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Turbulence at the Italian carrier could deter potential saviours and push it into Bankruptcy Christopher

Kummer, Institute of Mergers, Acquisitions and Alliances:

The airline industry has always been difficult and calls for operational excellence Italy's flagship airline Alitalia discovers its shortlist of bidders today despite scepticism over a deal going ahead. The interest comes as analysts predict levels of mergers and acquisitions in the sector will continue to soar.

Alitalia has been hamstrung by a militant workforce, which has prevented it from reacting to market changes such as low-cost carriers, and a lack of scale, according to Penny Butcher, airlines analyst for Morgan Stanley.

The Italian government, which is advised by Merrill Lynch, last month said it would sell at least 30% of Alitalia and possibly its full 49.9% holding in a bid to salvage the group. Under Italian law, an investor that crosses the threshold of 30% must launch an offer for the company.

Companies must register an interest in buying the government's stake by today.

"If Alitalia does not manage to merge with a rival, it will go the way of its Greek neighbour, Olympic – into bankruptcy. The government legally cannot help it out any more," Butcher said. Alitalia has been at the centre of takeover speculation and there has been reported interest from private equity houses including BC Partners, Goldman Sachs Capital Partners, Cerberus and Texas Pacific Group.

Rothschild has put together a consortium including two private equity firms while Management & Capitali, an Italian private equity fund run by Carlo De Benedetti, and Italian businessmen Paolo Alazraki and Diego della Valle have also been linked with a bid.

Rivals including Meridiana and Air One have also been mooted but reports from France last week claimed Air France-KLM had pulled out over price issues.

Butcher said the unions were to blame for Air France's decision, despite it being an obvious tie-up. The largest recent European airline merger was Air France's takeover of KLM of the Netherlands for €3.8bn ($4.9bn) in 2003. Alitalia was in partnership with both and bankers predicted a three-way link as inevitable at the time. That possibility is more remote, according to Butcher.

"Alitalia has had about eight chief executives in 10 years. The company has not necessarily suffered from mismanagement but any changes it tries to make have been batted back by the unions. The problem with this round of bidding is it wants a local partner," she said.

As well as union opposition, the Italian government shot itself in the foot when it imposed conditions on potential buyers, an analyst said. These included maintaining the airline's Italian identity and meeting the targets of an industrial plan drawn up to salvage the group last year.

Mike Powell, an analyst at Dresdner Kleinwort, said in a report this month: "Given the conditions attached to the tender, we doubt anyone will bid anything like the current share price for the government's stake." He added a failed tender or revised outlook predicting losses for the year could drive down the share price.

A rescue package was put together in October 2005. It included a plan to introduce outside investment, cut unit costs by 24% and reduce staff numbers from 20,500 to 9,100 by next year.

The European Union scrutinised the plan over suggestions the investment could have been provided by the government. Under EU law, a government may save its national carrier only once, which Italy did with Alitalia in 1997.

In the month of that rescue, the government guaranteed a €400m bridging loan from Dresdner Kleinwort Wasserstein to Alitalia to cover its immediate cash requirements. It mandated 12 banks to raise €1bn of fresh capital underwritten by them.

To highlight the extent of the group's financial problems, a memo was circulated by Deloitte & Touche, the company's auditors, which refused to sign off on the airline's half-year accounts.

It said: "The capital increase is essential to recover the company's equity, economic and financial balance."

The rescue was designed to help Alitalia break even by 2006. In the half-year to September 30, the company said the plan was progressing "below expectations". Dresdner predicted net losses would total €237m last year, against €168m the previous year.

Christopher Kummer, director of the Institute of Mergers, Acquisitions and Alliances, an M&A research group, said: "Any company that constantly fails to operate profitably is a takeover target. Alitalia has struggled for years. The airline industry has always been difficult and calls for operational excellence."

Airline mergers are gathering momentum. Last year, the value of announced deals worldwide trebled to €12.3bn, according to mergermarket, a data provider.

Kummer said: "The M&A deals in the airline industry are caused by the difficult economic environment, poor strategic leadership and weak operational management."

The fourth quarter of last year was particularly busy. US Airways launched a hostile bid for Delta Air Lines for $8.7bn (€6.7bn) in December, while United Airlines and Continental Airlines discussed a tie-up.

In October, Irish airline Ryanair launched a surprise €1.5bn hostile bid for newly privatised Aer Lingus. The budget airline has been forced to put its bid on hold after the European Commission referred it for investigation.

Kummer said: "I expect a lot more M&A deals in the airline industry. Alliances are only an intermediate step towards a consolidation that will take place when the industry is finally deregulated."

Private equity companies have targeted airlines. Apart from those linked with Alitalia, the largest deal in the past three years was done by a private equity consortium that included Texas Pacific Group, Onex and Macquarie, to buy Qantas Airways, Australia's flagship carrier, for A$11.1bn (€6.8bn) last month.

Kummer said: "Private equity investors can accept a different riskreturn relationship than strategic investors. Such financial investors are able to reorganise airlines in a more radical way."