Russian travel market and grow accordingly.



SKYEXPRESS MADE ITS FIRST commercial flight on January 29, 2007 to Sochi, a Black Sea resort. Despite the tough economic climate the carrier has displayed steady growth. In 2008 it carried 897,491 passengers through January to October, in 2009 the figure increased up to 931,591; its load factor grew to 70.75 per cent in 2009 compared with 62.72 per cent in 2008, over the same 10 month period.

The SkyExpress project was launched in November 2005. The business plan was developed on the basis that it would be Russia's first LCC. The project required \$70m to finance up to 40 aircraft on operational lease; provide working capital within five years; and open up to 20 internal routes to the biggest cities within a 3,000km radius of Moscow. The business idea attracted investors such as EBRD and Altima Funds as well as individual investors from the UK and Russia. The financing was provided in form of both equity and a loan option – totalling \$35m. Now the company is under the control of private Russian investors.



On March 6, 2006, CJSC 'Sky Express' was officially established, in May Vnukovo was chosen as its base airport. The organisational structure was finalised in August-October 2006 and personnel began to be recruited. In September-December management implemented the Navitaire reservation system (internet booking) and established a cash collection network (collection payments for tickets). Over August-September 2007 the first tranche of shareholder's financing – \$3.5m – was paid out.

Marina Bukalova, SkyExpress CEO, says: "The initial idea of the investment's group was to create the first low-cost carrier in Russia, by combining the best methods and technologies of Western discounters and the 'sleeping' Russian aviation market." She remarks that market research proved that the Russian aviation transportation market had great potential for growth, provided certain limitations – such as the price of an air ticket – could be removed. If the price could be made comparable with Russian railway: "a lot of people would prefer saving time travelling by aircraft instead of the train."

The SkyExpress fleet is represented by nine aircraft between 17- and 19- years-old. It has seven 737-500s (132 seats); three of them are leased from CIT, two from AWAS, and one each from ACG and Aercap. Two 737-300s (148 seats), are leased from BCC. Bukalova expects that in 2010 SkyExpress will add four 737-500 aircraft, in economy class configuration, to its fleet. This will bring the total fleet to 13, with all the 737s on lease.

With this choice of aircraft, the airline's continues its trend of operating Boeing 737 Classics. The reason for the use of of such "aged" aircraft is the price: they are cheaper to import into Russia. Bukalova states: "...customs fees and VAT is more than 41 per cent of aircraft cost". The currently operated aircraft were financed from both "revenue and investments".

SkyExpress seems satisfied with the manufacturer chosen and as Bukalova adds "[the] company is not interested in the Sukhoi Superjet". She seems concerned with the uncertainty involved in the programme at this stage: "Sukhoi Superjet is not in commercial service and it is still in test flight phase – there is no timetable to finish test flight and aircraft certification. But SkyExpress needs to operate here and now."

PLANS AND PERSPECTIVES

SkyExpress plans to open three or four new domestic routes in 2010 to destinations located up to 3,000km away from Moscow. Bukalova says this is because the company intends to keep to a low-cost model with short 2.5 hour's flights.

The airline opened a new domestic route on September 11 this year and is considering 10-15 new domestic/international destinations based on passenger turnover, dynamics and competitors offers. She says: "Our marketing people do their monitoring on an everyday basis and we have already defined five-eight destinations (not only domestic) to be opened next year."

Bukalova expects SkyExpress to operate a minimum of one flight daily to each destination. But her "optimistic intention" is two flights daily on each route. At the moment SkyExpress is not planning to remove any routes from the schedule, but Bukalova is clear that "this case should not be excluded".

GETTING RUSSIA FLYING

Russians are notoriously unwilling to make online credit-card operations such as flight bookings. Bukalova notes: "SkyExpress has had to be imaginative providing customers with payment options. Anyone can order a ticket on-line, but many people are suspicious of paying via the internet. So, SkyExpress customers have a choice of up to 100,000 cash collection points. We spend only two per cent of revenue on distribution costs and we are ready to offer our customers a special top-up card in the near future."

The main challenge that Bukalova sees is the inactivity of the Russian population. She points out: "Currently, most Russian travellers hop on trains and stay on them for long, long time periods. While there are



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SkyExpress CEO



only 27 million passengers on internal flights, there are more than 100 million passengers on long-distance trains. Each passenger travels 900km on average – which on Russian trains can mean journeys of up to 17 hours." SkyExpress is still in the process of tapping the potential of the Russian travel market and getting travellers from these trains to the air.

So, as with Wizz Air in Eastern Europe, SkyExpress considers ground transport means the main competitor to its business. Together with Aeroflot, Utair and S7, "which offers fares lower than budget carriers" Bukalova admits that: "Today all Russian airlines are low-fare carriers, including S7 and Aeroflot. But really low-cost or budget carriers, in terms of a

business model and marketing positioning, are SkyExpress and Avianova [which only began operations on August 27, 2009]." She notes that although S7 is competing with SkyExpress on technology, it is now introducing services that SkyExpress implemented in early 2007.

Despite the Avianova start-up, Bukalova asserts: "The only competition we have is the low fares of network carriers." Avianova only has two A320s at the moment, but it is still in its early days and the new low-cost rival does not yet represent a serious competitor.

In an effort to compete more effectively, SkyExpress has developed and introduced new services such as a pre-paid lunch (Sky Box) and pre-paid railway ticket giving

substantial discounts. This innovation is not shared by any other Russian airline.

"Regarding credit cards, we follow the other channel of sales and distribution – agents and off-line clients, because we have already got card holders." Off-line clients are the most expensive to attract because advertising is off-line (billboards, printing, off-line media) and very costly. But the fares provided to them by the agent channel are usually higher than the direct web or call-centre ones, so the rewards for capturing these passengers are greater.

GOVERNMENT GUARDED MARKET

Maxim Poberezhnik, Sky Express marketing director, has mentioned high import tax and protectionist government policies as hurdles to SkyExpress' business. The current import rate for a 737 or A319/320 is 20 per cent from its value for customs duties and 18 per cent VAT.

Although Bukalova admits that SkyExpress does not feel constricted by the government's interventionist policies: "Government tries to enforce some instruments that airlines don't like and can't accept. Insurance for passengers of bankrupt airlines for example."

She continues that: "It is difficult to run airline business in Russia generally, not only low-cost. Protectionism of state carriers, preferences and state support are the main barriers to aviation business in Russia." She believes the government shows no interest in cutting air travel costs or stopping the state fare monopoly supporting airlines with low margin profits.



THE RECESSION AND BEYOND

Bukalova gives no details of how the recession has affected SkyExpress. She simply states it has been a “common situation” in the Russian market, not only in the low-cost segment. Although she sees some opportunity there, together with many other LCCs, because budget airlines could gain passengers from network carriers. The figures seem strong through 2008/09 despite the recession which airline industry has gone through (see table).

The LCC business model usually dictates “aggressive” fuel hedging, and SkyExpress isn’t following this direction currently. Bukalova states: “SkyExpress take the fuel from an alternative supplier. We get the best price from their competition. But the hedging is just starting on the Russian market and is not transparent”.

Russia has great potential for a strong air transportation market. The country is vast, covering several different time zones, and is represented mostly by non-industrial land, which is poorly connected by ground transport networks. The climate is harsh enough to test even a very modern ground transport. Therefore, given the right investment, an affordable and reliable air network would do a great deal to connect the most distant areas of the country. Setting the right price will play a great part in changing opinions and convincing less well-off Russians of the value of turning to the skies. It is interesting that the Airbus Global Market Forecast 2009-2028 does not even mention Russia in its LCC projections. This suggests that Airbus, at least, does not see potential there being tapped for a considerable period.

Unit of measure	10 month		change 09/08%	October		change 09/08%
	2008	2009		2008	2009	
Pax (scheduled + charter) Passengers	897,491	931,591	3.80%	84,582	103,495	22.36%
Pax turnover Traffic	1,136,386,014	1,537,365,026	35.29%	113,206,450	139,504,441	23.23%
Cargo and post Tonn	962,857	1,272,937	32.00%	140,754	220,844	57.00%
Cargo turnover Tkm	1 259 984	2 072 241	64.47%	193,112	315,571	63.41%
Load factor %	62.72%	70.75%	% point 8.03%	59.24%	73.77%	% point 14.53%



However, Bukalova is positive about the future and lists some actual aims for SkyExpress: to lease three to four new aircraft, open three to five new local routes, to be the fifth largest in the domestic market, the 10th in general rating and gain a 2010 passenger turnover of 1.4 million. If SkyExpress can tap the potential of the Russian air transportation market, these aims may not only be easily met, but could lead to rapid expansion of the airline. However, if success of this kind takes place it is clear that the airline may easily find Avianova snapping at its heels.