COMMISSION DECISION

of 27 June 2012

on the State aid No SA.33015 (2012/C) which Malta is planning to implement for Air Malta plc.

(notified under document C(2012) 4198)

(Only the English version is authentic)

(Text with EEA relevance)

(2012/661/EU)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having regard to the decision by which the Commission decided to initiate the procedure laid down in Article 108(2) TFEU, in respect of the aid SA.33015 ([1]),

Having called on interested parties to submit their comments pursuant to the provisions cited above, and having regard to their comments,

Whereas:

1. PROCEDURE

(1) By letter dated 16 May 2011 Malta notified the Commission of the restructuring aid to Air Malta plc, following a rescue aid loan of EUR 52 million that was approved by a Commission decision of 15 November 2010 (N 504/2010, hereinafter "the decision on the rescue aid"). The Commission requested additional information by letters dated 5 July and 1 September 2011, to which then Maltese authorities replied by letters dated 2 August and 22 September 2011.

(2) By letter dated 25 January 2012, the Commission informed Malta that it had decided to initiate the procedure laid down in Article 108(2) TFEU in respect of the aid (hereinafter "the opening decision"). Malta provided comments on that decision by letter dated 5 March 2012. The Commission asked further questions by letter dated 19 March 2012, to which Malta replied on 19 April 2012.

(3) The opening decision was published in the *Official Journal of the European Union* on 21 February 2012. The Commission called on interested parties to submit their comments.

(4) The Commission received comments from six interested parties. It forwarded them to Malta, which was given the opportunity to react; its comments were received by letter dated 27 April 2012.

2. DESCRIPTION OF THE MEASURE AND THE RESTRUCTURING PLAN

2.1 Restructuring aid

(5) Malta 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 (RP) described below starting in November 2010 (after the approval of the rescue loan), and covering a five year restructuring period from autumn 2010 until autumn 2015.

2.2 Beneficiary

(6) Air Malta plc. is the national flag carrier of Malta since 1974. At the beginning of the restructuring process, Air Malta operated 12 passenger aircrafts and served 43 scheduled destinations in Europe, North Africa and the Eastern Mediterranean. Air Malta is owned by the Maltese government (98 %) and private investors (2 %).

(7) Air Malta is a very small player in the European aviation market (ca. 1,8 million passengers in 2010), representing only 0,25 % of the entire European airline industry's productive capacity and output (in terms of passengers). With the intended reduction of 2 aircrafts in Air Malta's fleet, it will become an even smaller player in a growing European air transport market. Air Malta plan to join a global alliance to improve connectivity in this reduced fleet scenario and also to improve fleet utilisation.

([1]) Commission Decision C(2012) 170 final of 25 January 2012 (OJ C 50, 21.2.2012, p. 7).

(8) Nonetheless, Air Malta is the most important air carrier for flights from and to Malta with a market share of 51 % (passengers) and 28 % (cargo). According to Malta, the restructuring of Air Malta is crucial as it provides Malta with a regular and dependable link to main European and North African centres whilst also supporting the economy through services such as the transportation of mail, cargo and patients for treatment abroad. This role is not filled by Air Malta's main competitors, above all low cost carriers (LCC) like Ryanair and easyJet.

(9) Air Malta has been making losses in its core airline business for several years and made a EUR 23,1 million operating loss in FY [1] 2010 and EUR 37,3 million in FY2011 (see Table 2).

(10) Air Malta plc. has the following subsidiaries ("Air Malta Group"):

Table 1

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)

2.3 **Restructuring Plan**

(11) The RP (dated 29 November 2011) and its Update of 28 February 2012 aim to restore Air Malta's profitability by FY2014 and its return to long-time viability by 2015. The duration of the RP is limited to five years, running from autumn 2010 to autumn 2015.

(12) The plan assumes that it will be possible to turn around the existing level of losses from an operating loss (EBIT) of EUR 37,3 million and a net loss of EUR 88,9 million in FY2011 to an operating profit of EUR […] (*) million and a net profit of EUR […] million in FY2014 and a further improvement of the profit situation in FY2015 and FY2016 (see Table 2).

Table 2

Profit and loss 2008-2016

(in EUR million)

Financial year	2008	2009	2010	2011	2012(f)	2013(f)	2014(f)	2015(f)	2016(f)
Revenues	273,7	249,5	210,8	207,5	[…]	[…]	[…]	[…]	[…]
Operating result	(8,9)	(33,8)	(23,1)	(37,3)	[…]	[…]	[…]	[…]	[…]
Net result	3,6	(23,7)	(11,6)	(88,9)	[…]	[…]	[…]	[…]	[…]

(13) The plan aims to achieve a return on capital employed (ROCE) [2] of [4 to 6] % and a return on equity (ROE) [3] of [5 to 7] % for FY2016.

[1] Air Malta's financial year starts on 1 April. Thus, e.g. FY2011 is from 01.04.2010 to 31.03.2011, FY2016 from 01.04.2015 to 31.03.2016.

(*) Business secret

[2] ROCE = Net profit / (Debt + Equity)

[3] ROE = Net profit / Equity

Table 3

ROCE and ROE 2012-2016

FY	2012	2013	2014	2015	2016
Return on equity (ROE)	n/a	– [30 to – 20] %	[2 to 6] %	[4 to 6] %	[5 to 7] %
Return on capital employed (ROCE)	– [60 to – 50] %	– [20 to 10] %	[0 to 5] %	[4 to 6] %	[4 to 6] %

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

Route and network strategy

(15) 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.

(16) Air Malta has already taken action to discontinue the loss making routes to Leipzig, Tunis, Damascus, Palermo and Turin in early 2011.

(17) 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 [1] (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 [2] 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.

(18) Concerning the profitability of the different routes, Malta provided the gross margin of all of the routes between FY2010-FY2013 as well as for Summer 2009-Summer 2012. The gross margin is calculated as follows: Revenue minus VDOC (variable direct operating costs) minus FDOC (fixed direct operating costs). The routes are profitable if they have a gross margin equal or above 0 %. Routes are 'marginally profitable' if their gross margin is currently lower than 0 % but higher than - 10 % but would become profitable in the future. According to Malta, both profitable and 'marginal routes' has been classified as relevant compensatory measures.

(19) The changes in the route network between FY2010 and FY2013 relate to an overall capacity reduction of 20,9 % ASK [3] of the 2010 overall capacity. This includes a capacity reduction of [27 to 33] % ([12,5 to 15,5] % [4] are related to routes claimed to be profitable, [5,5 to 7,5] % [5] to 'marginal routes' and [9 to 11] % [6] to unprofitable routes) and a capacity increase through the launching of new destinations and expansion of existing schedules of [8 to 10] %.

Table 4

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	[…]	[8 to 10] %
Total ASK (FY2013)	3 275 710	79 %
Overall decrease in capacity (FY2010-FY2013)	**869 812**	**20,9 %**

(20) Especially important are connections to international hubs which are essential for Malta's access to 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.

(1) OJ C 244, 1.10.2004, p. 2
(2) 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).
(3) ASK = available seat kilometre.
(4) 17,9 % when one compares the change between summer 2009 and summer 2012.
(5) 9,8 % when one compares the change between summer 2009 and summer 2012.
(6) 1,7 % when one compares the change between summer 2009 and summer 2012.

Cost initiatives

(21) 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 RP period which means a reduction in the total costs of the Company of [10 to 12] % and a decline of the total operating cost per passenger by [7,5 to 10] % (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).

(22) The planned 20,9 % capacity reduction has an impact on fixed and variable direct operating costs such as a reduction in fuel uplift of approximately […] million gallons (EUR […] million), 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 […].

(23) The airline will reduce the fleet from 12 to 10 aircraft. One aircraft has already been subleased to a Mexican carrier from […] and another aircraft, which is currently subleased under a short-term contract, has been subleased to a Polish carrier 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 [2,5 to 3,5] million.

(24) 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 [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.

(25) Air Malta is renegotiating the contracts with their major suppliers. The overall target for contract costs savings is ca. EUR [7 to 8] million. The review has been commenced with ten business partners. A big amount of savings […] was already achieved through negotiations with Malta International Airport [1].

Revenue initiatives

(26) Air Malta aims at increasing its revenues by introducing ancillary revenues from additional payable services (similar to the LCC approach) together with improving its revenue management and pricing.

(27) Given the 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 [110-120] 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 10] million), yield management (EUR [8 to 10] million) and ancillary revenues (EUR [9 to 11] million).

Load factor

(28) Air Malta has developed a new commercial strategy in order to improve its competitiveness and load factor. This strategy includes simplification and standardisation of processes and offerings, branding Air Malta as a "destination airline" (closer business relations with Malta Tourism Authority), building customer loyalty and repetitive business, guerrilla marketing and distribution and innovative products and offerings.

(29) This new strategy and improved marketing should lead to revenue enhancement. As can be seen from Table 5, according to Air Malta's RP, 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.

(30) With an expected growth in passenger volume of approximately [90,000 to 100,000] 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.

---

[1] The former state owned airport has been privatized. The major shareholder is a private consortium led by the Austrian Flughafen Wien AG. The Maltese government is only a minority shareholder (20 %).

Table 5

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 240 000]	[200 000 to 240 000]	[200 000 to 240 000]
Passengers (million) (1)	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]
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 (2)	**[72 to 75] %**	**[72 to 75] %**	**[72 to 75] %**	**[72 to 75] %**	**[73 to 78] %**	**[73 to 78] %**

(1) Based on Air Malta route economics inclusive of schedule and charter (Malta and UK operations)
(2) Load factor projections are an output based on projected seat numbers and passengers.

(31) 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 expected improvement of the political situation in Libya (plan assumes that flights to Libya are suspended during FY2012 due to the recent crisis).

(32) 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

(33) 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.

(34) 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).

(35) Revenue management initiatives include: simplification of processes, management of market rather than and individual flights (EUR [4 to 5] million).

Ancillary pre-flight and in-flight revenues

(36) 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.

(37) Pre-flight revenues initiatives include

— differentiated service fees by sale channel (tour operators, global distribution, call centre and online) between EUR 10,00 and EUR 15,00 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).

(38) 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

(39) 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 3] % per annum agreed with staff from FY2013 onwards.

(40) The four trade unions have a legally valid Collective Agreement, through which early retirement schemes (ERS) are available to staff as an entitlement. The eligibility criterion of the ERS is such that only […] staff are eligible to apply.

(41) 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 […].

(42) Moreover, the Company also underwent a main organisation structure change and recruited new key executives to its management team.

2.4 **State aid and financing of the restructuring costs**

(43) Given the total restructuring costs of EUR 238 million, the Government of Malta intends to recapitalise the beneficiary with EUR 130 million of equity according to the following schedule: 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.

(44) Air Malta proposes the remaining amount (i.e. the own contribution of 45 %) to be financed by the sale of land (EUR 66,2 million), sale of subsidiaries (EUR [9 to 12] million), sale of engines (EUR [9 to 12] million) and a bank loan (EUR [20 to 25] million).

(45) 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 from November 2011 by […], an independent evaluator appointed by the Government for this purpose.

(46) Air Malta secured a private loan of EUR [25 to 30] million provided by […] in December 2011. This bridging loan will facilitate the transition to the final equity structure over the next three years.

(47) Air Malta estimates to generate revenues of EUR [9 to 11] million through the sale of its subsidiaries […].

(48) The sale of spare engines […] took place on 28 October and 17 December 2010 respectively and generated revenues of USD [19 to 22] million. However, whereas engine No. […] was fully owned by Air Malta, engine No. […] was leased property of Air Malta with an option to purchase the engine at EUR [5 to 7] million, which was exercised. The net proceeds from the sale of the engines are EUR [9 to 12] million.

(49) The EUR [20 to 25] million bank loan will be concluded only in FY2014, Air Malta has thus not concluded the negotiations yet.

Table 6

Sources and uses of funding 2011-2016

(in EUR million)

Uses	FY2011-2016	Sources	FY2011-2016
Repayment of rescue aid	52 000	*Internal contribution:* Sale of land	 66 200
Repayment of third party loan	[20 000 to 25 000]	Sale of subsidiaries	[9 000 to 12 000]
Redundancy payments	[25 000 to 30 000]	Sale of engines	[9 000 to 12 000]
Restructuring costs	[13 000 to 16 000]	*Third party contribution:* Bank debt	 [20 000 to 25 000]
Capital 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]	*Government funding:* Government equity	 130 000
Total	**238 000**		**238 000**

2.5 **The opening decision**

(50) On 25 January 2012, the Commission opened the formal investigation procedure. In its decision, the Commission expressed doubts relating to the return to long term viability of the company, namely about the feasibility of the optimistic forecasts of the previous version of the RP which assumed a return to profitability by 2016 to be on a similar level as the profitability of major low cost carriers such as Ryanair or major traditional carriers such as Lufthansa. In particular, the Commission questioned the assumed impact of the ancillary revenues, cost reduction through contract renegotiation, market growth rates, yield and the non-inclusion of cost inflation in Air Malta’s RP. Furthermore, Malta was invited to provide clarifications regarding the scenario analysis.

(51) Regarding the proposed compensatory measures, the Commission doubted that the proposed overall capacity reduction of 20 % of ASK can be regarded as compensatory measures since it also contains loss-making routes whose closure is necessary to restore viability. The Commission also asked for further clarifications regarding the calculation of profitability of certain non-loss making routes as well as additional information that would demonstrate that the proposed measures are sufficient enough to compensate for the undue distortion of competition caused by the state aid.

(52) Apart from the capacity reduction, the Commission doubted whether the proposed sale of non-loss making assets can be considered as compensatory measure in view of the fact that according to point 40 of the R&R Guidelines, the compensation measure should take place in particular in the market where the firm will have a significant market position after restructuring.

(53) Regarding the own contribution, the Commission expressed its doubt whether it is indeed real, i.e. actual and excluding all future expected profits, as required by point 43 of the R&R Guidelines. In particular, the Commission requested clarification regarding the sale of Air Malta’s subsidiaries, the availability of the envisaged EUR 20 million loan and whether the sales of engines took place within the restructuring period.

(54) Lastly, the Commission requested further comments regarding the Plan’s compliance with the "one time, last time" principle with regard to an EUR 57 million capital increase that was carried out by Malta in April 2014.

3. COMMENTS FROM MALTA

(55) In its reply to the opening decision, Malta submitted comments and clarifications regarding all of the points raised in the Commission’s opening decision, indicating that the notified RP complies with all the conditions imposed by the R&R Guidelines. Moreover, Malta also provided an update regarding the restructuring process, demonstrating that significant progress has already been achieved.

(56) As regards the doubts on the forecasted return to profitability, Air Malta revised its forecasts (see Table 3) to an EBIT margin of [3 to 5] % in FY2016, which is lower than the historical margins achieved by Ryanair and Lufthansa. This reduction in profitability is mainly due to the realignment of the fuel assumptions.

(57) Air Malta provided substantiated comments regarding the ancillary revenues, demonstrating that they will represent [3 to 5] % of passenger revenues in FY 2016 which is significantly lower than the percentages achieved by the directly competing low Cost carriers (LCCs) such as Ryanair and easyJet as well as other network carriers that have embraced the ancillary revenue strategy, such as Aer Lingus. Regarding the costs reduction through contract renegotiation, Air Malta confirmed that over EUR [4 to 6] million p.a. has already been committed through concluded negotiations and a number of additional savings have been identified which would lead to a total amount of contract savings of EUR [9 to 11] million instead of EUR [7 to 9] million as previously planned.

(58) Malta has also revised its assumptions for Maltese market growth rates reducing it from 5,9 % annual growth rate to 4 % p.a. for the period to 2016. In addition a reduction in passengers flown of [2 to 4] % p.a. for the period FY2011-FY2013 has been assumed (in line with capacity reduction): following such reduction, an annual passenger growth rate of [2 to 4] % has been assumed for FY2013-FY2016. This growth rate remains lower than the average market growth rate for the overall period.

(59) Malta has clarified that the RP only assumes an average growth of less than 2 % for yields throughout the period (passenger revenues including ancillary/total passengers) which is in line with the forecast for several network carriers in Europe such as Aer Lingus or IAG and lower than the directly competing LCCs easyJet and Ryanair. Malta has also adapted its assumptions on cost inflation, in particular in aircraft leases and forecasted fuel costs and clarified the assumptions for the scenario analysis including the deviation from EBIT.

(60) As regards the proposed compensatory measures, Malta provided additional detailed information regarding the calculation of profitability of routes in respect of their contribution to the fixed/variable direct operating costs and overheads. Malta reiterated that the sale of its two profit-making insurance companies could be considered as a relevant compensatory measure because it provided Air Malta with cost effective insurance solutions and both of the companies were significant players in the local aviation insurance market. Since Air Malta is a small airline, it has a high component of overheads relative to its overall cost base due to the functional requirements of operating an airline. Excessive reduction of capacity would thus compromise the airline's long term viability.

(61) As regards the own contribution Malta confirmed that all sales of the subsidiaries will be conducted in an open, competitive, transparent and non-discriminatory manner. Malta also provided additional information regarding the sale of engines, the EUR [20 to 25] million facility that is to be drawn in FY2014 and confirmed the conclusion of the EUR [25 to 30] million bridge loan agreement.

(62) As regards the "one time, last time" principle, Malta submitted a business plan on the basis of which the EUR 57 million capital increase was carried out in 2004, demonstrating that this transaction should be viewed as conform with the market economy investor principle.

4. COMMENTS FROM INTERESTED PARTIES

(63) During the formal investigation procedure the Commission received comments from six interested parties: Ryanair; International Airlines Group SA (IAG, i.e. the holding company owning British Airways and Iberia); Malta Chamber of Commerce, Enterprise and Industry; Airline Pilots Association Malta (ALPA); Malta Hotels and Restaurant Association (MHRA) and a consultant who wishes not to disclose his identity.

(64) The observations of the Malta Chamber of Commerce, ALPA and MHRA were in favour of Air Malta's continuity in business underlining its importance for the whole Maltese economy, especially for the tourism sector. The Commission was asked to take into account the particularities of the case and the small size of Air Malta when assessing the RP.

(65) The critical comments made by Ryanair and IAG refer mostly to the doubts already expressed in the opening decision as regard to the return to viability and the underlying assumptions. Ryanair states that the small size of Air Malta's fleet deprives it of the possibility of benefiting from economies of scale and integration. This disadvantage will be further exacerbated by the decrease in the number of aircraft. Furthermore, Ryanair and the anonymous consultant criticise that the land sale will be carried out not in an open tender and allege that Malta hopes to inject extra aid into Air Malta through this transaction.

(66) As to the transport of patients for treatment abroad and the link to non-EU destinations based on bilateral agreement, Ryanair points to the legislation on public service obligations (PSO), in particular Regulation 1008/2008 according to which PSO must be imposed after an open tender and compensated on the basis of an analysis of the costs which a typical well run undertaking would have incurred in discharging those obligations. Ryanair warns of an ex-post application of supposed PSO in order to justify the RP and invites the Commission to investigate this issue, in particular in order to determine whether any such compensation has been determined.

5. COMMENTS FROM MALTA ON THE OBSERVATIONS OF INTERESTED PARTIES

(67) Malta addressed in detail all of the arguments raised by third parties in their comments. In particular, Malta rebutted the arguments regarding Air Malta's return to long-term viability asserting that the trend of escalating losses of the Airline has already been reversed.

(68) Air Malta's commercial strategy is to be a "destination airline" with its activities centred around the local airport. The successful turnaround of the company will in addition be achieved through significant reduction of waste and losses accompanied by the change in work practices of the company.

(69) Regarding the argument of Air Malta's inability to profit from economies of scale, the Maltese authorities argue that the operating costs in the airline industry are variable in nature (amounting to [60 to 70] % in Air Malta's case). These include fuel costs, aircraft rental and maintenance, landing, navigation and flight crew costs, all of which are driven by regulated market pricing which limits, to some extent, the economies of scale that an airline could benefit from.

(70) As to the valuation and sale of strategic property to the Government, Malta reasserts that the valuation was carried out by an external and independent evaluator […] with no conflict of interest and is based on a detailed report which follows international valuation standards as set out by the International Valuation Standards Council. The logic behind this transaction is evidenced by the new needs of the company (significantly reduced staff) and change of culture which require the workforce to be based in one modern office. Therefore the Airline disposed of property that it no longer needed. Given the scarcity of land resources in Malta, the Maltese authorities submit that the strategy to create an aviation park on this land predates Air Malta's restructuring by many years.

(71) As far as public services are concerned, the Maltese authorities confirmed that PSO under regulation No 1008/2008 on common rules for the operation of air services in the Community have neither been imposed in the past nor are planned for the future. Consequently, no compensation from the State has been or will be paid. Therefore, Air Malta has never been provided with any remuneration from public funds for any of the services which it provides to and from Malta, including the transport of medical passengers.

6. ASSESSMENT OF THE AID

6.1 **Existence of State Aid**

(72) 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.

(73) 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.

(74) 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, since it improves its financial situation.

(75) 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 measure in question enables Air Malta to continue operating so that it does not have to face the consequences normally deriving from its poor financial results and therefore it distorts competition.

(76) Under these conditions, the capital injection constitutes State aid within the meaning of Article 107(1) of the TFEU. This conclusion is not disputed by the Maltese authorities.

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

(77) Article 107(3)(c) TFEU stipulates 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.

(78) 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 ([1]), in order to establish whether it may be compatible with the internal market pursuant to Article 107(3) TFEU.

([1]) 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.

(79) The Commission acknowledges that the Maltese authorities have undertaken to respect the stand-still obligation (in accordance with point 34 of the R&R Guidelines) and have not granted any aid to Air Malta (apart from the Rescue aid as approved by the Commission on 15 November 2010).

6.2.1 *Eligibility*

(80) Regarding eligibility, point (33) of the R&R Guidelines states that the firm must qualify as a firm in difficulty within the meaning of these Guidelines (points 9-13).

Firm in difficulty

(81) According to point 9 of the R&R Guidelines 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.

(82) Subsequently, Point 10(a) 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.

(83) 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. Air Malta was found to be a company in difficulty already in the decision by which the rescue aid to the company was approved [1]. According to point (25) of the R&R Guidelines a Member State concerned must communicate to the Commission, not later than six months after the rescue aid measure has been authorised, a restructuring plan or a liquidation plan or proof that the rescue loan has been reimbursed in full. Malta has duly notified the RP of Air Malta within the six months deadline. Given that this relatively short period the situation of Air Malta has not substantially changed so that it requires restructuring aid for its return to viability, it follows that the company clearly still fulfils the criteria set in point 10(a) of the R&R Guidelines and hence qualifies as a company in difficulty for the same reasons indicated in the decision on the rescue aid (points 7-13 and 45).

(84) Point 12 of the Guidelines states that a newly created firm is not eligible for rescue or restructuring aid even if its initial financial position is unsecure. A firm is in principle considered as newly created for the first three years following the start of operations in the relevant field of activity.

(85) Air Malta was created in 1974 and cannot therefore be considered as a newly created firm.

Business group

(86) 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.

(87) Air Malta plc. forms a group together with its subsidiaries (see paragraph (10)). The accounts of the group show that the airline, despite being part of a larger group of companies, in fact constitutes 94 % of the total Air Malta Group turnover and there is therefore no possibility for any other part of the Group to finance the restructuring of the airline. Furthermore, the accounts demonstrate that the airline's losses are intrinsic to the airline itself and are therefore not attributable to any part of the Group.

(88) The Commission thus considers that the difficulties of Air Malta are not a result of an arbitrary allocation of costs within the group but are mostly due to weak revenues in its core business. The difficulties are too serious to be dealt with by the group itself especially because 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*

(89) 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.

(90) The plan must provide for a turnaround that will enable the company, after completing its restructuring, to cover all its costs including depreciation and financial charges.

[1] N504/2010 Air Malta plc., http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_N504_2010

The expected return on capital must be enough to enable the restructured firm to compete in the marketplace on its own merits (point 37 of the R&R Guidelines).

(91) The RP with five years long restructuring period aims to achieve a return to profitability as of FY2014 thereby ensuring long term viability.

(92) Moreover, the most important restructuring measures as well as the implementation of compensatory measures will take place in the first half of the restructuring period. However, some minor restructuring measures as well part of the notified capital injection should be carried out in 2014 and 2015. The Maltese authorities demonstrated that the strategy in the RP is set out over five years after a careful assessment of the shortest time required to restore the long-term viability of the Company, keeping in mind possible future operating conditions.

(93) The Commission notes that the notified five years restructuring period is especially required because of the relocation of Air Malta. Indeed, Air Malta had to first implement its voluntary redundancy and early retirement schemes (following the negotiations with trade unions) in the first half of the restructuring period. Subsequently, the company's reduced staff will be able to relocate to the new headquarter building. The sale of the land, which constitutes the main element of the own contribution can thus only take place in the second half of the restructuring period (FY2012-FY2014). Moreover, Malta intends to disburse the aid only in the second half of the restructuring period (see paragraph 43) due to budgetary constraints. Furthermore, the Commission notes that especially in the air transport sector in the current economic circumstances, the stabilization of operational and services performance has to be achieved in order to ensure a *long-term* viability as a solid base for future growth and not only a short-term turnaround. This takes by nature several years. The Commission notes that in previous cases a restructuring period of five years or more has been accepted [1]. Therefore, on balance, the Commission finds the relatively long restructuring period (November 2010 – 2015) acceptable.

(94) To enable a turnaround for Air Malta, the RP envisages significant cost reductions, especially through the reduction of capacity and staff as well as an improved cost management. The annual improvements in profitability from cost initiatives are expected to total EUR [42 to 52] million by the end of the restructuring period which corresponds to a reduction in total costs of [9 to 11] % between FY2010 and FY2016 or a decline of the total operating cost per passenger by [8 to 10] % between FY2010 and FY2016.

(95) The RP demonstrates that especially the reduction of capacity by downsizing the fleet from 12 to 10 aircraft and by consequently reducing the ASK capacity offered leads to significant cost reduction.

(96) The social costs of the restructuring amount to the legal obligations of the Company to those workers that will be made redundant. The airline has already concluded negotiations with three of its trade unions, covering 85 % of the workforce. The negotiations with the remaining trade union (ALPA) are in the final stages. The Commission notes that the airline has over-achieved its target of 500 voluntary applications for its Early Retirement and Voluntary Redundancy schemes. More than 40 % of the planned total of staff has already left the company.

(97) The assumed cost reduction through contract management of EUR [7 to 9] million in cost savings appears achievable since over EUR [4 to 5] million p.a. has already been committed through negotiations concluded to date and, according to the Maltese authorities, negotiations with Malta International Airport (which is mostly owned by private shareholders) contributing the highest amount of cost savings […] are 90 % concluded.

(98) As to the ancillary revenues, the Maltese authorities demonstrated that the assumed figures ([3 to 5] % of total revenues or [3 to 5] % of passenger revenues in FY2016) are substantially lower than the percentages achieved by other carriers including LLC and network carriers. Furthermore, Air Malta has successfully started to implement some of its ancillary revenue initiatives which deliver results that are in-line, if not above, the predictions contained in the RP.

Scenario analysis

(99) These results are based on realistic assumptions. The Commission positively notes that, following the opening decision, all the assumptions of the RP were revised and a number of key assumptions were adapted. In more detail:

(a) GDP and market forecasts have been revised to reflect the deteriorating economic situation in Europe. The 5,9 % annual growth rate for the Maltese air transport market has been reduced to 4 % per annum for the period to 2016 in view of the revised GDP growth forecasts by the IMF and Eurostat.

[1] See Commission decisions in the cases *Austrian Airlines* (C 6/09), OJ L 59, 9.3.2010, p. 1, paragraph 296 (6 years restructuring period) and *Royal Mail Group* (SA.31479), C(2012) 1834 final, paragraph 217 (5 years restructuring period).

(b) As to the assumed yield, Malta demonstrated that the assumed average growth of less than 2 % in yield is in line with the forecast for several network carriers in Europe (e. g. Lufthansa 1,3 % in 2012, Air France-KLM 1,0 % in 2012, IAG 2,9 % in 2012) and lower than the directly competing LCCs easyJet (3,4 % in 2012) and Ryanair (5 % in 2012).

(c) As to the assumptions on inflation, Air Malta reviewed its assumptions and corrected for inflation by including a 1,2 % p.a. escalation in costs to the fixed component of the aircraft leases. The revision of the inflation component on the rental agreements results in 60 % of the operating cost base of the airline (personnel costs, fuel and rental agreements) being corrected for inflation. Conservatively, no inflation assumptions have been made for revenue to account for an increase in purchasing power in the long-term. Furthermore, wage increases – wages are the second largest cost item for Air Malta – have been included in the RP.

(d) The costs for fuel, which are the largest cost item for the airline, are expressed in real terms. The fuel price forecast has been revised to better reflect the latest long-term oil price forecasts.

(100) In addition, Malta provided a scenario analysis including, beside the above mentioned most realistic assumptions (base case scenario), a best case and a worst case scenario with modified assumptions on several key drivers such as expected cost reductions through renegotiation of contracts, staff reduction, number of passengers, revenue per passengers, fuel price and foreign exchange rates.

(101) The revision and the adaptation of a number of key assumptions as described in paragraph 99 led to revised financial projections for the base case scenario resulting in the FY2015 operating profit to move from EUR [11 to 13] million to EUR [9 to 11] million and the FY2016 operating profit to move from EUR [13 to 15] million to EUR [9 to 11] million. Together with the provided clarification, the adapted assumptions and the revised forecasts give now a more realistic and sound picture of Air Malta's future development.

(102) Air Malta aims to achieve a return on equity of [4 to 6] % and [4 to 6] % and a return on capital employed of [4 to 6] % and [4 to 6] % respectively in FY2015 and in FY2016. These profitability figures are in line with other major European carriers in the last years.

(103) Some major European air carriers like British Airways, Iberia or easyJet target a much higher ROCE (12 % ([1])) in the next years. However, the Commission notes that Air Malta as a small carrier with a fleet of only 10 aircraft which does not have much possibility to benefit from synergies and which additionally intends to meet specific needs due to Malta's peripheral geographical situation is not comparable with major flag carriers or large LCCs. Given the particularities of the present case, a ROCE of [4 to 6] % appears to be enough to enable Air Malta to compete in the marketplace on its own merits.

(104) Furthermore, Air Malta made progress in restructuring up to now which demonstrates that the restructuring measures taken are already effective. 2011 figures show a revenue increase of 1,6 % compared with 2010 (notwithstanding 8 % capacity reduction) which is 2,9 % ahead of the levels originally forecasted in the RP ([2]). Air Malta's financial performance for the year to date December 2011 has improved by EUR 13 million on last year and is approximately EUR 1 million better than the results forecasted in the RP. Other key indicators for the same period show that the seat load factor has increased by [3 to 5] %, passengers have increased by [1 to 3] % and average fare has increased by [0 to 2] % whereas Cost per Available Seat Kilometre (CASK) is [0 to 2] % lower.

(105) Against this background, the Commission considers that the revised the RP will enable Air Malta to restore its long-time viability within a reasonable timescale.

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

(106) 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. These measures may comprise divestment of assets, reductions in capacity or market presence and reduction of entry barriers on the markets concerned (point 39 of the R&R Guidelines).

(107) In this regard, closure of loss-making activities which would at any rate be necessary to restore viability will not be considered as a reduction of capacity or market presence for the purpose of the assessment of the compensatory measures (point 40 of the R&R Guidelines).

([1]) See comments by IAG dated 2 March 2012.

([2]) The RP expected revenues in December 2011 amounting to EUR 169,939 m whereas the actual figures show revenues of EUR 174,896 m (which is 2,9 % ahead).

(108) Air Malta proposes the following compensatory measures:

— Reduction in absolute capacity in passenger transport;

— Surrender of profitable and potentially profitable routes;

— Surrender of landing slots at coordinated European airports;

— Reduction of cargo flights;

— Sale of subsidiaries.

Reduction in absolute capacity in passenger transport

(109) The first compensatory measure offered by Air Malta is the reduction of capacity in passenger transport. The total capacity reduction amounts to 19,7 % (Summer 2009 to Summer 2012) or 20,9 % (FY2010 to FY2013). The overall capacity reduction cannot be accepted under point 40 of the R&R Guidelines since this also includes the reduction and withdrawal of unprofitable routes.

Surrender of profitable and potentially profitable routes

(110) Based on the information provided in the formal investigation procedure, the Commission is in a position to identify 14 routes [1] to be reduced in capacity or withdrawn which are profitable as well as a number of charter flights which can be accepted as compensatory measures.

(111) The profitability of the scheduled routes is determined on the basis of the so called 'gross margin' which is calculated as follows: Revenue minus VDOC (variable direct operating costs) minus FDOC (fixed direct operating costs). The routes are profitable if they have a gross margin equal or above 0. The so called 'net margin' takes also into account the overhead costs. From the Commission's point of view, the gross margin appears to be the appropriate figure since it takes into account all costs which are directly linked to the route in question. Applying the 'net margin' would be too strict since the overhead costs have a non-linear relationship to fleet size and capacity and cannot be reduced below a certain level given the fact that some activities and functions are necessary to the normal operations of the airline, regardless of its size.

(1) […].

(112) The Commission does not take into account so called 'marginal' routes, i.e. routes which are not profitable today having a gross margin between 0 % and -10 % but have potential for profitability in the future with the right management and commercial attention and investment, since point 40 of the R&R Guidelines refers to 'loss-making activities' at the time of notifying the RP.

(113) As to the profitability of charter flights, the Maltese authorities confirmed that all charter services were profitable. The overall profitability of charter flights for FY2010 was [5 to 8] % (gross margin).

(114) The Commission takes into account the figures for the changes between FY2010 and FY2013 and not for between Summer 2009 and Summer 2012 since the end of FY2010 (i.e. March 2010) constitutes a more appropriate starting point than the summer 2009, i.e. six months earlier, in view of the restructuring period starting in autumn 2010. The Commission notes that the Maltese authorities confirmed that the route network should be constant from FY2013 onwards so that this capacity change applies for the whole restructuring period.

(115) Based on an overall capacity in FY2010 of 4 145 522 ASK, the capacity reductions related to both profitable scheduled routes and charter routes amount to […] ASK which is accompanied by an expected capacity increase of […] ASK. Therefore, the overall capacity reduction in passenger transport acceptable as compensatory measure (capacity reduction related to profitable routes minus capacity increase) between FY2010 and the end of the restructuring period amounts to 5 % of the 2010 capacity.

Surrender of landing slots at coordinated European airports

(116) As a result of the Air Malta's change in network, the reduction of frequencies operated and the cancellation of certain routes, […] landing slots pairs [2] will be surrendered are at European Level 3 Coordinated Airports [3]. The Commission notes that the surrender of these landing slots will enable other competing airlines to increase their capacity at those coordinated airports (regardless of the concrete route that has been withdrawn) and thus represents a reduction of entry barriers on the market. Therefore, this measure can be accepted as a compensatory measure.

(2) […].
(3) See Article 2 (g) of Regulation (EEC) No 95/93 as well as the definition of 'level 3 airports' under point 5 of the Worldwide Slot Guidelines by the International Air Transport Association (www.iata.org/wsg).

Reduction of cargo flights

(117) In the formal investigation procedure, Malta has proposed as additional compensatory measure a capacity reduction of 20 % in cargo flights. According to Malta, all cargo flights concerned have been profitable. Air Malta holds a significant market position in the local cargo and freighter market (with a market share of 28 % for flights from and to Malta). Therefore, the Commission will take into account this reduction as compensatory measure.

Sale of subsidiaries

(118) Beyond the capacity reduction, Air Malta proposes the sale of non-loss making assets as compensatory measures. This includes its subsidiaries Shield Insurance Company Ltd ("Shield Insurance") and Osprey Insurance Brokers Company Ltd ("Osprey Insurance Brokers"). Shield Insurance is a Captive Insurance Company operating in Guernsey and is primarily set up to insure Air Malta's peripheral aviation insurance policies. However it has access to the international insurance market and is licensed to transact insurance business of various classes, both in respect of the Air Malta Group as well as for third parties. Osprey Insurance Brokers is an insurance broker and specialises in handling accounts of a medium to large economical nature involving all classes of insurances, including aviation.

(119) 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.

(120) The market where Air Malta has and will have a significant market position is the Maltese air transport market (both passengers and cargo). This does not apply to the insurance sector. The insurance activities are non-core activities which are not strictly related to the air transport business. In fact, after the sale of Shield Insurance and Osprey Insurance Brokers, the Air Malta group will not be active in the insurance market anymore. Therefore, the sale neither of Shield Insurance nor of Osprey Insurance Brokers can be considered as compensatory measures.

Appropriateness of the proposed compensatory measures

(121) When assessing whether the compensatory measures are appropriate the Commission will take account of the market structure and the conditions of competition to ensure that any such measure does not lead to deterioration in the structure of the market (point 39 of the R&R Guidelines).

(122) The compensatory measures must be in proportion to the distortive effects of the aid and, in particular, to the size and the relative importance of the firm on its market or markets. The degree of reduction must be established on a case-by-case basis (point 40 of the R&R Guidelines).

(123) Air Malta is a very small player in the European aviation market representing only 0,25 % of the entire European airline industry's productive capacity and output (in terms of passengers).Even though Air Malta has still a leading position in the Maltese aviation market, the airlines which would benefit from Air Malta's market exit are above all large LCCs like Ryanair and easyJet that already have a significant market share in the European aviation market.

(124) The Commission notes that for a small carrier like Air Malta, any further reduction in its fleet size will have a negative effect on the viability of the airline, without providing any meaningful market opportunities for competitors. Air Malta's fleet may be too small to provide synergies and to efficiently have a multiple type fleet to attract a bigger market and reach potential markets. For Air Malta, it is very difficult to diversify on board products and seating configurations in its aircraft to maximise profits. Furthermore, the small size puts Air Malta at a disadvantage when financing aircraft, handling contracts and other matters where economies of scale bring tangible financial and competitive benefits. Any further capacity reduction could have a cumulative negative effect on the airline's ability to compete with larger competitors.

(125) Furthermore, Malta is an area eligible for assistance under Article 107 (3)(a) TFEU. According to point 56 of the R&R Guidelines, the conditions for authorising aid may be less stringent as regards the implementation of the compensatory measures.

(126) In addition, the Commission has to take into account the particularities of the present case when assessing the appropriateness of the proposed compensatory measures. Malta's peripheral geographical situation as an island causes problems with respect to accessibility to the rest of the European Union. The Commission acknowledges that 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 [1] (necessitating reliable transport links for business travellers) and the importance of the tourism industry [2]. They are also vital for Malta's economic and social cohesion both internally and with the rest of the EU by providing daily transportation of mail and freight including perishables goods between the islands and the European mainland as well as passengers transport for medical reasons in stretchers and incubators (in cases where special medical care required is not available in Malta).

(127) Also in its decision of 7 March 2007 concerning *Cyprus Airways* [3], the Commission, when assessing the appropriateness of the compensatory measures, considered in respect of Cyprus the

"territorial, and, therefore permanent, characteristics which impact on its socio-economic development. Cyprus' southern peripherality 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 Cyprus, air travel is the only viable means of business passenger."

(128) The Commission notes that Malta is in a situation comparable to that of Cyprus in respect of peripherality, accessibility and dependence on air transport.

(129) The Commission notes that, since Air Malta is a very small player in the European aviation market and since the notified aid will not enable Air Malta to conduct an aggressive expansion policy or grow in dimension, the distortive effect of the notified measure is limited.

(130) The Commission considers that the 5 % capacity reduction (for profitable activities) in passenger transport (which is related to the fleet reduction by two aircrafts over 12 aircrafts) may appear at first sight to be small. However, considering the small size of Air Malta compared to the European airline industry's productive capacity and output (in terms of passengers) and the small size of Air Malta's fleet, the Commission finds that this capacity reduction is not insignificant. Moreover, the Commission notes that the overall capacity reduction will result in a decrease of Air Malta's market share on the Maltese air transport market from 51 % in 2010 to less than 40 % expected in 2016 [4].

(131) In view of the above, and taking furthermore into account the fact that Air Malta will surrender an important number of slots at coordinated airports, immediately creating new business opportunities for its competitors, the important capacity reduction of 20 % in the cargo flights segment (which will affect the significant market position in the local cargo and freighter market held by Air Malta), the particular situation of Malta as regards peripherality, accessibility and dependence on air transport, the Commission concludes that the proposed compensatory measures are appropriate to minimise the distortive effects of the aid and proportionate to those effects, and the size and importance of Air Malta.

6.2.4 *Aid limited to the minimum (own contribution)*

(132) 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 can include the sale of assets that are not essential to the firm's survival, or external financing at market conditions.

(133) For large firms, the Commission normally considers a contribution of at least 50 % of the restructuring costs 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).

(134) The own contribution must be real, i.e. actual, excluding all future profits such as cash flow (point 43 of the R&R Guidelines). Inherently, the own contribution must not include any further state aid.

(1) The Maltese economy has a 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 %.

(2) 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.

(3) Commission decision C(2007) 300 of 7 March 2007 (OJ L 49, 22.2.2008, p. 25), paragraph 132.

(4) The Commission observes that in previous restructuring decisions, it did not distinguish between profitable and non-profitable activities when assessing the appropriateness of the capacity reduction as compensatory measure.

(135) As described above under section 2,4, the proposed own contribution of Air Malta consists of the sale of land, the sale of subsidiaries, the sale of engines and a bank loan.

Sale of land

(136) The most important part of the Company's own contribution (EUR 66,2 million) will come from the sale of land situated on the perimeter of Malta International Airport to the Maltese State. The Promise of Sale Agreement was signed on 7 December 2011.

(137) 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 Maltese 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.

(138) Air Malta has explained that in view of its restructuring some of its properties became redundant such as its head office which will be too large for its reduced workforce. With a move to new premises, the company also wishes to stimulate its cultural transformation into modern and dynamic airline.

(139) The Government of Malta has expressed its strategic interest to acquire Air Malta's property situated on the perimeter of the Malta international airport as the land sites concerned represent a scarce resource. Malta explained 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.

(140) The Commission acknowledges that with the land sale Malta pursues its strategy to develop the aviation related industry in Malta in order to increase employment in this sector. Therefore, the Commission considers that the land sale has not the main purpose to inject fresh money in Air Malta but pursues a credible policy objective.

(141) The value of the land is based on an independent valuation report dated 25 November 2011 by […], an independent evaluator appointed by the Government for this purpose. […] is a reputable real estate firm with long-standing international and local experience. The Commission has analysed the evaluation and found it sound. The evaluation gives no cause for concern since no manifest errors have been detected, accepted methodologies are applied – the applied valuation standards are set out by the International Valuation Standards Council – and the evaluation is based on credible assumptions. Therefore, the Commission considers that the result of the present appraisal report is an appropriate approximation for the realistic market price of the land.

(142) In view of the above, the Commission accepts the proceeds through the land sale as own contribution.

Sale of subsidiaries

(143) The sale of subsidiaries […] should, according to Malta, generate at least EUR [10 to 12] million.

(144) The value of the subsidiaries is based on indicative values established by […] in a document entitled "Review of potential disposal of assets" dated 24 June 2011.

(145) Malta confirmed that all sales and transactions will be conducted in an open, competitive, transparent and non-discriminatory manner. The sale process is managed by an independent adviser. The open tender sale process is launched with the publication of a Request for Proposals and the opening of an electronic data room. After the selection of short-listed bidders, the data room re-opens to the short-listed bidders for the purpose of due diligence. The short-listed bidders are invited to submit a final offer. The selected bidder is chosen and approved by the Air Malta Board of Directors in view of maximising the value of the assets. The most important steps are notified to non-selected bidder to ensure a transparent and non-discriminatory procedure. Two sale procedures have already been launched in line with the above described procedure: the sale of Selmun Palace and of Holiday Malta.

(146) The Commission notes that the first bids for one of the subsidiaries, Holiday Malta, were significantly […] than the indicative value. However, recent evaluation of Selmun Palace in December 2011 – […] – support a value ranging between EUR […] million and EUR […] million.

(147) Although Air Malta presented a conservative approach – the assumptions in the RP include a 15 % risk adjustment (proceeds from the sales of EUR [10 to 12 million instead of EUR [12 to 14] million) – the Commission considers that the information provided on the evaluation of the subsidiaries is not sufficient. The evaluation reports are of a relatively poor quality and do not enable the Commission to firmly conclude on the actual value of the subsidiaries.

(148) Against this background, the Commission is not in a position to quantify the exact amount of proceeds from the sale of subsidiaries. However, the Commission notes that, based on the available information, the subsidiaries are indeed of a certain value. Any revenues from the sale of subsidiaries, will therefore increase the own contribution.

Sale of engines

(149) The proceeds from the sale of two spare engines to […], a private international financing and leasing company for spare engines, should be included into own contribution of the company to its restructuring costs. The sale of the spare engine with the serial number ESN […] took place on 28 October 2010 and generated USD [10 to 12] million. The sale of the spare engine with the serial number ESN […] took place on 17 December 2010 and generated USD [9 to 11] million. The overall proceeds through the sale of engines amount to USD [19 to 23] million (about EUR [15 to 17] million). However, it should be noted that whereas engine No. … was fully owned by Air Malta, engine No. […] was leased property of Air Malta. The Airline had an option to purchase engine No. […] at EUR [5 to 7] million, which was exercised, and consequently the engine was sold to […] and then leased-back.

(150) For the purpose of own contribution, Air Malta has applied the net proceeds, coming from the sale of the engines, and has therefore considered the EUR [5 to 7] million as a cost. The net proceeds are calculated as the revenue from the sale of engines to […] (USD [10 to 12] million + USD [9 to 11] million = USD [19 to 23] million or EUR [15 to 17] million) less the cost of purchasing of engine No. […]) (EUR [5 to 7] million) netting EUR [10 to 12] million as own contribution.

(151) The Commission notes that the sales of engines took place within the restructuring period or just a very few days to its beginning. Therefore, the whole revenues from those sales can be considered as own contribution. Furthermore, the Commission accepts the proposed calculation of the real amount of proceeds from the sales and thus accepts the own contribution of EUR [9 to 12] million.

Bank loan

(152) A loan amounting to EUR [20 to 25] million should be granted by […] as of mid-2014.

(153) Malta has provided letters of intent by the two banks dated 24 and 29 November 2011. However, no legally binding agreement has been concluded yet since, according to Malta, it is commercial policy of the banks not to bind themselves more than two years prior to the transaction. As no binding agreements have been provided, this bank loan cannot be regarded as real and actual own contribution as required in point 43 of the R&R Guidelines.

(154) However, the Commission notes that Air Malta already arrived at the conclusion of a bridging finance in December 2011 amounting to EUR [25 to 30] million for a three years maturity, secured without any assistance of the Maltese authorities. The purpose of this loan is a bridging financing of the restructuring of Air Malta until 2014 when the proceeds from the land sale are expected to materialize.

(155) The loan will be provided by […]. Both banks are to be regarded as private banks. […]

(156) Air Malta has to pay an interest rate of currently [4 to 6] % p.a. (i.e. [150 to 350] basis point above the […] base rate as reference rate which currently amounts to 2,5 %) plus fees amounting to [1 to 1,5] % p.a. The loan is secured by a mortgage of EUR [25 to 30] million.

(157) The Commission notes that this loan agreement of December 2011 demonstrates that Air Malta was already able to obtain external financing at market conditions without any assistance of the Maltese authorities. Such financing shows that the market believes in the feasibility of the envisaged return to viability. The Commission hence considers the EUR [25 to 30] million loan as part of the own contribution.

Appropriateness of the proposed own contribution

(158) In view of the above, the Commission considers as appropriate and acceptable own contribution the proceeds from the sale of land (EUR 66,2 million); the sale of engines (EUR [9 to 12] million) and the bank loan concluded in December 2011 (EUR 30 million). The total own contribution hence amounts to EUR 107 million which constitutes 45 % of the total restructuring costs. Furthermore, the Commission notes that if the expected proceeds from the sale of subsidiaries materialize, then the level of the own contribution will raise by EUR [10 to 12] million and the total own contribution would thus amount to 49,5 % of the total restructuring costs.

(159) 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). Furthermore, 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 (see paragraph (126) above) which has to be taken into account.

(160) Due to the particularities of the present case, an own contribution slightly lower than 50 % appears acceptable. Since the RP, especially the submitted financial plan, demonstrates that the amount of aid is such as to avoid providing Air Malta with surplus cash which could be used for aggressive, market-distorting activities not linked to the restructuring process and that the aid does not finance new investment that is not essential for restoring the firm's viability as stipulated in point 45 of the R&R Guidelines, the Commission concludes that an own contribution of at least 45 % is appropriate in the present case.

6.2.5 *'One time, last time' principle*

(161) 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.

(162) In April 2004, before accession to the EU, Malta carried out a capital increase of EUR 57 million. The transaction in question was made in kind and involved the transfer of real property (land and buildings) in return for obtaining additional shares in Air Malta. This measure was not considered as rescue or restructuring aid by the Maltese authorities who considered the capital increase to be compatible with the market economy investor principle.

(163) 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 [1], 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.

(164) In order to determine whether an economic advantage in favour of Air Malta is present in the 2004 injection and therefore this measure involves state aid, the Commission must assess whether the undertaking received 'an economic advantage, which it would not have obtained under normal market conditions [2]'. To examine this question the Commission applies the market economy investor principle (MEIP). According to this test, where, in similar circumstances, a private investor operating in normal market conditions of a market economy of a comparable size to that of the bodies operating in the public sector could have been prompted to make the capital contribution in question, no State Aid would be involved. The Commission must therefore assess whether a private investor would have entered into the transaction in question on the same terms [3]. The attitude of the hypothetical private investor is that of a prudent investor [4] whose goal of profit maximisation is tempered with caution about the level of risk acceptable for a given rate of return [5].

(165) Moreover, '… [T]he comparison between the conduct of public and private investors must be made by reference to the attitude which a private investor would have had at the time of the transaction in question, having regard to the available information and foreseeable developments at that time [6]'.

(166) The Commission's analysis and assessment must include all factors that are relevant to the transaction at issue and its context. This will include the financial situation of the beneficiary undertaking at the relevant market, while ex-post developments or results are irrelevant unless they were foreseen at the time of the investment [7].

(167) The transaction in question involved the transfer by the Government of real property (land and buildings) to Air Malta in return for obtaining additional shares in Air Malta. The use of the property in question had long vested with Air Malta. The real estate in question had been formerly held by Air Malta under a lease agreement since 1979 for an indefinite period. Air Malta 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.

(1) Commission Decision 2007/509/EC of 20 December 2006 on State aid No C 3/2005 (ex N 592/2004 (ex PL 51/2004)) 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).

(2) Joined cases T-228/99 and T-233/99, paragraph 251.

(3) Judgment in Joined Cases T-228/99 and T-233/99 *Westdeutsche Landesbank GZ v Commission* [2003] ECR II-435 et seq, paragraph 245.

(4) Case C-482/99 *France v. Commission* [2002] ECR I-4397, paragraph 71.

(5) Joined cases T-228/99 and T-233/99, paragraph 255.

(6) Joined Cases T-228/99 and T-233/99, paragraph 246. See also, Case T-16/96, *Cityflyer Express vs. Commission*, [1998] ECR II-757, paragraph 76.

(7) Case C-124/10P, *Commission v EDF*, Judgement of 5 June 2012, paragraph 85.

(168) The Commission notes that this transaction was discussed and prepared over a number of years. The plan to transfer the land was already made in the 1990's. A board paper in 2000 already referred to this transaction. The reason for the delay of its implementation is the privatisation of Malta International Airport which was only completed in 2002.

(169) The transaction was made in view of a Corporate Strategy and Business Plan 2004-2007 (November 2003) and a 3-year financial projection. Given positive outlooks for the market environment such as expected market growth for the Maltese air transport market, increasing seat capacity and earning margins in the European aviation sector as well as encouraging results, the business plan expected a substantial increase in passengers and yield in the following years achieving profitability by FY2007.

(170) The relevant forecasts reflected the general opinion in the airline industry at the time predicting strong growth in the air transport sector. Furthermore, the positive results were based on additional expected growth opportunities due to the EU accession of Malta. Besides the improvement of the capital structure, the business plan proposed a number of reasonable initiatives such as the introduction of a standardised, modern and fuel efficient fleet of Airbus A319/A320 as well as rationalisation of maintenance. The Commission notes that in 2004 LCCs were not seen as a threat for Air Malta on its core market as the lengths of the routes to/from Malta were regarded as too long to make the LCC business model work. Although the expectations turned out to be too optimistic and the challenges on the market to be underestimated from an ex post perspective, given the information available in 2004 and the general opinion in the airline industry, the Commission considers the forecasts in the business plan and the 3-year financial projection to be credible at that time.

(171) Due to the fact that the Maltese government as major shareholder of Air Malta contributed only a minimal share capital when the company was founded in 1974, Air Malta was hugely undercapitalised compared to other flag carriers prior to April 2004 and needed a capital structure proportionate to its operations. The capital increase, which was made in kind by the transfer of land, was intended to ensure that the company had a balanced financial structure so as to enable it to engage in a growth strategy and allow further equity leverage through enhanced working capital management arrangements.

(172) 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".

(173) Moreover, the Commission notes that Air Malta was not a firm in difficulties in April 2004. Although Air Malta suffered from losses incurring by Air Malta's subsidiary Azzura Air in the aftermath of 9/11, Malta had significant cash reserves at that time. Based on the figures on 31 July 2003, Air Malta's total equity was EUR 45,7 million (issued share capital of EUR 11,7 million plus a positive balance on the profit and loss account). Based on the management account for the seven months ended 29 February 2004, the loss for this period was EUR 15,5 million and a loss of EUR 19,2 million was expected for the whole financial year. Further losses have been recognized when closing off the July 2004 statutory financial statements and computed in early 2005. However, these losses would not have been known or anticipated in April 2004.

(174) Furthermore, Air Malta was able to raise external debt from three private banks without any Government support.

(175) Finally, private minority shareholders participated in the capital increase in proportion to their holdings (less than 5 % of the total capital).

(176) Against this background, the Commission does not have compelling evidence demonstrating that the April 2004 transaction was not compliant with the market economy investor principle since it appears rather reasonable to assume that a private investor would have behaved in the same way as the Maltese government did, in similar circumstances. The 2004 transaction therefore did not constitute state aid to Air Malta.

(177) The Maltese authorities have furthermore confirmed that Air Malta has not received any rescue or restructuring aid in the past ten years. The Commission therefore considers that the 'one time, last time' principle is respected.

6.3 **Conclusion**

(178) In view of the above, the Commission considers that the envisaged aid amounting to EUR 130 million and the RP is compatible with the conditions required by the R&R Guidelines. The Commission hence considers the aid to be compatible with the internal market.

HAS ADOPTED THIS DECISION:

Article 1

The restructuring aid notified by Malta consisting in granting 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, constitutes State aid, within the meaning of Article 107 (1) of the Treaty on the Functioning of the European Union.

That State aid is compatible with the internal market on the basis of Article 107(3)(c) of the Treaty on the Functioning of the European Union.

Article 2

This Decision is addressed to the Republic of Malta.

Done at Brussels, 27 June 2012.

For the Commission
Joaquín ALMUNIA
Vice-President