

## V

*(Announcements)*PROCEDURES RELATING TO THE IMPLEMENTATION OF COMPETITION  
POLICY

## EUROPEAN COMMISSION

## STATE AID — MALTA

## State aid SA.33015 (12/C) — Air Malta plc

**Invitation to submit comments pursuant to Article 108(2) of the Treaty on the Functioning of the  
European Union***(Text with EEA relevance)*

(2012/C 50/04)

By means of the letter dated 25 January 2012 reproduced in the authentic language on the pages following this summary, the Commission notified Malta of its decision to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union concerning the abovementioned aid/measure.

Interested parties may submit their comments within one month of the date of publication of this summary and the following letter, to:

European Commission  
Directorate-General for Competition  
State aid Registry  
1049 Bruxelles/Brussel  
BELGIQUE/BELGIË  
Fax +32 22961242

These comments will be communicated to Malta. Confidential treatment of the identity of the interested party submitting the comments may be requested in writing, stating the reasons for the request.

## TEXT OF SUMMARY

Air Malta plc, Malta's national air carrier, is a small national carrier with a present fleet of only 12 aircrafts. Except for being a regular link for tourist and business travellers, the airline also provides other important services that are vital to Malta's economy. Air Malta, mostly owned by the Maltese government, has been making losses on its airline business for several years.

The Commission authorised rescue aid to Air Malta of EUR 52 million on 15 November 2010 (N 504/10). On 16 May 2011, Malta notified a restructuring plan to the Commission containing restructuring aid in the form of a capital injection amounting to EUR 130 million, including a debt-to-equity swap of the approved rescue loan of EUR

52 million. Air Malta will raise 45,5 % of a total restructuring funding requirement of EUR 238 million as own contribution through the sale of land, subsidiaries and other assets.

The restructuring plan covers a five year restructuring period from 2011 to 2016 aiming to restore Air Malta's long-term viability by 2016 by implementing several cost and revenue initiatives.

As compensatory measures for possible distortion of competition, Air Malta offers inter alia an overall capacity reduction of 20 % including surrender of certain profitable or potential profitable routes.

As the proposed measure constitutes State aid within the Article 107(1) of the TFEU and Air Malta has to be regarded as a firm in difficulty, the Commission has assessed the measure under the Community guidelines on State aid for rescuing and restructuring firms in difficulty.

The Commission has several doubts concerning compliance of the aid with the conditions of these Guidelines, especially with regard to the criteria of long-term viability, compensatory measures, own contribution and the 'one time, last time' principle. The Commission's major concerns are whether the optimistic forecasts on long-term viability are realistic to achieve (especially concerning the underlying assumptions on market growth and inflation), whether the proposed capacity reduction involves genuine compensatory measures and, if these measures are sufficient to compensate undue distortions of competition and whether the aid violates the 'one time, last time' principle in view of a capital injection carried out by Malta in April 2004.

#### TEXT OF LETTER

The Commission wishes to inform the Republic of Malta that, having examined the information supplied by your authorities on the measure mentioned above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the functioning of the European Union.

#### 1. PROCEDURE

- (1) In 2010, Malta notified its intention to grant a loan of EUR 52 million of rescue aid to Air Malta plc ("Air Malta"). In its decision of 15 November 2010 <sup>(1)</sup>, the Commission did not raise any objections against this rescue aid. The Maltese authorities committed themselves to notify a restructuring plan within 6 months of the authorisation of the rescue aid.
- (2) On 16 May 2011, Malta notified the restructuring plan to the Commission including restructuring aid in the form of a capital injection amounting to EUR 130 million <sup>(2)</sup>.
- (3) The Commission requested further information from Malta by letter dated 5 July 2011. The Maltese authorities replied and submitted a revised Restructuring Plan on 2 August 2011. The Commission requested further information from Malta by letter dated 1 September 2011, to which the Maltese authorities replied on 22 September 2011. Malta submitted a newly revised Restructuring Plan on 30 November 2011.

#### 2. MALTA'S AIR TRANSPORT MARKET

- (4) The Maltese Islands are geographically isolated and therefore cross-border links with mainland Europe and

other parts of the world are limited to sea and air transportation. Appropriate air links are crucial for Malta's economy given its high degree of economic openness <sup>(3)</sup> (necessitating reliable transport links for business travellers) and the importance of the tourism industry to its economy <sup>(4)</sup>. It is also vital for Malta's economic and social cohesion both internally and with the rest of the EU (daily transportation of mail and freight including perishables between the islands and the European mainland).

- (5) Concerning passenger air transport, Air Malta is the most important air carrier for flights from and to Malta International Airport (MIA) with a market share of 51 %. During the last couple of years, the concentration of passenger traffic to Malta has increased due to low cost carriers (LCC) — both Ryanair and EasyJet have grown their passenger numbers from zero in 2005 to a combined total of almost 1 million in 2010 and a combined market share of 30 % — at the expense of the market share of Air Malta (from 56 % in 2008 to 51 % in 2010). Given the capacity and fleet reduction envisaged in the present Restructuring Plan, the Company's market share could decline to less than [40 % to 50 %] in 2016.

Table 1

#### Air passenger traffic to/from Malta in 2010

Major airlines operating out of MIA	Market share (2010)	Changes 2007-2010
Air Malta	51 %	- 4 %
Ryanair	21 %	+ 13 %
easyJet	9 %	+ 9 %
Lufthansa	3 %	- 1 %
Emirates	3 %	- 1 %
Alitalia	2 %	- 1 %

<sup>(3)</sup> The Maltese economy has an high degree of openness, with exports and imports accounting for around 77 % and 73 % of GDP in 2009. 58 % of export trade was conducted using air transport. In relation to imports, although the majority of import trade was conducted using sea transport, air transport has also a significant share of 30 %.

<sup>(4)</sup> Malta is highly reliant on tourism, which in turn is dependent on air transport. The tourism sector has long been a key pillar of the Maltese economy and is the leading services activity both in terms of employment creation and foreign exchange earnings. Tourism contributes approximately 25 % to the GDP of Malta. In 2009, Malta attracted around 1,2 million tourists who spent EUR 638 million. According to Edition 2010 of European statistics, the ratio of international tourism receipts to GDP was highest in Malta (11,4 %). Malta is also heavily reliant on the HORECA (hotel, restaurant and catering) sector. According to the EU Labour Force survey, as much as 8,6 % of the employed population — the highest for any EU-27 country — works in the HORECA sector which is directly related to tourism, compared to 4,3 % for EU-27. The importance of tourism for Malta is reflected in the fact that tourism intensity was 19,4 % (guest night per inhabitant) while the EU-27 average was 4,6 %. About 98 % of tourist passengers relied on air transport rather than sea transport.

<sup>(1)</sup> N 504/10 Rescue Aid to Air Malta plc, C(2010) 8171.

<sup>(2)</sup> That includes a debt-to-equity swap of EUR 52 million in Government debt substituting the approved Rescue Aid loan and already disbursed to Air Malta.

- (6) Concerning air cargo, Air Malta is also the most important air carrier for cargo flights from and to MIA with a market share of 28 %. Low-cost carriers do not carry mail or cargo and industry is therefore dependant on legacy carriers, in particular, Air Malta. Given that Malta's import/export volumes are relatively unpredictable, it is difficult to sustain non-tourism routes or dedicated freighters. The industry is therefore mainly served through passenger aircraft with a limited number of scheduled freighters.
- (7) Given Malta's forecasted internal growth in GDP of 2,2 % for 2012 and beyond <sup>(5)</sup>, the traffic to and from Malta is expected to continue its recent trend, with growth forecasted at 5,9 % per annum to 2016 and 3,1 % beyond. The total number of passengers is expected to grow from the actual 3,3 million to approximately 4,7 million in 2016 and 5,3 million in 2020 <sup>(6)</sup>.

### 3. THE BENEFICIARY

- (8) Air Malta plc is a limited liability company established in 1974. Air Malta is owned by the Maltese government (98 %) and private investors (2 %).
- (9) Air Malta is the national flag carrier of Malta with approximately 1 300 employees. Air Malta operates 11 passenger aircrafts and currently serves 43 scheduled destinations in Europe, North Africa and the Eastern Mediterranean <sup>(7)</sup>.
- (10) With only about 1,8 million passengers in 2010, Air Malta is a small player in the European aviation market, representing only 0,25 % of the entire European airline industry's productive capacity and output. With the intended fleet reduction it will become an even smaller player in a growing European air transport market.
- (11) However, Air Malta is the most important carrier for flights from and to Malta as regards both passengers and cargo. Furthermore, Air Malta is the principal mail carrier in/out of Malta.
- (12) Air Malta is also the principal carrier which transports patients for treatment abroad, mainly into London. Air Malta carries incubators and stretchers mostly to the UK. The alternative would be an air ambulance which is much more expensive. According to the Maltese authorities there are very few other airlines that operate such a service in Europe.
- (13) As the Maltese legacy carrier, the Company is the only European airline that can link Malta to important non-EU destinations such as Libya, Tunisia and Egypt based on bilateral agreements.
- (14) Air Malta has been making losses in its core airline business for several years. It generated an aggregate operating loss of EUR 116 million over a six year period (FY2006-FY2011). The airline has consistently delivered losses with the exception of financial year <sup>(8)</sup> (FY) 2008 when it generated a small net profit, though this was achieved through the sale of assets.
- (15) The situation sharply worsened as of FY2009 when Air Malta suffered almost a EUR 34 million operating loss, followed by a EUR 23 million operating loss in FY2010. An operating (result) of EUR [...] is expected for FY2012.
- (16) According to the Maltese authorities, Air Malta has been able to avoid liquidity problems and undue financial stress due to the fact that the operating losses sustained over the recent years were funded by the proceeds from substantial asset disposals.
- (17) While the Maltese authorities have indicated that at this point in time, Air Malta is not subject to any collective insolvency proceedings, in the absence of rescue and later restructuring aid, it is likely that it will become subject to such proceedings.
- (18) As already described in the Air Malta — Rescue aid decision, at the end of FY2009 (ending 31 March 2009) Air Malta had accumulated total losses amounting to more than half of its registered capital and more than one quarter of that capital had been lost in the previous year. Its registered capital was EUR 68,7 million while its FY2009 net loss amounted to EUR 23,7 million and its accumulated losses as of the end of FY2009 had reached EUR 61,7 million.
- (19) During FY2010 Air Malta suffered a further EUR 11,5 million net loss. The accumulated loss at the end of FY2010 was EUR 69,3 million which is higher than the value of Air Malta's registered capital. The total equity in FY2010 was positive only as a result of property re-evaluation.
- (20) According to Malta, reasons for these losses are weakening revenues despite the annual growth in passengers, increasing cost base, deteriorating levels of aircraft utilisation, a change in the competitive landscape with the advent of low cost carriers' competition in Malta and Air Malta's inability to respond either by reconfiguring its route network or its marketing strategy, lack of management skills and leadership to respond to an ever changing landscape, the relatively high and uncompetitive cost base on which the Company presently operates, the inability or unwillingness to compete for Malta Tourism Authority's incentives for route development, confused product positioning and the existence of a number of non-core, unprofitable businesses.

<sup>(5)</sup> IMF World Economic Outlook, September 2011.

<sup>(6)</sup> Eurocontrol, Long-term Forecast, December 2010. All data based on Regulated Growth scenario.

<sup>(7)</sup> In 2011, Air Malta operates routes to following destinations: Amsterdam, Athens, Berlin, Birmingham, Bologna, Brussels, Budapest, Catania, Damascus, Frankfurt, Geneva, Hamburg, Istanbul, Leipzig, London-Gatwick, London-Heathrow, Lyon, Manchester, Marseille, Milan, Moscow-Domoddedovo, Moscow-Sheremetyevo, Munich, Naples, Palermo, Paris-Charles de Gaulle, Paris-Orly, Prague, Reggio, Rome, Sophia, Stuttgart, Toulouse, Tripoli, Tunis, Turin, Verona, Vienna, Zurich.

<sup>(8)</sup> The company's financial year runs from 1 April to 31 March.

- (21) Air Malta plc has the following subsidiaries ("Air Malta Group"):

Table 2

**Air Malta Group structure**

Subsidiary	Share of Air Malta plc	Profit b/tax in FY2010 (in EUR 000's)
Osprey Insurance Brokers Ltd. (an insurance broker)	100 %	618
Shield Insurance Company Ltd. (a captive insurance company)	100 %	1 165
Selmun Palace Hotel Co. Ltd. (a four star hotel in Malta)	100 %	(879)
Holiday Malta (a UK based specialist tour operator)	100 %	(GBP 1 081)
World Aviation Group (a general sales agent for Air Malta and other airlines)	50 %	241
Lufthansa Technik Malta (joint venture with Lufthansa Technik AG to perform aircraft maintenance and repair operations)	8 %	(10 896)

**4. DESCRIPTION OF THE MEASURE AND THE PROPOSED RESTRUCTURING PLAN****4.1. Restructuring aid**

- (22) Malta has notified restructuring aid of EUR 130 million to Air Malta in the form of equity, including a debt-to-equity swap of the approved rescue loan of EUR 52 million, on the basis of the Restructuring Plan described below starting in November 2010, after the approval of the rescue loan, and covering a five year restructuring period from FY2011 to FY2016.

**4.2. Restructuring Plan****4.2.1. Restructuring aims**

- (23) The Restructuring Plan aims to restore Air Malta's long-term viability by 2016. The plan assumes that it will be possible to turn around the existing level of losses from an operating loss (EBIT) of EUR 31,3 million and a net loss of EUR 37,8 million in FY2011 to breakeven level by FY2014 and to profitability by FY2015. According to the Plan's assumptions, Air Malta will generate an operating profit of EUR [...] and a net profit of EUR [...] by FY2016.

Table 3

**Profit and loss FY2011-FY2016**

(in EUR million)

FY	2011	2012	2013	2014	2015	2016
Revenues	205,4	[...]	[...]	[...]	[...]	[...]
EBIT	(31,3)	[...]	[...]	[...]	[...]	[...]
Net Profit	(37,8)	[...]	[...]	[...]	[...]	[...]

- (24) Concerning profitability, the Restructuring Plan aims to achieve a return on capital employed (ROCE) <sup>(9)</sup> of [7,6 % to 9,2 %] and a return on equity (ROE) <sup>(10)</sup> of [8,7 % to 10,7 %] for FY2016 which is supposedly in line with average levels achieved by other European airlines.

Table 4

**ROCE and ROE 2012-2016**

FY	2012	2013	2014	2015	2016
Return on equity (ROE)	[n/a]	[- 47,2 % to - 38,6 %]	[- 7,7 % to - 6,3 %]	[6,7 % to 8,1 %]	[8,7 % to 10,7 %]
Return on capital employed (ROCE)	[- 92,3 % to - 80,0 %]	[- 19,8 % to - 16,2 %]	[- 4,2 % to - 3,4 %]	[5,4 % to 6,6 %]	[7,6 % to 9,2 %]

**4.2.2. Restructuring measures**

- (25) To achieve these results, Air Malta proposes the following key actions:

**Route and network strategy**

- (26) The target is to create a more cost-effective schedule. Therefore, Air Malta will terminate certain routes — both loss making and profitable — and increase frequency on selected core routes.
- (27) Air Malta has already taken action to discontinue the loss making routes to Leipzig, Tunis, Damascus, Palermo and Turin in early 2011.
- (28) Furthermore, as of autumn 2011, Air Malta has started to discontinue or reduce capacity on certain routes which are offered as compensatory measures according to the Community guidelines on State aid for rescuing and restructuring firms in difficulty <sup>(11)</sup> (hereinafter, "the R&R Guidelines"). This will also release the pertinent slots in a number of foreign airports, with Air Malta thus forgoing any grandfather rights it currently has on these slots. By 2013, [...] slot pairs will be surrendered at coordinated airports <sup>(12)</sup> such as London-Gatwick, Manchester, Amsterdam, Frankfurt, Geneva, Catania, Stuttgart, London-Heathrow and Munich. Through the withdrawal or reduced frequency other airlines will be able to benefit from potentially increasing their load factors and/or yields.

Air Malta has earmarked the following routes as compensatory measures:

<sup>(9)</sup> ROCE = Net profit/(Debt + Equity).

<sup>(10)</sup> ROE = Net profit/Equity.

<sup>(11)</sup> OJ C 244, 1.10.2004, p. 2.

<sup>(12)</sup> Coordinated airports are airports where the slots are allocated by a coordinator under Regulation (EEC) No 95/93 on common rules for the allocation of slots at Community airports flight (OJ L 14, 22.1.1993, p. 1).

Table 5

**Routes earmarked as compensatory measures**

Destination (to/from Malta International; otherwise two destinations are indicated)	Load factor 2010	Contribution margin 2010	ASK <sup>(1)</sup> change 2010-2013	Dropped (X) or reduced rotations (▼)
Catania–Geneva	[...]	[...]	[...]	[...]
Catania–London–Gatwick	[...]	[...]	[...]	[...]
Rome–Reggio Calabria	[...]	[...]	[...]	[...]
Amsterdam	[...]	[...]	[...]	[...]
Birmingham	[...]	[...]	[...]	[...]
Bologna	[...]	[...]	[...]	[...]
Catania	[...]	[...]	[...]	[...]
Frankfurt	[...]	[...]	[...]	[...]
London–Gatwick	[...]	[...]	[...]	[...]
London–Heathrow	[...]	[...]	[...]	[...]
Lyon	[...]	[...]	[...]	[...]
Manchester	[...]	[...]	[...]	[...]
Marseille	[...]	[...]	[...]	[...]
Munich	[...]	[...]	[...]	[...]
Palermo	[...]	[...]	[...]	[...]
Prague	[...]	[...]	[...]	[...]
Reggio Calabria	[...]	[...]	[...]	[...]
Stuttgart	[...]	[...]	[...]	[...]
Toulouse	[...]	[...]	[...]	[...]
Leipzig	[...]	[...]	[...]	[...]
Verona	[...]	[...]	[...]	[...]

(<sup>1</sup>) ASK stands for available seat kilometre (seats flown multiplied by the number of kilometres flown); ASK is the most important indicator for capacity of an airline as employed by the air transport industry and the Commission itself in previous restructuring cases in the air transport sector.

- (29) Concerning the profitability of the different routes, Malta provided the contribution margin of FY2010 for nearly all of the earmarked routes. Contribution margin of a route or rotation is defined as the percentage result of

the contribution (after deducting the variable costs of operations) divided by the total revenue of that route or rotation. A positive contribution margin means therefore that at least the variable costs are covered.

- (30) However, according to Malta, the target average for FY2010 was approximately (47 % to 57 %) which is the benchmark for retaining, investing and discontinuing routes for Air Malta. Thus, if any return flight or set of flights on any particular route exceeds (47 % to 57 %) contribution margin, then that flight contributes to cover the rest of the fixed operating costs as well as administrative overheads.
- (31) As part of the turnaround plan, costs are being reduced both in fixed operational terms and overheads. This means that the breakeven contribution margin percentage should reduce to [36 % to 44 %] by 2014. Malta provided a forecast with the expected contribution margins for FY2014. Approximately 68 % of routes will pass the [36 % to 44 %] threshold. However, some of the routes which are earmarked as compensatory measures will still remain below the [36 % to 44 %] threshold such as [...].
- (32) Air Malta will also start additional routes including new destinations and expansion of existing schedules in the 2012/2013 network.
- (33) The changes in the route network between FY2010 and FY2013 relate to an overall capacity reduction of 20,2 % ASK of the 2010 overall capacity. This includes a capacity reduction of [27 % to 33 %] [12,5 % to 15,5 %] (<sup>14</sup>) are related to routes claimed to be profitable, [5,5 % to 7,5 %] (<sup>15</sup>) to “marginal routes”, i.e. routes that are currently not profitable but would become profitable in the future, and [9 % to 11 %] (<sup>16</sup>) to unprofitable routes) and a capacity increase through launching new destinations and expansion of existing schedules of [9 % to 11 %].

Table 6

**Capacity change 2010-2013**

Capacity change	ASK	% of FY2010
Total ASK (FY2010)	4 145 522	
ASK reduction in capacity	[...]	[27 % to 33 %]
ASK increase in capacity	[...]	[9 % to 11 %]
Total ASK (FY2013)	[...]	[72 % to 88 %]
Overall change in capacity (FY2010-FY2013)	836 750	20,2 %

(<sup>14</sup>) [16 % to 20 %] when one compares the change between summer 2009 and summer 2012.

(<sup>15</sup>) [9 % to 11 %] when one compares the change between summer 2009 and summer 2012.

(<sup>16</sup>) [1 % to 2 %] when one compares the change between summer 2009 and summer 2012.



- (34) Especially important are connections to international hubs which are essential for Malta's access to the global markets. Because of this, Air Malta concluded code share agreements with a number of airlines. Furthermore, Air Malta plans to join a global alliance [...] to improve connectivity and fleet utilisation.

#### Cost initiatives

- (35) Cost initiatives are focused on improving the efficiency of Air Malta's operations in order to reduce the cost structure by streamlining the core business, addressing operational inefficiencies and bringing the airline into a competitive and sustainable position. The annual improvements in profitability from cost initiatives are expected to total EUR [42 to 52 million] by the end of the Restructuring Plan period which means a reduction in the total costs of the Company of [10 % to 12 %] between FY2010 and FY2016 and a decline of the total operating cost per passenger by [7,5 % to 10 %] between FY2010 and FY2016 (while total passengers carried during the same period remain almost constant). The major items are: network based reductions [EUR 21 to 27 million], personnel savings [EUR 9 to 11 million] and contract management [EUR 7 to 9 million].

#### Network based reductions

- (36) The planned 20,2 % capacity reduction has an impact on fixed and variable direct operating costs such as a reduction in fuel uplift of approximately [...] gallons (EUR [...]), the reduction in the number of flown hours and therefore a decrease of the overall maintenance costs [...] and a reduction of landing, handling and navigation and en-route charges by [...].
- (37) The airline will reduce the fleet from 12 to 10 aircraft. One aircraft has already been subleased to [...] from [...] and another aircraft, which is currently subleased under a short-term contract, will be subleased to [...] from [...] to [...]. Both aircraft will be sub-leased at cost and hence will reduce Air Malta's overall lease expenditure. The overall lease rate is expected to decrease by EUR [...].
- (38) However, the reduction in network is expected to have a negative effect on passengers and cargo carried, before initiatives are implemented. It is assumed that passengers (scheduled and chartered) will decrease from 1,75 million in FY2011 to [EUR 1,5 to 1,7 million] in FY2013 resulting in a revenue reduction of EUR [11 to 13 million]. Cargo revenue is also expected to decrease by EUR [1 to 2 million] as a result of network reduction.

#### Contract management

- (39) Air Malta is renegotiating the contracts with their major suppliers. The overall target for contract costs savings is ca. EUR [7 to 9 million]. The review has been commenced with ten business partners. The biggest amount of savings (EUR [...]) was achieved through negotiations with [...]. However, according to the Restructuring Plan, the negotiations are still at a very early stage for some of the contracts.

#### Revenue initiatives

- (40) Air Malta aims to become a hybrid carrier, which means combining the LCC style approaches to building ancillary revenues together with legacy carrier techniques for improving the quality of revenue through better revenue management and pricing.
- (41) Given the extreme seasonal nature of Air Malta's market, the focus of the revenue initiatives is to improve yield in summer, when load factors are already strong, and to build revenue in winter through targeted marketing, campaigns and seat sales. Total passenger revenue per passenger (including ancillary revenues) is projected to increase to EUR [110 to 120] per passenger in FY2016 compared with EUR [100 to 105] in FY2011. Ancillary passenger revenue streams will then represent [3 % to 4 %] of total revenues in FY2016, compared with approximately 20 % for the Company's primary competitors, easyJet and Ryanair. The main revenue initiatives include: improvement of the load factor (EUR [9 to 11 million]), yield management (EUR [8 to 10 million]) and ancillary revenues (EUR [9 to 11 million]).

#### Load factor

- (42) Air Malta has developed a new commercial strategy in order to improve its competitiveness and load factor.
- (43) This new strategy and improved marketing should lead to revenue enhancement. As can be seen from Table 7, according to Air Malta's Restructuring Plan, passenger numbers will decline between FY2011 and FY2013 driven by the reduction in the planned reduction in capacity; however, by FY2016 the reduction in passengers will have been recovered through: targeted marketing, [...]; filling seats in troughs by focusing on increasing passenger numbers in the winter and shoulder seasons and market growth.
- (44) With an expected growth in passenger volume of approximately [90 000 to 110 000] at average yields less incremental passenger related costs, revenue is expected to increase by [7 % to 9 %] from EUR 205.4 million in FY2011 to EUR [200 to 240 million] in FY2016.

Table 7

#### Load factors, FY2011 to FY2016

FY	2011	2012	2013	2014	2015	2016
Revenues (EUR 000's)	205 369	[180 000 to 220 000]	[180 000 to 220 000]	[190 000 to 230 000]	[200 000 to 240 000]	[20 000 to 240 000]
Passengers (million) <sup>(1)</sup>	1,75	[1,6 to 1,8]	[1,6 to 1,8]	[1,6 to 1,8]	[1,6 to 1,8]	[1,6 to 1,8]

FY	2011	2012	2013	2014	2015	2016
Total seats (million)	[2,5 to 3]	[2 to 2,5]	[2 to 2,5]	[2 to 2,5]	[2 to 2,5]	[2 to 2,5]
Load factor <sup>(?)</sup>	[72 % to 75 %]	[72 % to 75 %]	[72 % to 75 %]	[72 % to 75 %]	[73 % to 78 %]	[73 % to 78 %]

<sup>(1)</sup> Based on Air Malta route economics inclusive of schedule and charter (Malta and UK operations).

<sup>(?)</sup> Load factor projections are an output based on projected seat numbers and passengers.

(45) The increase in forecast load factors reflects the improved commercial strategy of the airline and greater focus on yield management. The key drivers behind the load factor changes are a growth in traffic (based on an expected market growth of 5,9 % as forecast by Eurocontrol), reduced fares to improve competitive position resulting in a [4 % to 6 %] reduction in yield and an increase in number of passengers, network re-evaluation in order to focus on commercially viable routes only, expanding code shares agreements and cooperation with [...], the cessation of the granting of complimentary tickets to a range of beneficiaries and the Libya crisis (plan assumes that flights to Libya are suspended during FY2012 due to the recent crisis).

(46) Following a number of changes to the commercial approach and route strategy that have already been implemented at the beginning of the restructuring process, the airline has already achieved an increase in load factor by [6 to 8 %] (from [65 % to 67 %] in FY2010 to [72 % to 75 %] in FY2011).

#### Yield management

(47) Air Malta will apply industry standard practices to revenue management, pricing and increasing focus on MICE (Meetings, incentives, conferencing, exhibitions), corporate travel and tour operator relationships. These efforts are predicted to result in improved revenues of EUR [8 to 10 million].

(48) Pricing revenue initiatives include: changes to pricing structures, concentration on higher passenger volumes in off-peak periods and better yield performance during high season as well as a strategic framework for managing Tour Operators (EUR [3 to 4 million]).

(49) Revenue management initiatives include: simplification of processes, management of markets rather than individual flights, public rather than private fares (EUR [4 to 5 million]).

#### Ancillary pre-flight and in-flight revenues

(50) Following the approach of many LCC's, Air Malta will charge fees for ancillary services both pre- and in-flight which is expected to lead to increased revenues by EUR [9 to 11 million] in FY2016.

(51) Pre-flight revenues initiatives include

- differentiated service fees by sale channel (tour operators, global distribution, call centre and online)

between EUR [10] and EUR [15] in order to drive business to cheaper and more profitable sale channels such as the internet (increase in profitability by EUR [1 to 2 million] p/a);

- improved revenues through all added services booked through the airline's new Internet Booking Engine (EUR [1 to 2 million] p/a);

- additional bag charge fees of EUR [35 to 45] for any second or subsequent bag, it is assumed that 3 % all passengers travel with more than one bag (EUR [1 to 2 million] p/a);

- additional revenue shall also be generated through seat reservations fee of EUR [9 to 11] for each reservation, it is assumed that on average 10 passengers a sector will make a seat reservation;

- lounge access fee of EUR [9 to 11] with an assumed take-up rate of 1 % (EUR [100 000 to 200 000] p/a);

- revenues through bag insurance of EUR [3 to 5] offered when making an online booking with an assumed take-up rate of 1 % (EUR [50 000 to 100 000] p/a).

(52) In-flight revenues initiatives include

- paid catering service (EUR [4 to 5 million] p/a);
- sale of duty free and other goods (EUR [1 to 2 million] p/a).

#### Reduction of staff and organisation change

(53) Air Malta plans to significantly restructure its organisation in order to reduce the costs of the back office and support functions but also to improve the productivity of the front line operational functions. Migrating to the new organisation will release approximately 430 full-time equivalents (FTE), giving an annual saving of EUR [9 to 11 million]. The transition process to the new organisation will take approximately 18-24 months and so the full saving will not impact the profit and loss results until FY2014. It should be noted that this overall saving will be eroded by contracted increases in wages of [2 % to 4 %] per annum agreed with staff from FY2013 onwards.

- (54) The four trade unions have a legally valid Collective Agreement which still applies, through which early retirement schemes (ERS) are available to staff as an entitlement. The eligibility criterion of the ERS is such that [...] staff are eligible to apply.
- (55) Additionally, Air Malta will offer a voluntary redundancy scheme (VRS) which will be universally available to staff wherein the Company retains the right to accept or refuse the staff member's application. Employees are eligible for the VRS when they have continuously worked with Air Malta for at least [...] years. The VRS offers a payment of up to EUR [...] per employee [...].
- (56) Moreover, the Company also underwent a main organisation structure change. Major changes to structure have

been made in Finance, Commercial, Ground Services and Organisation Development (formerly HR).

- (57) Furthermore, Air Malta hired several new key executives such as a new CEO who has long experience in the air transport sector.

#### 4.2.3. Funding

- (58) Based on the forecast cash flows the Company will require significant recapitalisation. Throughout the restructuring period Air Malta will require an additional capital injection of EUR 130 million plus an internal contribution by the sale of assets of EUR [...] and a private loan of EUR [...] to provide additional working capital, totalling EUR 238 million.

Table 8

#### Sources and uses of funding 2011-2016

(in EUR million)

Uses	FY2011-2016 (59)	Sources	FY2011-2016
Repayment of rescue aid	52 000	<i>Internal contribution:</i> Sale of land Sale of subsidiaries Sale of engines	66 200
Repayment of third party loan	[20 000 to 25 000]		[9 000 to 12 000]
Redundancy payments	[25 000 to 30 000]		[9 000 to 12 000]
Other restructuring costs	[13 000 to 16 000]	<i>Third party contribution:</i> Bank debt	[20 000 to 25 000]
Cash expenditure	[13 000 to 16 000]		
Change in working capital/net losses	[50 000 to 60 000]		
Maintenance reserves payment	[40 000 to 50 000]	<i>Government funding:</i> Government equity	130 000
Total	238 000		238 000

#### Own contribution

- (59) As described above, Air Malta will finance EUR 108 million (45,4 % of funding requirement) of its own restructuring. Air Malta will raise EUR 66,2 million from the sale of land, EUR [...] from the sale of subsidiaries, EUR [...] from the sale of engines and EUR [...] in additional third party debt.
- (60) Negotiations are currently ongoing to secure the loan of EUR [...] from [...]. Malta has provided letters of intent by the two banks dated 24 and 29 November 2011.
- (61) The most important part of the Company's own contribution will come from the sale of land. Air Malta owns a leasehold title on valuable property situated on the perimeter of Malta International Airport. The Government of Malta has expressed its strategic interest to acquire Air Malta's airside properties. The land sites concerned represent a scarce resource that Government would like to see developed in a manner consistent with

its long term strategy for the development of aviation related activity in Malta, including the creation of a cargo hub as part of an enlarged aviation park that also includes aircraft repair and other related facilities. The sale will not be carried out in an open, transparent and non-discriminatory tender. However, in line with its general policy and the national legal requirements, all property acquisitions by the Government have to be effected at a fair open market value, which reflects the price that would be paid on an arm's length basis by a private investor. The Plan assumes the sale of the land adjacent to the airport for a total of EUR 66,2 million between FY2012 and FY2014. The value is based on an independent valuation report dated October 2011 by [...], an independent evaluator appointed by the Government for this purpose. A private loan of EUR [...] provided by [...] will guarantee the bridge finance between 2011 and the payment of the full purchase price in 2014.

- (62) The sale of spare engines [...] took place on [...] and generated revenues of EUR [9 to 12 million].



- (63) Air Malta estimates to generate revenues of EUR [9 to 12 million] through the sale of its subsidiaries, [...].

#### State aid

- (64) Malta intends to recapitalise Air Malta to the extent of EUR 130 million of equity. This includes a debt-to-equity swap of EUR 52 million. A further EUR 60 million will be injected via fresh share issue in FY2013, EUR 15 million in FY2014, EUR 3 million in FY2015 in

addition to EUR 52 million in Government debt substituting the approved Rescue Aid loan and already disbursed to be converted to equity.

#### 4.2.4. Scenario analysis and assumptions

- (65) The Base case represents the target which Air Malta is aiming to achieve and believes is attainable from the implementation of the submitted Restructuring Plan.

Table 9

#### Base case scenario

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Number of aircraft	12	11	10	10	10	10	10
Number of passengers	1 796 426	[1 600 000 to 1 800 000]	[1 600 000 to 1 800 000]	[1 600 000 to 1 800 000]	[1 600 000 to 1 800 000]	[1 600 000 to 1 800 000]	[1 600 000 to 1 800 000]
Load factor	63,3 %	[72 % to 75 %]	[72 % to 75 %]	[72 % to 75 %]	[72 % to 75 %]	[73 % to 78 %]	[73 % to 78 %]
Yield per passenger (EUR)	105	[100 to 110]	[100 to 110]	[100 to 110]	[105 to 115]	[105 to 115]	[105 to 115]
Total revenue (EUR 000)	210 870	[180 000 to 220 000]	[180 000 to 220 000]	[180 000 to 220 000]	[190 000 to 230 000]	[200 000 to 240 000]	[200 000 to 240 000]
RASK <sup>(1)</sup> (EUR cent)	5 087	[5 to 6]	[5 to 6]	[5 to 6]	[6 to 7]	[6 to 7]	[6 to 7]
Total cost (EUR 000)	234 026	[210 000 to 250 000]	[210 000 to 250 000]	[210 000 to 250 000]	[200 000 to 240 000]	[200 000 to 240 000]	[200 000 to 240 000]
CASK <sup>(2)</sup> (EUR cent)	5 645	[5 to 6]	[6 to 7]	[6 to 7]	[6 to 7]	[6 to 7]	[6 to 7]

<sup>(1)</sup> Revenue per available seat kilometre.

<sup>(2)</sup> Cost per available seat kilometre.

- (66) Key assumptions for the base case scenario are the following:

**Network:** The network has been assumed to be reduced by 20 % in ASK terms between FY2011 and FY2013. Network capacity has been assumed constant after FY2013.

**Destinations:** Although it has been assumed that the main destinations in the network will remain the same, substantial rationalisation of the network has been assumed with changed frequencies in line with the reduction in capacity.

**Fleet:** It has been assumed that the fleet will be reduced to 10 aircraft from [...] 2011. Fleet size has been then assumed constant at 10 aircraft after [...] 2011.

**Maintenance:** Air Malta will change the treatment of engine performance restoration reserves from FY2014 onwards.

**Fuel:** Fuel has been assumed at USD 115 per barrel Brent equivalent in FY2012 and beyond <sup>(21)</sup>.

**Exchange rate:** Exchange rates have been assumed constant at current levels (USD/EUR 1,36 and GBP/EUR 0,86).

**Passenger growth:** The main focus for passenger growth will be on managing the load factors during the shoulder and low seasons.

**Yield growth:** The main focus for revenue passenger growth will be on managing average yields during the high-demand summer season, when load factors are already high.

**Inflation:** Known price increases are included such as salaries [2 % to 4 %]. Otherwise cost inflation is not included.

<sup>(21)</sup> Societe Generale, Long-Term Key Commodity Forecasts, November 2011, average of 2011-2016.

(67) In addition to the base case, Air Malta has modelled worst and best case scenarios, analysing the risks inherent in several key internal and external driven assumptions underlying the Restructuring Plan (Table 10).

Table 10

**Worst, base and Best case scenarios assumptions FY2016**

	Worst case	Base case	Best case
Contract initiatives — cost reduction (2016)	[4 to 5 m]	[7 to 10 m]	[10 to 12 m]
Implementation completion	[12/2014]	[06/2014]	[01/2014]
FTE reduction	[200 to 250]	[400 to 450]	[500 to 550]
Redundancy costs (430 FTE)	[30 to 35 m]	[25 to 30 m]	[25 to 30 m]
Load factor	[70 % to 75 %]	[73 % to 78 %]	[75 % to 80 %]
Revenue per pax	[100 to 110]	[110 to 120]	[110 to 120]
Fuel price/bbl equivalent	USD 150	USD 115	USD 110
USD/EUR rate	USD 1,25	USD 1,36	USD 1,50
Operational stoppage	3 months	—	n/a

(68) The combination of all worst or best case scenarios would lead to substantial losses or profits in FY2016. However, a probability analysis demonstrates that there is a [60 % to 70 %] probability that FY2016 operating profit will fall between EUR [0 to 1 million] and EUR [20 to 25 million].

## 5. COMMENTS OF MALTA

(69) Malta is of the view that the capital increase constitutes state aid to Air Malta, which should be declared compatible with the Internal Market on the basis of the R&R Guidelines.

### Restoration of long-term viability

(70) According to Malta, the Restructuring Plan aims to restore the long-term viability of Air Malta by delivering operating and revenue improvements to support the sustainable recovery of Air Malta, whilst the duration of the Plan corresponds to the minimum duration necessary to restore long-term viability. The Restructuring Plan shows that the existing level of losses can be turned around to breakeven levels by FY2014 and to profitability by FY2015 and that Air Malta could generate an operating profit of EUR [...] and a net profit of EUR [...] by FY2016.

(71) Malta argues that the expected of [7,6 % to 9,2 %] and ROE of [8,7 % to 10,7 %] for FY2016 will be enough to enable Air Malta to compete in the marketplace on its own merit.

### Compensatory measures

(72) Malta regards the following measures as compensatory measures in the terms of the R&R Guidelines:

- Reduction in absolute capacity of 20 % of ASK;
- Surrender of profitable or potential profitable routes;
- Surrender of landing slots at coordinated European airports;
- Sale of subsidiaries.

(73) Malta argues that the Commission should take into account the market structure and that the compensatory measures shall not lead to a deterioration of the structure of the market. On a number of routes Air Malta is the only carrier and a further reduction would not be compensated by another airline. This applies most noticeably to core business routes [...] where air connectivity is required for Malta's economy. As the "home carrier" Air Malta has an obligation to maintain such connections.

(74) As regards the requirement that compensatory measures shall not relate to closure of loss-making activities which would at any rate be necessary to restore viability, Malta regards all routes to be profitable which make a positive contribution, i.e. which cover the variable costs, regardless of passing the [47 % to 57 %] threshold described in paragraph 30, since in the short term, the fleet size and the operational staff are fixed and therefore any route which makes a contribution is operating well from a business perspective. Therefore, Malta claims a reduction of at least [12,5 % to 15,5 %] (change FY2010-FY2013) or [16 % to 20 %] (change summer 2009 — summer 2012) to be counted as a compensatory measure within the meanings of the R&R Guidelines.

(75) Whilst Malta acknowledges that some of the routes that have been reduced are structurally loss making for Air Malta, those routes which are currently not profitable but would become profitable following the initial restructuring of the airline's cost base (so called "marginal" routes) amount to [5,5 % to 7,5 %] of the capacity change between FY2010 and FY2013. These routes should be regarded as representing an access to profitable market capacity for an operator with a more efficient cost structure than Air Malta. Therefore, they still present an opportunity for a competitor to benefit. In the case where a competitor operates a route in direct competition to Air Malta any release in Air Malta capacity will result in an increase in the competitors load factors and arguably profitability.

### Own contribution

- (76) Air Malta will raise EUR 108 million of a total restructuring funding requirement of EUR 238 million through own contribution. This amount comprises of EUR [9 to 12 million] from the sale of engines, EUR 66,2 million from the sale of the property portfolio, EUR [9 to 12 million] from the sale of subsidiaries and EUR [20 to 25 million] from raising third party debt, resulting in own contribution of 45,4%. Malta argues that this own contribution is in line with the indicative threshold established in Art 44 of the R&R Guidelines. It should be also noted that Air Malta has been undercapitalised for many years and the equity investment indicated in this Restructuring Plan is the minimum necessary to ensure an appropriate level of capitalisation and gearing for sustainable and viable future operations.
- (77) Moreover, a proportionate and balanced approach is appropriate in this case, taking due account of the exceptional circumstances of this case given the comparatively small size of the Air Malta operations, the market realities involved and Malta's specificities. Malta clearly exhibits a number of territorial and therefore permanent characteristics, which impact on its socio-economic development. Malta's geographic position on Europe's southern periphery results in direct problems with respect to accessibility to the rest of the European Union and as a result the country is extensively dependent on air and sea transport, but particularly on air transport. This is important as in the case of Malta, air travel is the only viable means of business passenger transport apart from being essential for other critical and essential services, including medical related travel. The geographical realities of Malta make the economy extremely dependent on air travel.
- (78) The European Union's wider economic and social cohesion objectives should be taken into account in this particular case given that Malta is considered an assisted area within the meaning of Article 107(3) (a) TFEU.

## 6. ASSESSMENT

### 6.1. Existence of State Aid

- (79) By virtue of Article 107(1) of the TFEU, any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threaten to distort competition by favouring certain undertakings or the production of certain goods, shall, in so far as it affects trade between the Member States, be incompatible with the internal market.
- (80) The concept of State aid applies to any advantage granted directly or indirectly, financed out of State resources, granted by the State itself or by any intermediary body acting by virtue of powers conferred on it.
- (81) In this context, the decision of the Maltese authorities to inject new equity of EUR 130 million has to be seen as State aid. The capital injection involves State resources and constitutes a selective advantage to Air Malta.
- (82) The measure affects trade between Member States and Competition as Air Malta is in competition with other European Union airlines, in particular since the entry into force of the third stage of liberalisation of air transport ("third package") on 1 January 1993. The measures in question enables Air Malta to continue operating so that it does not have to face, as other competitors, the consequences normally deriving from its poor financial results.
- (83) Under these conditions, the capital injection constitutes State aid within the meaning of Article 107(1) of the TFEU. This appreciation is not disputed by the Maltese authorities.

### 6.2. Compatibility of the aid with the internal market under the R&R Guidelines

- (84) Article 107(3)(c) TFEU provides that State aid can be authorised where it is granted to promote the development of certain economic sectors and where this aid does not adversely affect trading conditions to an extent contrary to the common interest.
- (85) The Commission considers the present measure to constitute a restructuring aid which must be assessed in the light of the criteria under the R&R Guidelines as well as the 1994 Aviation Guidelines<sup>(22)</sup>, in order to establish whether it may be compatible with the internal market pursuant to Article 107(3) TFEU.

#### 6.2.1. Eligibility

##### Firm in difficulty

- (86) Point 9 of the R&R Guidelines states that there is no Community definition of what constitutes a firm in difficulty, and adds that the Commission regards a firm as being in difficulty when it is unable, whether through its own resources or with the funds it is able to obtain from its owners/shareholders or creditors, to stem losses which without outside intervention by the public authorities, will almost certainly condemn it to going out of business in the short or medium term.
- (87) Subsequently, Point 10 of the R&R Guidelines clarifies that a limited liability company is regarded as being in difficulty where more than half of its registered capital has disappeared and more than one quarter of that capital has been lost over the preceding 12 months.
- (88) The Commission notes that Air Malta is a company with limited liability which has lost almost all of its registered capital and is unable to meet its current obligations. As explained in detail in paragraphs (14)-(19), the Company is clearly a firm in difficulty according to the definitions used in the Guidelines.

<sup>(22)</sup> Application of articles 92 and 93 of the EC Treaty and article 61 of the EEA Agreement to State aids in the aviation sector (OJ C 350, 10.12.1994, p. 5).

### Business group

(89) Point 13 of the R&R Guidelines states that a firm belonging to or being taken over by a larger business group is not normally eligible for rescue or restructuring aid, except where it can be demonstrated that the firm's difficulties are intrinsic and are not the result of an arbitrary allocation of costs within the group, and that the difficulties are too serious to be dealt with by the group itself. Where a firm in difficulty creates a subsidiary, the subsidiary, together with the firm in difficulty controlling it, will be regarded as a group and may receive aid under the conditions laid down in this point.

(90) Air Malta plc forms a group together with its subsidiaries. The difficulties of Air Malta are not a result of an arbitrary allocation of costs within the group but mostly due to weak revenues in its core business. The difficulties are too serious to be dealt with by the group itself. Especially, many of the subsidiaries are loss making and the positive contribution by the profitable subsidiaries is far too small to compensate the losses in Air Malta's core business.

### 6.2.2. Restoration of long-term viability

(91) Firstly, according to point 35 of the R&R Guidelines the restructuring plan, the duration of which must be as short as possible, must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions.

(92) The restructuring plan forecasts the profitability by 2016 to be on a similar level as the profitability of major [...] carriers such as [...]. The Commission has doubts whether these optimistic forecasts are realistic to achieve, especially in view of the following:

(93) The Commission doubts whether the significant impact of the ancillary revenues both in-flight and pre-flight of at least EUR [9 to 11 million] p/a is realistic, especially whether the expected take-up rates reflect the growing price consciousness in consumer behaviour mainly on short range flights. In particular, the revenues through catering and on-board sale seem to be too optimistic.

(94) The Commission doubts whether the assumed cost reduction through contract management can be achieved since the negotiations are still at a very early stage for some of the contracts. Therefore, Malta is invited to give an update on these negotiations and the expected savings.

(95) The Commission doubts whether the assumed market growth of 5,9 % is still realistic. The annual growth survey of the Commission of 23 November 2011<sup>(23)</sup> shows that the economic recovery has come to a standstill and that low levels of confidence are

adversely affecting investment and consumption due to the current sovereign debt crisis and the situation in the financial sector together with a slowdown in the global economy. The impact has been particularly acute in the Euro area. As a result, GDP is likely to stagnate in the coming year and overall growth in the EU is forecast to be as low as 0,6 % for 2012. In contrast to Malta's assumed growth in GDP of 2,2 % in 2012, the latest economic growth figures by Eurostat<sup>(24)</sup> forecast a growth in GDP in 2012 of only 1,3 %. The economic slow down also affects the countries of origin of the foreign passengers flying to Malta, especially from UK (0,7 % growth in 2012) and Italy (0,1 % growth in 2012).

(96) The Commission doubts whether the assumed yield is still realistic to achieve. In a press release dated 7 December 2011, the International Air Transport Association (IATA) gives a negative outlook for profitability on the European air transport market. Higher passenger taxes and weak home market economies have limited profitability in Europe. European carriers are forecast to generate a collective profit of just USD 1,0 billion, down from the previously forecasted USD 1,4 billion, and an EBIT margin of 1,2 %<sup>(25)</sup>.

(97) The Commission doubts whether the assumptions for the base case scenario on inflation are realistic. The Restructuring Plan only includes known price increases such as salaries; otherwise cost inflation is not included. However, e. g. the European Central Bank expects inflation rates for the Euro area of 2,0 % (2012) and 1,9 % (2013)<sup>(26)</sup>.

(98) Against this background, it appears necessary to collect comments by interested parties during a formal investigation procedure. The Commission invites interested parties to comment on the assumptions described above, especially those in Sections 4.2.2. and 4.2.4.

(99) The Commission invites third parties to give their view whether the envisaged results at the end of the restructuring process, especially the ROE and ROCE figures (see Section 4.2.1.) in comparison to figures of its competitors, ensure long-term viability in the market environment of the air transport sector. The Commission invites the Maltese authorities to provide updated information on the implementation of Air Malta's turnaround strategy, including the progress made on contract management.

(100) As regards the scenario analysis, Malta has not provided an analysis of the overall impact on the profit and loss situation for both the best and the worst case scenario. Furthermore, the standard deviation analysis is not clear enough and has to be explained in more detail; especially Malta has to demonstrate how and on what basis the standard deviation is calculated.

<sup>(24)</sup> Eurostat: <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=de&pcode=tsieb020&plugin=1>

<sup>(25)</sup> IATA: <http://www.iata.org/pressroom/pr/Pages/2011-12-07-01.aspx>

<sup>(26)</sup> ECB: [http://www.ecb.int/stats/prices/indic/forecast/html/table\\_3\\_2011q3.en.html](http://www.ecb.int/stats/prices/indic/forecast/html/table_3_2011q3.en.html)

<sup>(23)</sup> COM(2011) 815 final.



6.2.3. *Avoidance of undue distortion of competition (compensatory measures)*

- (101) Secondly, according to point 38 of the R&R Guidelines, compensatory measures must be taken in order to ensure that the adverse effects on trading conditions are minimized as much as possible. In this regard, closure of loss-making activities which would at any rate be necessary to restore viability will not be considered reduction of capacity or market presence for the purpose of the assessment of the compensatory measures (point 40 of the R&R Guidelines).
- (102) Since the overall capacity reduction of 20 % of ASK also contains loss making routes whose closure is necessary to restore viability, there are serious doubts whether the overall reduction can be regarded as compensatory measures.
- (103) Malta proposes to discontinue or reduce capacity on certain routes which are profitable, or have potential for profitability with the right management and commercial attention and investment.
- (104) The total ASK change related to the routes explicitly earmarked as compensatory measures (see Table 5) amounts to [...] ASK, which corresponds to [14 % to 18 %] of the 2010 overall capacity. The net capacity reduction related to these routes — i.e. capacity change related to the routes explicitly earmarked as compensatory measures minus the capacity increase by additional routes and expansion of existing schedules — amounts to [...] ASK which corresponds to [5 % to 7 %] of the 2010 capacity.
- (105) In contrast, Malta offers an overall capacity reduction of [12,5 % to 15,5 %] for “profitable” routes plus a capacity reduction of [5,5 % to 7,5 %] for “marginal” routes to be regarded as compensatory measures. These numbers conflict with the ASK figures provided for the routes explicitly earmarked as compensatory measures. The Commission invites the Maltese authorities to clarify this incoherence. The Commission notes that for the route Malta–Verona the contribution margin and the load factor are missing although this route should be counted as a compensatory measure.
- (106) The Commission has doubts whether these routes are profitable. All the routes earmarked as compensatory measures have a 2010 contribution margin below the [47 % to 57 %] threshold, the benchmark described in paragraph 31. The contribution margin of some routes is even negative (e. g. [...]).
- (107) Malta argues that, in order to exclude loss-making routes, a positive contribution margin, regardless of passing the [47 % to 57 %] threshold, is sufficient. Even if the Commission followed Malta’s approach, the capacity reduction would amount to only [...] ASK<sup>(27)</sup> (corresponding to [8 % to 10 %] of the 2010 capacity) which is accompanied by a capacity increase of [...]
- ASK, resulting not in a net capacity reduction (i.e. capacity reduction minus capacity increase) but in a net capacity increase of [...] ASK. In any case, the Commission has doubts whether this approach is appropriate as it does not ensure the coverage of fixed operating costs and administrative overheads by the retained bundle of routes.
- (108) Malta argues that some routes which are not profitable today have potential for profitability with the right management and commercial attention and investment. Therefore, Malta provided a contribution margin forecast for FY2014. However, some of the routes will still remain below the [36 % to 44 %], the relevant threshold in FY2014 (see paragraph 31). This includes routes earmarked as compensatory measures such as [...].
- (109) The Commission notes that only capacity data until FY2013 have been provided and invites the Maltese authorities to also submit information on the route network development as of 2014. The capacity reduction carried out until 2013 may not be significantly counterbalanced by future capacity increase.
- (110) Beyond the capacity reduction, Air Malta proposes the sale of non-loss making assets as compensatory measures. This includes its subsidiaries Shield Insurance Co. Ltd. (an airline insurance company) and Osprey Insurance Brokers Co. Ltd. (an airline insurance broker).
- (111) However, according to point 40 of the R&R Guidelines, the compensation measures should take place in particular in the market where the firm will have a significant market position after restructuring.
- (112) The market where Air Malta has and will have a significant market position is the Maltese air transport market. This does not apply to the insurance sector. Therefore, there are doubts whether the sale of Shield Insurance Co. Ltd. (an insurance company) and Osprey Insurance Brokers Co. Ltd. (an insurance broker) can be considered as compensatory measures.
- (113) Although, since Malta is an area eligible for assistance under Article 107(3)(a) TFEU, in assisted areas the conditions for authorising aid may be less stringent as regards the implementation of the compensatory measures (point 56 of the R&R Guidelines), the Commission has doubts whether the proposed compensatory measures are sufficient enough to compensate undue distortions of competition.
- (114) In view of the above, the Commission invites the Maltese authorities to provide additional information which would allow it to determine whether the proposed compensatory measures indeed go beyond what is necessary in order to achieve long term viability. In addition, the Commission invites the Maltese authorities to comment if there are any other measures undertaken in the context of the restructuring plan which constitute adequate compensatory measures.

<sup>(27)</sup> Sum of the ASK changes related to the routes which have a positive contribution margin in 2010 in Table 5.



#### 6.2.4. Aid limited to the minimum (own contribution)

- (115) Thirdly, according to point 43 of the R&R Guidelines, in order to limit the amount of aid to the strict minimum of the restructuring costs necessary, a significant contribution to the restructuring plan by the beneficiary from its own resources is necessary. This includes the sale of assets that are not essential to the firm's survival, or from external financing at market.
- (116) For large firms, the Commission normally considers a contribution to the restructuring of at least 50 % to be appropriate. However, in exceptional circumstances and in cases of particular hardship, the Commission may accept a lower contribution (point 44 of the R&R Guidelines).
- (117) Furthermore, Malta is an area eligible for assistance under Article 107(3)(a) TFEU. In assisted areas the conditions for authorising aid may be less stringent as regards the size of the beneficiary's contribution (point 56 of the R&R Guidelines).
- (118) The proposed own contribution of Air Malta is 45,5 % of the funding requirement.
- (119) Malta's peripheral geographical situation causes problems with respect to accessibility to the rest of the EU and as a result the country is extensively dependent on air transport. This is important as in the case of Malta, air travel is the only viable mean of business passenger transport apart from being essential for other vital services, including medical related travel. Against this background, an own contribution of 45,5 % may be appropriate in the present case.
- (120) However, the own contribution must be real, i.e., actual, excluding all future expected profits such as cash flow (point 43 of the R&R Guidelines).
- (121) As regards the sale of subsidiaries, it is not clear for the Commission whether the sales will be carried out by an open, transparent and non-discriminatory procedure. The values should have been established by independent evaluation. However, these evaluations have not been provided to the Commission. The Commission invites Malta to submit further information about the envisaged sale procedure and to provide the mentioned evaluation reports. This applies especially to the sale of subsidiaries with a relevant value such as [...].
- (122) As regards the EUR [...] loan which should be granted by [...], the Restructuring Plan notes that the negotiations are currently in progress to secure the bridge loan. Malta has provided letters of intent by the [...] banks dated 24 and 29 November 2011. It is the Commission's understanding that no legally binding agreement has been concluded yet. The Commission invites the Maltese authorities to submit updated information about the progress of the negotiations and to provide the legally binding loan agreement.
- (123) Air Malta also claims that the proceeds from sale of two engines (EUR [...]) should be included into own contribution of the company to its restructuring costs.

The sale of these spare engines [...] took place on [...]. Since the restructuring period of Air Malta starts in November 2010 (following a 6 months rescue period), these sales took place outside the restructuring period. Therefore, the Commission has doubts whether the proceeds from the sale should be considered a part of own contribution to the Company's restructuring costs.

#### 6.2.5. "One time, last time" principle

- (124) Finally, the aid must respect the condition that it is "one time, last time". Point 72 of the R&R Guidelines provides that a company that has received rescue and restructuring aid in the past ten years is not eligible for rescue or restructuring aid.
- (125) In April 2004, before accession to the EU, Malta carried out a capital increase of EUR 57 million. This measure was not considered as rescue and restructuring aid by the Maltese authorities who considered the capital increase to be compatible with the market economy investor principle (MEIP).
- (126) The Commission was informed about this measure at the time in the context of pre-accession cooperation. Since the measure was granted before Malta's accession to the EU, it was not necessary for Malta to seek the Commission's approval prior to implementing the capital increase in 2004. However, in line with consistent Commission practice<sup>(28)</sup>, the Commission will take account of restructuring aid granted prior to accession for the application of the "one time, last time" principle in subsequent cases of restructuring aid.
- (127) The transaction in question involved the transfer by the Government of real property (land and buildings) to Air Malta under a long-term (63 years) lease agreement in return for obtaining additional shares in Air Malta. This real estate had been formerly held by Air Malta under rental agreement.
- (128) At that time, the Maltese authorities considered that this capital increase did not constitute State aid because it had been carried out in conformity with the MEIP at market price, that the private shareholding in Air Malta had not been diluted by the capital increase (i.e. the minority shareholders had participated in proportion to their shareholding) and that the transaction was not related to rescue or restructuring Air Malta which was not a firm in difficulties at that time.
- (129) According to the MEIP, it is necessary to establish whether Air Malta received an economic advantage, which it would not have obtained under normal conditions. Public authorities may inject capital, but at the same time they must behave in the same way as a private investor would behave in similar circumstances.

<sup>(28)</sup> Commission Decision 2007/509/EC of 20 December 2006 on State aid C 3/05 (ex N 592/04 (ex PL 51/04)) which Poland is planning to implement for Fabryka Samochodow Osobowych SA (formerly Daewoo — FSO Motor SA) (OJ L 187, 19.7.2007, p. 30); Commission Decision 2010/174/EC of 10 March 2009 on the State aids C 43/07 (ex N 64/07) and C 44/05 (ex NN 79/05, ex N 439/04) granted by Poland to Huta Stalowa Wola SA (OJ L 81, 26.3.2010, p. 1).

- (130) The use of the property in question had long vested largely with Air Malta, which had over the years enhanced the value of the property at its own cost and on the basis of an expectation that the property would be transferred. The Commission notes that this transaction was discussed and prepared over a number of years. A board paper in 2000 already referred to this transaction.
- (131) Before the capital increase, on 30 March 2004, Air Malta's management produced a draft three year projection projecting the return to profitability in FY2007 (ending in July 2007) and profit before tax of EUR 1,32 million. Air Malta was forecasting a return to profitability within a relatively short period — as a result of both cost cutting initiatives and revenue generation measures
- (132) The transaction was based on a market value with advice from PriceWaterhouseCoopers which stated that “the value of assets being allocated to the company corresponds to at least the nominal value of the shares and the share premium thereon issued in the company to the Government of Malta”.
- (133) Private minority shareholders participated in the capital increase proportionate to their holdings.
- (134) The Commission considers that the 2004 capital increase might be in conformity with the MEIP, in which case it would not constitute State aid and should not be taken into account for the application of the “one time, last time” rule. It invites the Maltese authorities and third parties to provide comments.
- (135) In its decision of 15 November 2010 concerning the EUR 52 million rescue loan granted to Air Malta <sup>(29)</sup>, the Commission could not arrive at a definite conclusion as to whether the 2004 transaction complied with the MEIP or whether Air Malta had received restructuring aid. Rather, the Commission considered that for the purposes of its decision, due to the need to approve the rescue aid rapidly in order to avoid the serious social consequences that would have resulted from a closure of Air Malta and in light of the specific circumstances of the case, it was not necessary to decide whether Air Malta had received restructuring aid in 2004. Thus, the “one time, last time” principle did not constitute a bar to the notified rescue loan being considered compatible <sup>(30)</sup>.

(136) In case the 2004 capital increase should constitute restructuring aid, or in case it should not be possible to come to a conclusion on this point, the Commission wonders whether the special circumstances mentioned in the 15 November 2010 decision could equally apply in the present case as regards the notified restructuring aid. It also invites the Maltese authorities and third parties to comment on this issue.

(137) Beyond that, Malta confirmed that Air Malta has not received any further restructuring aid in the past.

### 6.3. Conclusion

(138) For the reasons explained above in sections 6.2.2., 6.2.3., 6.2.4. and 6.2.5., at this stage, the Commission has several doubts concerning compliance of the aid with the conditions of the Rescue and Restructuring Guidelines.

## 7. DECISION

In light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 108(2) of the TFEU, requests the Republic of Malta to submit its comments and to provide all such information as may help to assess the compatibility with State aid rules of the measures at stake, within one month of the date of receipt of this letter. It requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

The Commission wishes to remind the Republic of Malta that Article 108(3) of the TFEU has suspensive effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns the Republic of Malta that it will inform interested parties by publishing this letter and a meaningful summary in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries that are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the *Official Journal of the European Union* and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.'

<sup>(29)</sup> See footnote 1.

<sup>(30)</sup> See paragraph 64-76 of that decision.