KLM Restructuring Plan

Briefing Paper on Manageable Costs for the Ministry of Finance

28th October 2020

Background

PA Consulting has produced a draft report dated 22nd October 2020 (“our Report”) for discussion with the Ministry of Finance summarising our findings following a review of KLM’s Restructuring Plan dated 1st October (“KLM RP”). One of our key findings has been that “manageable costs” in Section 6.3.3 of the Framework Agreement has not been clearly defined. The KLM RP assumes that 50% of the cost base, after allowing adjustments for volume and inflation related costs, represents the “manageable cost base” throughout the 5-year plan. The significance of this assumption is that Section 6.3.3 requires a 15% reduction in KLM’s manageable cost base.

This briefing paper summarises the various points made by PA Consulting in our Report in relation to the requirement for a “15% reduction in manageable costs” with supporting evidence and, where applicable, references to our Report.

What definition of “manageable costs” is appropriate?

10.1.c, 10.2.g

PA Consulting’s view therefore is that 10.1.c, 10.2.g are manageable within the timeframe of the KLM RP and could therefore be argued to be 70% by FY25. Indeed, with the help and influence of government it could be argued to be higher than 70%. The major cost items that account for the difference of c. 20% between PA Consulting and KLM management (70% less 50% respectively) are as follows:

10.1.c, 10.2.g

What cost adjustments have been allowed in the KLM RP?

As is normal in any airline financial planning process KLM management has assumed that there are certain cost headwinds that are inevitable and are therefore factored into the KLM RP. These include the following:

10.1.c, 10.2.g

10.1.c, 10.2.g

11.1

11.1

What further cost reduction initiatives exist?

The KLM RP as presented delivers at least 15% of manageable costs (based on 50% of cost base) in each year to FY25. By redefining "manageable costs" from 50% to 70% of the total, all things remaining equal, KLM would need to deliver an additional annual reduction of 10.1.c by FY25. Such a reduction would also improve the profit margin from 10.1.c and further reduce CASK to become more competitive.

10.1.c, 10.2.g

10.1.c, 10.2.g

In particular, based on our discussions with KLM management, we would point out the following potential cost reduction opportunities:

1)

10.1.c, 10.2.g, 11.1

2)

10.1.c, 10.2.g, 11.1

3)

4)

Conclusions

In conclusion we would reiterate that KLM considers the requirements of the Framework Agreement ("FA") to be a contractual commitment and has prepared a comprehensive plan to ensure delivery of those requirements. It would be normal within an airline restructuring plan for near term opportunities to be developed in detail and also for the plan to contain higher level actions and value/cost estimates during later years. Those higher level actions and value/cost estimates would then be further refined and developed in detail and prepared for implementation as the plan evolves.

KLM has already taken decisive action to deliver key aspects of the RP with immediate effect from October 2020 onwards, and through detailed action plans fully expects to deliver (and in some areas exceed) the RP and meet the requirements of the FA during the first two years i.e. FY21 and FY22.

During the final three years from FY23 to FY25, further cost saving opportunities exist, some of which have already been identified by management but are not included within the plan. These further opportunities could be developed and included within the final three years of the KLM RP.