



### **Airlines get tough in Europe merger battle**

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By Maria Sheahan

FRANKFURT (Reuters) - European airlines are playing hardball in an increasingly frenetic industry shake-up on Wednesday as Air France-KLM snubbed making an offer for Austrian Airlines and Lufthansa pulled out of talks to buy local carrier TUIfly.

The two continental European giants are jostling with British Airways (BAY.L: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) as major airlines target smaller rivals in a Darwinian battle for survival driven by the recent economic turmoil.

Austrian Airlines (AUAV.VI: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) stock plunged as much as 39 percent after Air France-KLM (AIRF.PA: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) said it had declined to make a binding offer in time for a bid deadline on Tuesday due to the "current financial and economic climate."

Rival Lufthansa filed a bid, a source close to the deal told Reuters in Vienna, and was seen as the only serious contender for the loss-making Austrian airline.

At the same time, Lufthansa pulled out of talks to merge its Germanwings unit with TUI's (TUIGn.DE: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) low-cost TUIfly airline.

Governments are putting for-sale signs on their national carriers and small rivals are seeking investors to help keep their cash-sucking planes aloft after months of high oil prices.

Consolidation is picking up pace as the financial crisis helps the big players scoop up the smaller pieces off the chessboard.

Sluggish consumer spending has chipped away profitability, just as easing oil prices off record highs promise to take pressure off airlines' massive fuel bills. Austrian Airlines issued a profit warning last week.

Some analysts said Air France-KLM, whose shares fell 3.9 percent in line with the market, could be bluffing by pulling out of the Austrian race. It said that while it had not submitted a binding bid, it was still interested in talks.

"Air France can create counterpressure. That is part of the game," said Juergen Pieper, an analyst at Metzler Equities.

"The Austrian Airlines sale is still in the poker phase."

Alitalia (AZPIa.MI: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) and Scandinavian SAS (SAS.ST: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) are also looking for a prop, with Air France-KLM and Lufthansa both in contention for a slimmed-down version of the Italian national airline and Lufthansa eyeing a stake in SAS.

Most market watchers are unwilling to speculate who will come out on top when the dust settles on the European shakeup.

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Air France-KLM may be betting that talks with Lufthansa fail and it can jump in to rescue Austrian Airlines at a lower price.

The Austrian carrier at the end of last year had net debt of close to 1 billion euros (\$1.29 billion), and Air France could be hoping Vienna will agree to sell its stake without debt obligations.

If Air France pulled together a last-minute bid for Austrian Airlines or set its sights on Alitalia, Lufthansa could start expanding its eastern European and Italian route networks to undermine Air France's efforts.

"If Lufthansa let Alitalia go to Air France, then Air France would be saddled with having to solve the problems at Alitalia while Lufthansa would be in a position to continue its own expansion, especially at (Milan's) Malpensa," LBBW analyst Per-Ola Hellgren said.

Lufthansa declined to comment on its plans for Austrian.

All parties could now base their next moves on what they think their rivals' strategies will be, analysts said.

"You have to assume that if you do X, then your opponent will do Y. There are lots of different possible permutations," said LBBW analyst Per-Ola Hellgren.

Lufthansa has given no public strategy hints since the financial meltdown in banking triggered warnings of a recession.

"You can neglect any public statements in this process, said Christopher Kummer, President of the Institute of Mergers, Acquisitions and Alliances in Zurich. He said that the companies' statements may not reflect the true strategies in play.

But given the uncertainty of the Alitalia bidding process, both Lufthansa and Air France could jump at Austrian Airlines to secure a European airline for themselves, analysts said.

"Austrian Airlines is not a hopeless case, they have just failed to position themselves in the right way over the past couple of years," Kummer said.

"Both processes, however, are influenced by too many variables dictated by government and other stakeholders making commercial success more difficult."

Russia's S7 airline said it had filed a letter concerning Austrian Airlines on Tuesday, but sources said this letter did not contain the binding, unconditional bid that was asked for.

(Additional reporting by Boris Groendahl and Angelika Gruber; Editing by Tim Hephher and Mike Nesbit)