

## First Budget Airline Takes to the Skies

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When the inaugural Sky Express flight takes off from Moscow's Vnukovo Airport for Sochi on Monday afternoon, the low-cost airline phenomenon familiar in Europe and the United States will have finally come to Russia.

The brainchild of Boris Abramovich, general director of the country's third-largest carrier, Krasair, Sky Express will be the first budget airline to start operating in the country. With a handful of competitors expected to follow, the airline looks set to change the face of domestic air travel by offering tickets for as little as 500 rubles (\$19).

As the country's airlines have struggled to adapt to market conditions over the last 15 years, the number of passengers taking internal flights in the country has plummeted from over 130 million per year to fewer than 20 million.

Now Sky Express hopes to step into this breach.

"When you look at the air transport market 20 years ago, only a fraction of that air travel happens today," said Rod Brandt, the company's American CEO.

"It is not a demand that we have to invent but a demand that exists already. It is staring us in the face," said Brandt, a veteran of airlines Hong Kong Express, Air South, Air Atlanta and Pan Am.

With established Russian airlines often proving relatively expensive -- Aeroflot low-season returns to Sochi go for about 6,000 rubles (\$225) -- millions of Russians opt for often ponderously slow and uncomfortable cross-country rail journeys. Currently, only 5 percent of Russians use internal flights, according to Sky Express.

Sky Express said it has sold almost 3,000 tickets sales since last week, including over the telephone and the Internet, and hopes that it will carry 600,000 passengers in the first half of the year, growing to 3.5 million next year.

Sky Express will initially operate two flights per day to Sochi out of its hub at Vnukovo, a 35-minute train ride from the city center.

The company aims to expand its current fleet of two 140-seat Boeing-737s to eight by April, and add six more destinations, including Rostov, Murmansk, Samara and Kaliningrad, over the next few months. The longest flight planned is the 1,800-kilometer trip to Tyumen.

The start-up capital is \$48 million, and investors include the European Bank for Reconstruction and Development, or EBRD, which is putting \$10 million into the project.

"It should offer a good model to improve the efficiency in air transport [in Russia]," an EBRD official involved in the deal said Wednesday on condition of anonymity. The airline was a "high risk, high gain" investment, she said.

Speaking on the sidelines of the World Economic Forum in Davos, Switzerland, EBRD president Jean Lemierre acknowledged Thursday that the bank was going out on a limb by investing in a low-budget airline in a country where no such airline has yet succeeded.

"We have taken a risk to support this, but we hope it will fly well -- excuse the expression," Lemierre said.

Another investor, London-based fund management company MG Capital, which has recently acquired a 4 percent stake in Sky Express, was upbeat about the airline's chances Thursday.

"There is no reason why the low-cost approach should not be as successful in Russia as it has been in the rest of the world," said Charles Fowler, MG Capital's managing director.

Citing the U.S. success stories JetBlue and Southwest, Brandt said Sky Express would follow the established streamlined models for budget airlines worldwide, meaning that on-board meals are not included in the ticket price. He pointed out, however, that certain elements had been adapted to suit the peculiarities of the situation in Russia.

With little culture of credit card spending in the country, Sky Express has had to come up with a network of 56,000 alternative payment points.

Tickets are available over the Internet, but with many people unwilling to give out their details online, they can also be purchased at branches of the Post Office, bank VTB 24 and cell phone firm Yevroset.

Unlike many of its European counterparts, Sky Express will be flying to cities' main airports.

Brandt said negotiations with regional airports had been turbulent at times, with some "wary" of upsetting local airlines. But he said the obvious economic bonuses of hosting a budget airline had calmed worries.

Vital for any domestic airline's success is a need to address concerns about safety, as domestic flights have suffered a string of tragic accidents in recent years.

Yelena Sakhnova, an aviation analyst at investment bank Deutsche UFG, said most Russians traveled by train not just "because the trains are relatively cheap, but because they are afraid of flying."

Brandt, despite admitting that domestic flights had "an image problem," stressed that Western safety standards would be followed, pointing to the reliability of the Boeing 737 and a maintenance deal with Lufthansa.

Other low-cost airlines are reported to be in the works, with Alexander Lebedev's National Reserve Corporation and Mikhail Fridman's Alfa Group among those considering start-ups.

National Reserve Corp. mooted a low-cost airline, National Wings, last February and was reported Monday to be in negotiations to buy Moscow-based Airlines-400 as part of its plans.

No one at National Reserve Corp. or Alfa Group was immediately available to comment on the projects Thursday.

At Sky Express, the assumption is that sooner or later a number of competitors will join the market.

"That is why we have to get in there first and do it right. We have to create a recognized and trusted brand based on how well we treat our customers," Brandt said.

Ilya Novkhatsky, a spokesman for No. 2 airline Sibir, or S7, welcomed the competition from Sky Express but questioned the viability of running a budget airline in the country. "We will have to see whether the low-cost model can function here," he said.

Deutsche UFG's Sakhnova also sounded a cautious note, saying that previous proposed ventures by Aeroflot and Sibir had failed to get off the ground due to a lack of passengers and the right airports.

"I really doubt that these sorts of projects can be successful in Russia," Sakhnova said. "They are needed and if they can succeed then I'll be the first to applaud them, but I'm doubtful that they will."