

Seguridad en Tiempo de Crisis un desafío permanente

Safety in Time of Crisis: a permanent challenge

Presentation Topics

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- Aviation Policy
- Role of authorities in the region
- Lan business strategy for inserting itself in the market
- Economic consequences of the crisis
- Existing programs in terms of safety
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First of all, we would like to express our appreciation to the Federal Aviation Administration FAA for the invitation to Lan Airlines to participate in this important meeting and present Lan's strategy in times of crisis.

Economic policy of Chile

The first point we would like to make is that the economic policy of Chile is based on three fundamental pillars.

The first pillar is represented by the principle that our economy is an economy that is completely open to international trade, that basically seeks to position Chile as a major platform for business and the transfer of goods and service to the region, and at the same time it seeks to transform Chile into the port of entry for basically Asian products to the region.

The second fundamental pillar of the economic policy is represented by the signing of the Free Trade Agreement with the leading economies in the world. Today Chile has signed Free Trade Agreements with the leading economies in the world that represent 87% of world gross domestic product, which obviously positions us as an open economy, not only to the world, but also with possibilities of interacting from the point of view of trade.

The third fundamental pillar of the economic policy is based on an export strategy that is closely related to the two previous pillars, where our economy aims at exporting the largest amount of goods and services with value added. This challenge is permanent, and it has been hard to consolidate because of the large amount of raw material we have.

Aviation Policy

The second point is related to Chile's aviation policy: Here we can say that the main objective of aviation policy is to obtain the largest number of aeronautical services at the best prices, with the highest level of efficiency and the lowest costs. This is achieved through a system where there is no price regulation, where the authorities' intervention is very limited from a commercial point of view, and where there is free access to internal aeronautical markets.

From that point of view we should say that Chile has an open sky policy where there are no barriers to entry, where there are no regulatory limits on ownership for control of the Airline, and there are absolutely no subsidies.

As the country has a large number of bilateral agreements with different countries, we even have open-sky commercial agreements with seven countries where cabotage is included.

The second fundamental pillar of the aviation policy is obviously represented by the airport concession policy, where the state has defined the integration of private capital as a priority for investment in air terminals so that public resources can be directed to areas where there is greater social profitability. In the last 15 years, there has been about two billion dollars worth of investment in airport infrastructure, which has obviously constituted an important strength from the point of view of restructuring the airport systems and improving the quality of their current operations.

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Role of the authorities in the region

The third subject of this presentation is related to the role of the authorities in the region, which is always complicated because our region, as we said in the presentation, is a region with high accident indices.

IATA statistics for 2008 indicate that at world level we had an accident rate of 0.81 accidents per million aircraft manufactured, and the region has 2.55. In other words, we are three times over the world rate and way over the rest of most of the regions; therefore, from that perspective the authorities' role is always a complicated one that is not always understood properly by the operators, but it is always a good idea to make a brief comparison of the basic problem, and the basic problem on our continent is related to regulations.

If one makes a brief comparison with other regions of the world, for example Europe, one sees that it consists of 50 countries, it administers or manages 30% of the world traffic, and they have only one regulation that one way or another organizes the activity of operators on the continent.

The situation is the same in North America. There are three countries, they administer 45% of the world traffic, and they have also progressed towards a standardized, consensual regulation from the operations standpoint, which gives those regions a higher level of safety and a better level of efficiency from the point of view of use of resources.

If one analyzes the region of Latin America we are 22 countries, we administer approximately 7% of the traffic in the world, and we have as many regulations as there are authorities; from that perspective we have a big problem in the sense that our continent has been slow in moving towards a single regulation. Work has been done toward this end, and I know the authorities have been working since 1996 on a Latin American regulation that can somehow organize the way we operate in the region better.

Business strategy versus market

Commercial Strategy

What has Lan's commercial strategy been for inserting itself in this highly competitive market appropriately, which is in permanent crisis and where profitability margins are very low.

The commercial strategy starts by stating it is based on four values that are fundamental and permanently ingrained in everyone who works for the organization.

- The first value is **Safety**.
- The second value of the company is **Excelling**.
- The third is **Efficiency**
- The fourth is the **Warmth** of our service.

The most important point to make is that the value of safety is an essential value that is non-negotiable and has been defined as such in the company.

Passenger Strategy

Based on these values Lan prepares a commercial strategy that basically seeks to combine, as perfectly as possible, the transportation of passengers and cargo, using all of the company's capacity. From that perspective, passenger transportation has been structured in four distribution Hubs.

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Buenos Aires
Santiago
Lima
Guayaquil.

This Hub combination enables us to strengthen, in terms of operations, passenger demand so it can be distributed to different parts of the world and the continent, using a low-cost strategy on domestic flights, which enables us to access a segment of society that traditionally did not use air transportation. When Lan's low-cost strategy was implemented on domestic flights, rates were reduced approximately 20%, which immediately created an increase in demand of approximately 40%.

Cargo Strategy

The cargo strategy is based on the implementation of four cargo distribution Hubs:

Brazil
Colombia
Mexico
United States

This strategy has sought to position the company in the markets that generate the highest demand for cargo, well complemented also by the availability in passenger aircraft in order to make the most of the capacity of the aircraft and, at the same time, take advantage of the possibilities provided by the market.

Results of the commercial strategy

This commercial strategy has enabled us to position ourselves very well in the Latin American market, to the extent that in Argentina we have 28% of the market, in Chile 81%, in Peru 90%, and in Ecuador 13%. As a result of the Cargo strategy, we have 40% of the market on the continent, which obviously positions us as a very strong company.

Advantages

First of all, the amount of net operating income has increased considerably in the last few years, as shown on the slide, and this has also made it possible for the company's profitability levels to increase considerably, resulting in a number of honors.

Aviationweek recently published a very important article where it ranks Lan as the best airline in bad times, given the commercial crises that are affecting the industry. Besides that mention, there are number of other distinctions in different sectors of the aviation industry where they recognize the validity of this commercial strategy and the strength of the company in dealing successfully with the fluctuations of a market in permanent crisis.

Economic consequences of the crisis

The economic crisis that was unleashed in the first part of 2009 has obviously posed an important problem, and you can see today how passenger traffic has dropped dramatically, not only at Lan but throughout the industry. At the same time the amount of cargo has experienced very significant decreases.

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In the face of this dramatic drop in demand in terms of passengers and cargo, we have managed the issue of safety by following and maintaining the standards established by the company and coordinated with the authorities.

➤ Safety Policy

All the SMS Safety Programs (Safety Management System) are set forth in a Safety, Quality and Environment policy. This policy states first that there is Corporate motivation and a commitment to Safety standards, that safety is everyone's responsibility and it starts at the highest level.

The responsibility for safety in the company falls on everyone, starting with the CEO.

The mission of the safety report is encouraged in order to have the maximum amount of information related to unsafe conditions in order to evaluate them and subsequently manage them. Operating errors are an opportunity for improvement and safety objectives are very well defined, measured, and promptly recognized when they are achieved.

Existing safety programs

Safety Management System

In the Safety Management System, safety processes are structured in three major areas.

In first place, the Proactive area

In second place, the Reactive area

In third place, the Prediction area.

1. Proactive Area

When we speak from the proactive point of view we have the whole analysis process that is permanently carried out in the industry in order to extract teachings and experiences that may be valid in the day-to-day operation. There is a permanent analysis of the risks and changes the industry is experiencing. We have a whole Line Operation system in Safety Audit that is called LOSA, which includes a team of experienced pilots who are permanently auditing the routes in order to standardize and solve any operating problems. We have a complete system of Operating Safety Auditing that follows the standards that IATA and OASI have established for the operation of operators. Finally, we have a complete alcohol and drug program that aims at making sure that every member of our crew is going to be in optimal physical and mental condition to operate an aircraft.

1. Reactive Area

From the reactive point of view we have an Aviation Safety Information System that is called AVSIS, which collects all the information on events and incidents that might occur in order to obtain a database so that we can permanently analyze the variables that are interacting in daily operations.

We also have an Operating Safety research system that enables us to get to the bottom of incidents and events that we might detect in the operation of our aircraft.

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2. Prediction Area

This is an early detection program of fatigue in flight crews. Its purpose is to be able to act in a predictive way on those factors or persons who might be submitted to, or under, operating stress.

Finally, we have the Fly Data Monitory (FDM), which is a whole system that makes it possible to download data or flight information digitally. The purpose of the system is to recreate promptly the conditions in which specific events or incidents occur, in order to find out exactly what happens or happened on a specific flight.

Strategies in times of Crisis

In view of the complicated scenarios we are facing this year, company strategy has been structured around three points: Strict Operating Cost Control, Reinforcement of the Business Model, and Reinforcement of safety measures and programs.

For this work, we will refer in some detail to the Strict Control of Operating Costs and Reinforcement of safety programs.

Within Strict Control of Operating Costs, the following measures were taken this year:

1. Lean Project

Project LIM was implemented. This is a methodology that comes from Asia, and it was used to evaluate and analyze all the processes in the maintenance area. It has resulted in savings of significant resources. In numerical terms, we can state the following:

- We have reduced the down time of aircraft in the hangar for inspections by almost 40%. We have reduced the number of man-hours for inspections by 20%, with a zero accident rate.

In practical terms, this means not only there is an issue of cost reduction, not only is there an issue of greater efficiency, there is also an issue of an increase in the self-esteem of personnel who participate in these processes, who realize they can be much more efficient and they are delivering higher value added with their work for the company, and that is also transformed into greater safety.

2. Vacation Period

As a result of the drop in demand, we have advanced vacation periods for crews in order to provide appropriate rest and to reduce the company's liabilities for this labor debt.

3. Restructuring of Calendars for reception of aircraft

The calendars for reception of new aircraft have been restructured to give the company a breather in recovering from the crisis.

3. Work with the authorities

Lan has worked in close coordination with the authorities on the redesign of specific instrumental approaches and instrumental takeoffs to save the maximum flight time, which leads to greater efficiency and lower operating costs.

4. Winglet Project

A WINGLET project has been implemented in the whole 767 fleet of aircraft, permitting savings of an amount of fuel that we have defined between 4 and 5%, which represents a very important amount of resources that are going to be saved in the operation.

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From the point of view of the Safety programs implemented this year, we can point out the following:

1. Reinforcement of LOSA Program:
In crisis periods, it is fundamental to increase operating control in order to assure that operations are in compliance with the company's operating standards, like the ones established by the authorities. Taking advantage of the opportunity of the fact that crews are more available, Line Operating Audits have been reinforced. They consist basically of the establishment of Safety inspections in the cockpit in order to control compliance with operating standards.
2. IOSA – ISAGO Certification
At the same time we have established IOSA certification of ISAGO as absolutely obligatory for all subsidiaries, both passenger and cargo, to operate with one standard. We are definitely achieving lower cost, but at the same time a higher level of safety.
3. FAST Program:
In parallel with the above, a fatigue control program among crews has been implemented for prompt detection when there is an issue involving anxiety or fatigue, permitting timely management of the risk from a medical standpoint.
- 4.- Operations Standards Program
A standardization program of the Operations Standards of all the subsidiaries has been established to achieve the standard “Lan, one way of flying” aimed at expressing that regardless what region the operations take place in, the company standard is the same. This is undoubtedly a contribution to safety.
- 5.- Reinforcement of FDM
FDM is a very useful predictive tool that requires great dedication in Man Hours to analyze the large amount of information that is obtained from each flight. A special effort has been made to allocate human resources to analyzing the information obtained, which enables us to predict risk factors that could eventually become an operations problem.

Future challenges

The big permanent challenge to the industry is for air operators and authorities to have the possibility and ability to work in a coordinated and complementary way in order to strengthen aeronautical activity at the industry level where the authorities have a very important role to play.

Second, I think there is a very important challenge to the operators in the sense that in times of crisis and in normal periods they have to develop the maximum creativity and innovation in order to have better production and efficiency to deal with crises like the ones we have been experiencing this year.

Finally, I would like to say that also in times of crisis the authorities have to be capable of developing a perfect balance between the flexibility they should have towards the operators' innovation and creativity, supporting different alternatives for projects that circulate in the industry and are definitely beneficial projects at both industry and company level, but at the same time they have to maintain the levels of control that an industry of this nature requires. The authorities play a double role, supporting companies but also being strict enough to enforce and maintain industry standards at an international level.

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CLOSING

LAN's commercial strategy is based first on strict respect for aeronautical regulation, and at the same time it is based on three fundamental pillars: first, on perfect quality service, efficiency in the use of resources, and a central pillar, which is the strongest of all, that is represented by commitment and respect for all the safety measures we can implement and for all the ones the authorities implement in the framework of their exclusive powers. We have done this for the last 80 years, and there is no doubt we will continue to do so for the rest of the XXI century.

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