

REPORT  
GUNTER ENDRES  
IN ALMATY

# BEATING THE BLACKLIST

Kazakh carrier Air Astana's robust defence kept it off the European blacklist when all other carriers from the former Soviet territory were banned. President Peter Foster explains how it achieved this seemingly impossible feat and what's next for the carrier

**L**ike the elusive snow leopard in the Tien Shan mountains of Kazakhstan, Air Astana is a rarity among airlines in this vast and land-locked central Asian republic. Air Astana is the de facto flag-carrier, with equal stakes held by the Kazakhstan government and BAE Systems. And, with its experienced multi-national management team, an all-western fleet, internationally-approved engineering and maintenance and a well-structured safety system, Air Astana is reconnecting this remote former Soviet territory with the global community.

It is these assets and attributes which kept Air Astana off the European Union blacklist, even when the country's regulatory and safety oversight was deemed inadequate, leading to a ban of all other local airlines from flying into Europe. More specifically, says Air Astana president Peter Foster, it was the airline's robust, three-pillar defence at a European Union Air Safety Committee hearing in Brussels in June, which averted this fate.

"We pointed out that the airline's air operator's certificate and oversight was provided by the internationally-respected Aruba department of civil aviation, our maintenance and engineering is carried out in accordance with the recently acquired EASA Part 145 certification and audited twice-yearly by the UK CAA and, finally, we demonstrated a coherent and pyramidal safety reporting structure, as evidenced by the airline having passed the IATA Operational Safety Audit in 2007, which was



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**PETER FOSTER**  
President, Air Astana

successfully re-certified in 2009," says Foster. On the strength of this defence, the ASC took the unprecedented step of putting the entire airline on "Annex B", allowing it to continue flights into Europe, but prohibiting further new frequencies or routes into Europe.

In spite of all the good work undertaken by the airline, Air Astana came very close to being swept up in the ban. Foster explains: "If Air Astana had been included on the blacklist, this would have been extremely harsh."

How Kazakhstan came to be in this sorry state can easily be explained. When the airline was founded, president of the republic, Nursultan Nazarbayev, set up a framework which generally supported the aviation industry. But old Soviet regulations and oversight rules were never updated by the Civil Aviation Committee, primarily due to a lack of investment and skilled personnel, not least because of the low salaries offered.

Also, the fall of Communism was a traumatic event and priorities for the fledgling nation probably lay elsewhere. On top of this, Foster explains that the situation was not helped by the ICAO audit being somewhat less critical in 2003 than it is today. This kept the CAC in a relative comfort zone, which in part led to continued inactivity and the issue of some 62 AOCs in the years following.

The renewal of the ICAO audit in April 2009 highlighted glaring deficiencies, which led to an immediate EU investigation. After several meetings in May and June, all Kazakhstan air carriers were blacklisted, with the exception of Air Astana.

Foster continues: "There has been some resentment from the local airlines, with Air Astana – as a semi-foreign company – being accused of receiving preferential treatment, but beyond that there has not been any measurable negative effect on the airline." The restriction on new European routes and frequencies in the short term, at least for the next 15-18 months, is not an issue for Air Astana, insists Foster, but he acknowledges that if the



CAC does not make the necessary changes, Air Astana may hit difficulties in the future: "Our exempted status remains precarious and is to a great extent dependent on oversight improvements at national level."

Foster says some progress has been made. The CAC has set up an independent inspectorate, the Flight Safety and Airworthiness Centre, implanting five qualified inspectors from Aruba. However, this body will not address the AOC issue, which requires new legislation. To tackle this issue, a legislative programme has been put before parliament.

Kazakhstan has also submitted a response to ICAO's action plan and it is required to submit a progress report to the EU every four months. In the meantime, the president has issued an unequivocal order that no new licences are to be issued. "There is movement and there is progress," Foster confirms, "but the jury is still out."

#### A GOOD YEAR

In spite of 2009 being challenging due to the EU safety issue and the ongoing recession, Air Astana had its most successful financial performance to date. "We have had an extremely good year," says Foster, noting that revenues were 16% down, but costs narrowed by 22%, translating into a net profit of \$50.2 million.

"We had a degree of luck in that \$10 million was earned from the revaluation of our dollar-dominated assets when the Kazakh Tenge was devalued in February, but even without that windfall, the result compares very favourably with our previous best year in 2007, when we made a net profit of \$35 million," he says. In 2008 Air Astana's revenues totalled \$643.6 million.

Roughly 65% of the savings came from local fuel costs. "We were not hedged initially and were able to take advantage of the fall in oil prices. We then reached ground-breaking agreements with the government and local refineries in terms of price and quantity, which were completed last March. We buy our fuel direct from the refinery and store it on site at our airports. This accounts for about 70% of our total uplift. Of course, we are paying a higher price now and have hedged about half of our fuel till the end of 2010."

Cost savings were also extracted from every single cost centre. Air Astana optimised its international network, downsizing from Boeing 767s to 757s, and from 757s to Airbus 321s where appropriate. It cut some frequencies,



Air Astana was created in 2001 as a joint venture between Kazakhstan and BAE Systems

improved yield and froze salaries. "We also achieved significant savings in extending the lease terms of some of our aircraft from pre-existing dates, which enabled us to secure reduced rates, and finally, we made enormous savings from cancelling our general sales agency agreement here in Kazakhstan, which saved about \$11 million."

In spite of the government shareholding, Foster stresses that Air Astana's operations are in no way subsidised. The only money it receives from state coffers is about \$500,000 per annum for operating 12 weekly frequencies on four "social" routes to remote northern towns. Other local airlines also operate social routes to more distant parts. Fares for local travellers are set at an extremely low fare – as little as \$25 – but foreign passengers have to pay the full commercial fare. While these social routes were important in the early days, Foster says they now represent only a tiny proportion of the airline's operation.

Looking back, Air Astana has come a long way since it launched on 15 May 2002 with a domestic service between Almaty and Astana, following a series of failed state attempts to create a viable international carrier.

Foster is the first to acknowledge the sterling work done by the previous management, but he says when he arrived in 2005 Air Astana was suffering serious growing pains, having started from nothing just three years earlier. "The market was growing fast and the Boeing 737s then in service were nowhere near sufficient, nor were the aspirations of the

government. Having established the airline very quickly, the internal processes were simply not there, and this extended right across all aspects of operations. We could not find any 737-800s at that time [in 2006], that's why we switched to the Airbus A320.

"It was that crucial time when many businesses realise that they have to deepen their processes if they are to be firmly established, or become vulnerable to takeover or disappear altogether. We drew up a strategic plan very quickly – I arrived in September and the plan was ready by December. We bought ourselves time to source aircraft and additional staff, and we stuck rigidly to that plan. The result is that the airline now has a motivated team in all key positions. We have all the things we set out to achieve and are slightly ahead. We have now extended our planning to 2014. By then we'll have a fleet just shy of 30 aircraft, a substantially expanded regional network, and will have conservatively extended our long-haul network," says Foster.

#### REGIONAL STRATEGY

Air Astana's strategy is currently focussed on its "surrogate home market", which includes Kazakhstan, its central Asian neighbours, south-eastern Russia and South-East Asia. "All of this we regard as fair game," says Foster. The airline has recently opened services to Baku in Azerbaijan, Bishkek in Kyrgyzstan, Novosibirsk and Kuala Lumpur. It is also eyeing Dushanbe in Tajikistan and Tashkent in Uzbekistan, as well as Omsk, Yekaterinburg



and Kazan in southern Russia. This strategy increases the airline's catchment area from 15 million in Kazakhstan, to some 65 million. "This is a sizeable number and we regard the opening up of these markets as our mission," says Foster. He adds that Air Astana has no ambitions to open ultra long-haul routes, to the Americas for example, but Munich and Prague are on the radar once European restrictions are lifted, along with Osaka in Japan.

At present, Air Astana flies to 15 destinations on 22 domestic routes, which account for 76% of the market. It also offers a similar number of international routes, serving 17 cities, supporting a combined 2.1 million passengers in 2009, down 6% year-on-year. Air Astana operates virtually all international routes, with rival Scat Air flying the only other scheduled cross-border services.

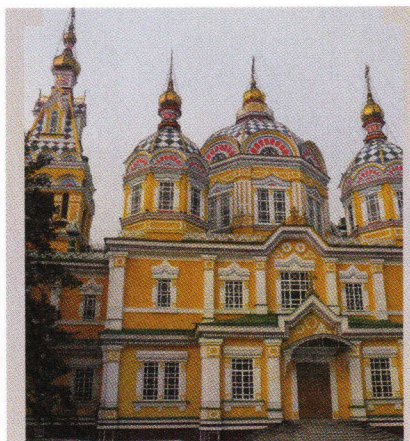
#### THE RIGHT FLEET

Air Astana's fleet renewal and expansion plans are based on clearly defined parameters over the next five years. Over that period, it will replace its six Fokker 50s with either ATR 42s or Bombardier Q300s and will add six more A320s under a \$267 million purchase deal which it agreed in May 2008. This acquisition will be financed without government guarantees or funding. It is also adding two Embraer 190LRs on lease from Jetscape which are due to arrive in March and April 2011 and negotiations are underway for a third.

"We signed a MoU for Boeing 787s in 2007," recalls Foster. "But we now consider this as inactive because, at the last count, our delivery date could well have extended to 2019. Even if Boeing gave us a good deal, in terms of price, that was astonishing in today's money with a little built-in escalation, the MoU would remain inactive. That is not to say that we will not revisit this in the future."

Another item on Air Astana's fleet agenda is whether to extend its 767 leases or change to Airbus A330-200s. One benefit of the 767 is that the airline is familiar with the type and the crews are interchangeable, but the cabins are "getting a little tired" and would need a complete retrofit, says Foster. Meanwhile, Air Astana has struggled to find a similar range and capacity replacement for its 757s, so it has extended its leases on the type. The four aircraft have been fitted with Aviation Partners' winglets, resulting in a 6% saving in fuel.

Air Astana presently operates a 21-strong fleet acquired on operating leases, including



**Kazakhstan is larger than western Europe and ranks as the ninth largest country in the world**

two Boeing 767-300s, four 757-200s, one A319-100, seven A320-200s, two A321-200s, and five Fokker 50s. All aircraft are on the civil aircraft register of Aruba.

Air Astana faces tough competition at Almaty and Astana from larger European, Middle Eastern and Asian carriers, such as Lufthansa, KLM, Etihad, Asiana and Transaero. This was expected, and is being met, but Foster does not believe that a serious Kazakh challenger will emerge.

"There is no question that here, in Kazakhstan, there are plenty of people and organisations that wish to mount a genuine challenge to Air Astana. But I believe that the existing shareholding structure and staff management, in particular, ensure that we have at our disposal the best corporate governance and personnel, who will simply not go and work for any other organisation. That is certainly what has happened until now. We find ourselves in this virtuous cycle and are putting greater distance between ourselves and the other [local] airlines. And that doesn't make everyone happy."

If Air Astana has a vulnerability, it is the risk of an enforced or voluntary exit by BAE Systems. This could prove a major setback, casting it back into the early post-Soviet darkness, but Foster dismisses such concerns: "We have consistently delivered growth, with the exception of 2008, and our pitch is that there

is no reason for BAE Systems to divest itself of its shareholding. Whether or not it will in the future is, of course, impossible to predict and out of our hands. What I would say, however, is that the shareholding structure has been crucial for our success in the past, is crucial in the present, and will be crucial in the future.

"BAE Systems does not interfere in the day-to-day running of the company, but what it does do is impose strong discipline in terms of ethics, transparency and behaviour. In that sense it sets the framework. The way the charter of the airline is set up, it gives to the shareholders virtually equal powers, which prevents political and other unwelcome interference. Kazakhstan has a patchy record, but we are able to stand out as a company with excellent corporate governance and this is very much due to the presence and discipline of BAE Systems."

Foster reveals that the airline has repaid more than the initial capital investment of \$17 million (\$8.5 million from each shareholder), in dividends alone. The government has further benefited from tax payments, which by the end of 2008 amounted to \$150.8 million. When the airline was set up on 29 August 2001, the shareholding was divided equally between the government and BAE Systems, but this was adjusted by 1% in favour of the government. This is because a majority government holding was required for the airline to gain international traffic rights, especially to China and Russia. But Foster points out that the decision making process and control remain strictly on an equal footing.

Air Astana has shown that it can successfully mix with more established carriers, both in Europe and Asia and it has proven a worthy ambassador abroad. It has also led the way at local level. Kazakhstan, itself, now has an opportunity to establish a world-class safety oversight system, and needs to act thoroughly and with speed if its progress is to be maintained. Infrastructure, especially at airports in more remote regions, will also need to be improved to meet accepted standards. Air Astana itself has invested some \$2 million in de-icing equipment at local airports. These measures will both strengthen Air Astana and enable the creation of a strong aviation system in this large, under-populated country. ■



Air Astana was among the carriers included in our recent revenue management focus: [flightglobal.com/revenue management09](http://flightglobal.com/revenue management09)