

Canadian Equity Research  
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## New entrant, NewLeaf Travel

### ULCC entrant – we are skeptical, pending more information

NewLeaf Travel (NL) announced it intends to commence flight service on February 12, 2016 between 7 Canadian cities. The company intends to operate as an ultra low cost carrier (ULCC).

ULCCs, such as Spirit Airlines, Frontier Airlines and Allegiant Travel in the US, typically offer very low base fares with add-on fees for ancillary services such as seat selection, printed boarding passes and other services. Canada does not currently have a ULCC.

NL could prove a threat to Air Canada (AC) and WestJet (WJA) as a true ULCC aims to have a much lower cost structure than AC and WJA.

We view the NL initiative with skepticism, pending information that suggests the company will truly have ULCC costs and financial resources to withstand competitive reaction from existing players.

We question NL's ULCC cost claim. NL is outsourcing flying to Flair Airlines. Flair operates a fleet of 5 B737-400s, which are old-generation aircraft that have higher operating costs than AC's A320 and WJA's B737 fleets. In addition, NL's costs are presumably increased by Flair's profit margin.

Financial staying power is just as important as low costs for new airline entrants. The Canadian airline market is littered with failed entrants including Canada 3000 (1988-2001), JetsGo (2001-4), Roots Air (2000-1), Zoom (2002-8) and most recently CanJet (standalone operation started and stopped in 2015). We believe incumbent competitive reactions played a role in the demise of these airlines. We are unclear whether NL has the financial resources to withstand a dogfight with AC and WJA.

However, NL has some positive points. Its business model may work in a low aircraft utilization strategy as third-party flying of old aircraft should minimize capital cost. Allegiant, which is a low utilization ULCC model, uses older aircraft because the low capital cost more than offsets the higher operating cost. But Allegiant also operates its own aircraft, unlike the NL strategy.

In addition, NL's CEO, Jim Young, appears to have a strong background. Mr. Young is the ex-CMO of Frontier Airlines and ex-President of Canada Jetlines, another potential Canadian ULCC.

NL is also following a low cost airport strategy, operating from secondary airports such as Hamilton (Toronto proxy) and Abbotsford (Vancouver proxy) and smaller Canadian cities such as Winnipeg (largest city and headquarters), Regina, Saskatoon, Kelowna and Halifax. NL is also using the classic ULCC point-to-point flying model, which should decrease costs by reducing complexity.

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