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US industry:
At last profits return

In the spring of 2004, when crude oil prices had hit the mid-to-high $30s per-barrel range (a level that now sounds utopian) and the US legacy carriers were headed for a fourth consecutive year of heavy losses, the consensus opinion was that the long overdue US airline industry consolidation process was imminent. Experts predicted that, through mergers or liquidations, the number of large network carriers would whittle down from six to three or four. The June 2004 issue of *Aviation Strategy* covered this subject in an article titled "US legacy carriers: shakeout to begin this autumn?"

But even though oil prices have since then doubled, exceeding $70 per barrel in recent months, the shakeout never happened. There has been only a single liquidation - FLYI, the parent of Independence Air, in early 2006 - and only one merger, between US Airways and America West in 2005.

Independence Air was a rather special case; the ex-regional failed because it could not make its unusual new LCC model - an independent hub operation at Washington Dulles and a fleet of primarily 50-seat RJs - work in the competitive East Coast environment. The airline was too small to have much positive impact on industry capacity when it disappeared, and there is little chance of a resurrection because the operating certificate has been sold to Northwest's new regional subsidiary Compass Airlines.

US Airways and America West, in turn, pulled off what can only be described as a miracle - an intelligent, well-funded and well-executed merger that created a new type of "hybrid LCC". The old US Airways used the Chapter 11 bankruptcy process to rationalise its fleet and reduce its high legacy labour costs to effectively LCC levels, transforming itself into an attractive merger target (see *Aviation Strategy*, December 2005). The new AWA-managed entity is reporting strong results and is on the "buy" list of every analyst. However, there remain significant labour integration challenges, the outcome of which may not be clear until early 2007. US Airways contributed meaningfully to the industry capacity reduction by removing 59 aircraft or 15% of its fleet through the merger and choosing not to grow over the next couple of years. If the integration is successful, the merger could provide a blueprint for future deals.

The industry shakeout has not happened because, amazing as it seems, the US legacy carriers are staging a financial recovery despite crude oil prices remaining around $70 per barrel.

The US airline industry is expected to return to profitability in the current (second) quarter; Merrill Lynch's mid-June estimate was an aggregate net profit of around $600m for the three-month period (excluding Delta and Northwest, which are in Chapter 11, but including the main LCCs).

After five years of heavy losses, the industry is also poised to report

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a net profit for 2006; the current estimate from Calyon Securities is "over $400m". Of the solvent carriers, only United and JetBlue are expected to report losses for the year. Excluding fuel, the US airline industry is actually currently achieving record operating profits. In other words, without the past three years' hike in oil prices, this would be a boom year for airlines.

Former UBS airline analyst Sam Buttrick (now at the bank's Fundamental Investment Group) noted in a speech in early May that the US airline industry was "structurally, meaningfully profitable at $60 oil", adding that he was impressed that the industry had adapted in a relatively short period of time to a significant negative shock. The recovery trend has been reflected in airline stocks. As at mid-June, the Amex Airline Index had risen by 27% since its low point in late September 2005. Airlines such as American, Continental, Alaska and US Airways continue to be on the "buy" lists of most analysts.

"Who would ever have thought that we would be recommending stocks with fuel prices at $70 a barrel?" marveled Mesa's CFO Peter Murnane at Merrill Lynch's annual transportation conference in mid-June. "It is unbelievable."

New capacity discipline

Of course, none of this is surprising outside the US, where many airlines have remained profitable in the current fuel environment thanks to their ability to pass on increased fuel costs to customers.

Until recently that was not the case in the US domestic market, where the competitive dynamics are such that no airline with a sizable presence on a route dares charge higher fares than competitors for risk of losing market share. For many years it was difficult to get fare increases to stick, and the problem was exacerbated by the increased presence of LCCs and excess capacity (which Continental's CEO estimated at 25% in mid-2004). The legacy carriers had no domestic pricing power.

However, unexpectedly large capacity cuts by US Airways in its second Chapter 11 visit last year and by Delta and Northwest soon after they went into Chapter 11 in September 2005, together with a highly disciplined approach by the solvent carriers (except Continental), have removed much of the excess capacity from the domestic market.

Domestic industry capacity (ASMs) is expected to decline by 2% this year, which analysts say will be the first-ever instance of domestic shrinkage in a non-recessionary environment, except for September 11. (Of course, airlines outside the US will not derive comfort from the knowledge that much of that capacity will shift to international markets.)

The strongest of the legacies, American, has reiterated that it cannot grow until it reaches profitability; the airline is shrinking its domestic mainline capacity by 4% this year, as it grows international ASMs also by 4%. By contrast, Continental is sticking to plans to grow by 5-7% annually in the next few years, with the 2006 rate being even higher, justifying it by the need to provide feed to international routes (read: wanting to capture market share). Of course, many LCCs continue to add capacity in double-digits.

The magnitude of the legacies' domestic shrinkage is best illustrated using pre-September 11 as the baseline. According to JP Morgan data, between 2000 and 2006, Delta, United, US Airways, American and Northwest reduced their domestic capacity by 28%, 24%, 23%, 23% and 22%, respectively.

The tight capacity situation, combined with strong demand particularly this spring and summer, has led to a dramatically improved domestic revenue environment - a trend that began in the autumn of 2005. There have been numerous fare increases and most of them have stuck. Domestic mainline unit revenue (RASM) growth in the first half of 2006 has been running in double-digits, with May seeing a 15.1% increase.

These positive domestic revenue trends are expected to continue, given the constrained supply, strong summer bookings and a new Delta-led $50 business fare increase put in place in mid-June. Also, there is some way to go to full recovery - the May RASM was still 20% below the 2000 peak.

As a result, as Merrill Lynch analyst Mike Linenberg pointed out in a recent report, top line growth is now more than offsetting rising fuel costs; this happened in the first quarter

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and is likely to continue through 2006.

The legacies' results are also benefiting from continued efforts to reduce non-fuel costs - after five years of heavy cost cutting, it is amazing that the airlines are still finding potential targets (other than through Chapter 11). American, for example, is trying to reduce its costs by another $1bn this year, needed just to keep expenses in line with 2005 levels; the airline has identified $700m of those cuts through measures such as fuel conservation and lowering distribution costs.

American's improved prospects received an important acknowledgement in the form of a June credit ratings upgrade by Standard & Poor's (from "B-minus" to "B"). The agency concluded that better revenue generation and ongoing cost cutting efforts had more than offset the effect of high fuel prices. S&P also noted that AMR raised $400m in a public share offering in May and had an ample $4.3bn in available cash.

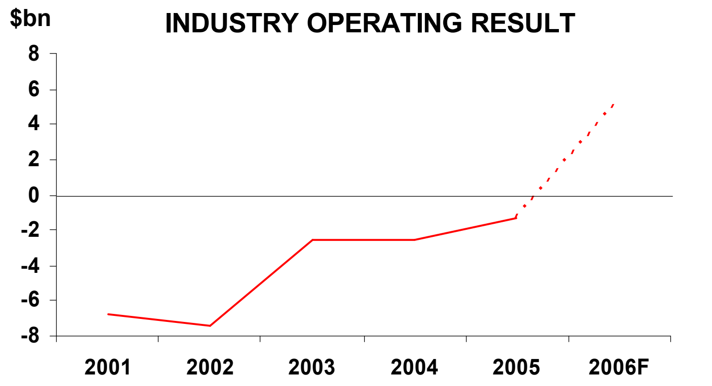
Industry liquidity remains strong, with Continental (as in the past) being the black sheep in that regard with cash reserves of less than 20% of annual revenues. JP Morgan analyst Jamie Baker suggested in a recent report that "only above $80 crude should investors start to fret about liquidity, and then only about CAL". However, the legacy balance sheets are expected to benefit from pension reform and/or continued access to the public equity market. Continental recently announced plans to monetise more of its 27.3% stake in Panama's Copa in a public offering.

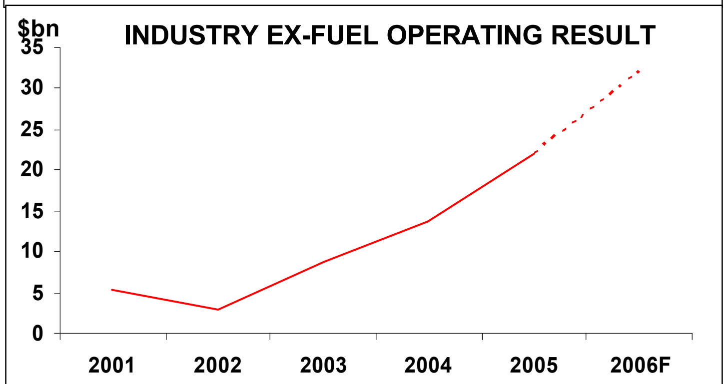
All the indications are that if the positive revenue trends continue and there is excess cash, it will be used to repair balance sheets rather than make acquisitions.

Consolidation later?

At UBS's annual transportation structured debt conference in early May, two very different views on where the US legacies' direction in terms of consolidation, were presented.

UBS's Sam Buttrick, while noting the dramatic improvement in legacy profitability, argued that structural issues dictated that "consolidation among large network carriers is close at hand", and that his best guess is the second quarter of 2007. Buttrick made the point that the US legacy sector is a "chronically oversupplied business" that does not need six or seven carriers pursuing the same plan (hub-and-spoke operations). "Business combinations would be a blaringly obvious solution"; yet, unlike in other industries, there has not been a merger between healthy sizable carriers for two decades (since USAir/Piedmont in the mid-1980s).





Note: Airlines included - American, Continental, US Airways, Southwest, Delta, Northwest, Alaska, JetBlue, AirTran and Frontier
Source: JP Morgan equity/credit research

Buttrick noted the many valid reasons why there have not been mergers, including labour integration problems, regulatory issues, lack of management resolve, mediocre track record of past mergers and the existence of "synthetic" substitutes such as codesharing. However, he noted potential positive developments on the labour and regulatory fronts. US Airways' ability to successfully integrate the labour forces could set an important precedent. And a well-crafted merger plan may now be more favourably received by regulators.

As Buttrick pointed out, the fact that the third and fourth largest airlines (Delta and Northwest) are in bankruptcy obviously heightens the possibility of mergers in the future.

In contrast, Avitas' SVP Adam Pilarski said that he did not see additional bankruptcies or consolidation because of the substantial capacity cuts already accomplished by four legacy carriers in Chapter 11. He made the point that since 2000 United, US Airways, Delta and Northwest have seen their combined market share fall from 50.5% to 41.6%. That voluntary capacity reduction was similar to the 10.1% capacity share removed when Pan Am and Eastern ceased operations in the early 1990s - the last major industry shakeout. As Pilarski put it, "there does not have to be bloodshed". Furthermore, Pilarski did not buy the overcapacity argument, particularly since load factors were at record highs. "You don't have overcapacity, you have wrong airline pricing."

Both Buttrick's and Pilarski's predictions seem plausible, depending on circumstances. If the industry recovery continues and/or US Airways fails in its integration efforts ,there may not be consolidation. But if the industry recovery falters, through a demand downturn or excessive capacity addition, and/or US Airways succeeds, there may well be mergers.

If US Airways succeeds, it may encourage consolidation along the lines of nimble smaller carriers doing reverse merger type transactions with the legacies, as CEO Doug Parker has predicted. Importantly, the US Airways/AWA deal demonstrated that outside capital is readily available to fund solid and innovative business plans.

Another possibility, in the wake of US Airways/AWA, is that there will be opportunistic mergers or cooperation among the smaller carriers. Calyon Securities analyst Ray Neidl has suggested that Frontier, which is being squeezed in its Denver home base by United and Southwest, needs more market mass and would be a good fit with JetBlue, which has also indicated that it is now open to cooperative deals. The two business models have similarities in terms of equipment type, in-flight service and culture, and the route systems would be complementary.

But such deals would not solve structural problems such as reduce the number of hubs, which many Wall Street analysts believe will hit the industry in the next economic downturn at the latest. Consequently, speculation persists about a potential Delta/Northwest combination. United/Continental is also mentioned regularly, while American apparently does not believe that it is out of the picture either.

It would seem that, for the current year at least, both Delta and Northwest are too busy getting their own houses in order. While investors are reportedly eagerly awaiting any opportunity to participate in merger transactions involving those airlines, analysts such as Neidl take the realistic view that, even though the route systems are complementary, the DoJ is not yet ready to allow such larger mergers.

By Heini Nuutinen

Air Deccan: IPO struggle reflects Indian overcapacity worries

After a last minute price reduction and an extension of the offer period, Indian LCC Air Deccan just managed to complete its IPO in June - only to see the value of its shares fall by a third on its stock market debut. As with the Air Berlin (see *Aviation Strategy*, May 2006), is Air Deccan's IPO a victim of poor timing, or does the poor reception from the market indicate trouble ahead for the Bangalore-based carrier?

Air Deccan was launched in August 2003 as a subsidiary of Deccan Aviation, a Bangalore helicopter charter company that was set up in the late 1990s by Indian army officers (including Capt G.R. Gopinath, the current managing director of Air Deccan). Today Air Deccan operates 90 routes to 55 domestic destinations and has a 14% market share, making it the third largest domestic airline in India.

Air Deccan follows elements of a typical LCC business model, with outsourced ground handling, few frills and both online and telephone booking (although - as is traditional in the Indian market - there is still a large proportion of travel agent bookings). However, it varies from the LCC model in that it operates both turboprops and A320s. Air Deccan initially focussed on "underserved" destinations in the south of India, with fares typically around 20%-35% lower than fares at full service competitors, but it has since expanded to the east, west and north of the country, both to cities that previously have not had any scheduled passenger services but also to an increasing number of domestic trunk routes. The airline has bases at seven Indian cities - Delhi, Mumbai, Kolkata, Bangalore, Hyderabad and Chennai - with the latest addition being Trivandrum in the south of India, which was launched in April 2006 with a new A320 stationed there operating to Delhi via Chennai and to Mumbai via Cochin.

In April 2005 Air Deccan raised $55m in convertible debentures to fund fleet expansion from US-based Capital International and Indian investor ICICI Venture Funds, but continued rapid growth (it carried 4.1m passengers in the year to March 2006) led to this year's IPO. This was launched in mid-May with a range of Rs150-Rs175 per share (€2.78-€3.25), a price that with 24.55m shares being issued (representing 25% of the airline's equity) would raise between €68m-€80m for the airline.

Lead managers for the IPO were Enam Financial Consultants and ICICI Securities, although it was reported that they were appointed only after other companies - including JP Morgan and ABN Amro Rothschild - "declined to manage the issue", citing that they had other commitments in May. However, sources indicate that they pulled out because of differences over timing, with their preferred IPO date being much later in the year. Air Deccan, however, had already delayed the IPO from February this year due to ongoing negotiations with Airbus on a new A320 order, and the airline also had to meet a May deadline for an IPO or else it would have had to re-apply to the Securities and Exchange Board of India for listing permission. Ominously, the banks that withdrew were allegedly also unhappy about an initial suggested price by the airline of Rs 300-Rs 325 per share - a level that would have raised as much as €148m.

At the actual market range of Rs150-Rs175, the aim was to close the offer period on 23 May. However, the prospectus was poorly received by potential investors, and so the offer period was extended to 26 May and the price band extended downwards to Rs 146 (€2.71).

In the end the IPO went away at a price of Rs148 (€2.75) per share, which raised €67.4m, valuing the airline at €269m. However, this was

AIR DECCAN'S FLEET

	Fleet	Orders (Options)
A320-200	14	62 (2)
ATR 42	13	
ATR 72	4	27
Total	**31**	**89 (2)**

almost €13m less than had been envisaged - and considering that as late as April this year Air Deccan was still hoping to price its shares at up to Rs 250 each (which would have raised more than €100m), the return of €67m from the IPO - prior to issue fees - must be regarded as disappointing.

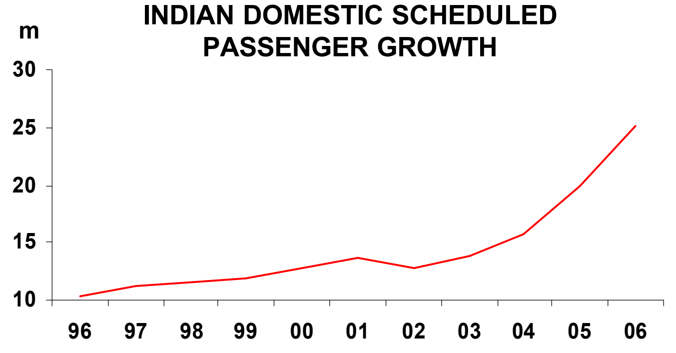
But worse was yet to come, because as soon as the shares began trading on the Bombay stock exchange - on 12 June - they fell immediately, closing at a price of Rs98, a worrying 33% below the IPO price. As *Aviation Strategy* went to press, the shares were trading in the mid-80s.

Approximately €25m of the targeted €80m (at a price of Rs 175) had been earmarked to pay off high-interest debt over the next four years, with the remainder to be used mainly for infrastructure investments (including a training centre, a hangar, and better facilities at airports) and to fund fleet expansion. How the €13m shortfall will affect Air Deccan's expansion plans is unclear, but the airline is committed to substantial fleet expansion over the next seven years.

Fleet

Air Deccan currently operates a fleet of 31 aircraft. Initially the core of the airline's fleet was the 48-seat ATR 42, but in February 2005 Air Deccan ordered 30 72-seat ATR 72-500s - half of which are to be purchased and half leased - and also agreed to lease three second-hand ATR 72-500s and three second-hand ATR 42-500s. The ATRs are arriving at the rate of eight per year and will boost Air Deccan's regional network.

Air Deccan ordered its first jets - a couple of A320s - in February 2004 (they were delivered in late 2005), and followed this up with an order for 30 A320s in December of the same year, for delivery from 2007 onwards. Air Deccan then tried to bring forward the delivery dates, and the first aircraft will now arrive from late 2006 onwards. After bringing in other A320s on tempo-



Note: Year to end March ***Source****: Indian DCGA*

rary leases, in December last year Air Deccan also placed an order for 30 more A320s, for delivery from 2008. At list prices this deal is worth around $1.5bn, but it is believed the airline received a substantial discount, probably of the order of 25-30%.

The A320s will lower the airline's unit costs and are being used for more links between the bigger cities. In particular the aircraft will extend Air Deccan's network to northern India, although this means the airline will start to face increasing competition. For example, a daily A320 service from Delhi to Patna in northwest India started in June, but on this route Air Deccan competes against Indian Airlines, Air Sahara and Jet Airways.

Altogether, Air Deccan plans to add up to another 100 aircraft by 2013, when it will have a fleet of 125. It currently has 89 aircraft on order, with 17 due to arrive by the end of the next financial year (March 2007), and the airline will receive a new aircraft virtually each month for the next eight years.

In the 2006/07 financial year alone 60 new routes will be added, bring the total network to 145 routes by April 2007. However, this raises one key problem - pilot recruitment. The airline currently has 385 pilots (out of a total workforce of 2,400) and is looking to employ another 100 pilots through 2006, in order to staff a fleet of more than 40 aircraft by 2007. However, Air Deccan (along with all other Indian airlines) has been affected what the Indian CAA describes as "an acute shortage of experienced commercial pilots". Pilot shortage forced Air Deccan to postpone the launch of some routes in 2005, and as a stop gap the airline has had to borrow pilots from Singapore-based LCC Jetstar Asia.

Assuming that pilots can be found, there is one more fundamental question: can Air Deccan continue to find enough new routes and passengers to fill up its aircraft? The airline insist that it can, and points out that that of the 150 Indian airports that are suitable to commercial passenger traffic, more than 50 currently have no service. With an estimated 300m Indians (out of a total population of 1.1bn) classified as "middle class" - i.e. able to afford air transport - Air Deccan has made a strategic decision to expand as fast as it possibly can in the face of growing competition so that, as one analyst puts it, it wins the "land grab" race. And it's hard to argue against the potential of a market where the average number of air trips per person is just 0.02 a year, compared with 2.02 in the US. Approximately 25m passengers were carried domestically in India in 2006, up from 14m three years ago, and this is expected to grow by 25% a year to the end of the decade.

By keeping to a strategy of connecting smaller cities in India combined with expansion on selected trunk routes, Air Deccan believes it will continue to attract business travellers and the middle class who, according to Capt. Gopinath, "don't mind spending slightly more than what they spend on rail travel to save time and effort".

The problem is that many other airlines have made the same analysis of the market potential, and are expanding (or planning to expand) just as quickly as Air Deccan.

IPO blues

With only two other airlines listed in India - Jet Airways and Spice Jet - it had been thought that Air Deccan's IPO would be well received. The relative failure of the IPO is therefore being blamed on a substantial fall in the Bombay stock exchange in mid-May. Air Deccan was also not helped by a New Delhi consumer court decision in June that it had to pay compensation to a business passenger for a delayed flight and poor inflight service. As part of the court proceedings, Air Deccan admitted that it had "many defective aircraft", with the court declaring that the airline needed to improve its fleet maintenance.

But while these issues affected the success of the IPO, the poor reception by the market also reflects concern about increasing competition in the Indian aviation market.

Air Deccan was India's first LCC and the provided the impetus to encourage new demand and stimulate a dormant Indian aviation sector. But at the same time this has encouraged a host of new entrants and fierce competition for that lucrative middle class and business traveller market. Currently, domestic competition comes from Jet Airways (serving 43 domestic destinations), Air Sahara (23), Indian Airlines (59) and a host of start-ups, including SpiceJet, GoAir, Paramount and Kingfisher, with many others planning to launch, including Easy Air, Magic, Indigo, Indus Air and AirOne.

The failure of the merger between Jet and Sahara to materialise is perhaps indicative of the fiercely independent nature of Indian airline entrepreneurs who all appear determined to compete for increasing shares of a rapidly growing market.

The growth of competition means that Air Deccan is increasingly running into a rival airline whenever it opens up a new route - and that competition can only erode Air Deccan's margins. That's significant because as Devesh Desai - Air Deccan's finance controller - points out, only one-third of its routes are profitable at present, as it normally takes at least a year for a new route to break even. Losses at the more than 30 routes Air Deccan started in the March-November 2005 period (which increased the airline's overall capacity by more than 50%), contributed to the airline's poor financial performance during that that period (the last period of results reported in the IPO prospectus).

In the financial year to end of March 2005 the airline recorded revenue of €56m, with an operating loss of €3m and a net loss of €6m. However, the prospectus stated that in the eight months to the end of November 2005 that although Air Deccan had a turnover of €96m, operating losses totalled €23m and net losses €22m. The airline attributes this to the costs of expansion, but the airline has also been hit badly by rising fuel prices, which are now responsible for more than a third of all costs (see chart, above). Although rivals such as Jet Airways and Indian Airlines have imposed fuel surcharges, Air Deccan has not passed on extra costs to its passengers. Warwick Brady, who became COO of Air Deccan in September 2005 (and who previously headed up Ryanair's operations at London Stansted) says that "we can manage without doing it".

Captain Gopinath says that the airline has made investments in new routes "in the hope that the middle class flies" and that "it will take another 12 months for us to record profits." The airline expects to carry 7.5m passengers in the 2007/08 year, but some analysts are cautious about the future. One Indian analyst say he does not believe the airline will break even until the first quarter of 2008, thanks to rising fuel costs and increasing competition.

AIR DECCAN COST BREAKDOWN

	FY ending Mar 31 2004	FY ending Mar 31 2005	Apr-Nov 2005
Fuel	14%	27%	34%
Aircraft/engine leases	16%	13%	13%
Maintenance	13%	15%	11%
Other operating costs	25%	22%	20%
Employee costs	11%	9%	10%
Admin costs	11%	6%	7%
Dep. & Amort.	3%	3%	2%
Finance/bank costs	6%	3%	2%
Other costs	0%	2%	1%
Total	**100%**	**100%**	**100%**

The warning signs are there already. In the year to end of March 2005 Air Deccan's load factor was 76.4%, but growing competition pared this back to 73% in the eight month period ending November 2005 - although Air Deccan argues this is due mainly to the frantic pace of routes launches.

At present Air Deccan has no international traffic rights because of the Indian government's rule that no start-up airline can operate international flights within five years from launch. That precludes Air Deccan from launching international routes until August 2008. In the meantime Air Deccan has signed an alliance with Thai LCC Nok Air - which will launch routes from Bangkok to Bangalore in October - with each airline selling the other's flights on its respective website. Deccan Aviation is also launching an LCC in Sri Lanka, based on Deccan Lanka, an existing charter helicopter operation. In order to obtain a scheduled passenger licence from the Sri Lankan government Deccan Aviation sold 52% of Deccan Lanka to local investors, and the "new" airline aims to operate between Sri Lanka and India later this year with a fleet of six ATRs and A320s. Yet this is likely to be no more than a temporary tactic, and Air Deccan is likely to be seeking its own international route rights in 2008.

Hawaiian Airlines: escalated competition for niche operator

Hawaiian Airlines, an old-established niche operator and the 17th largest US carrier, emerged from a two-year Chapter 11 reorganisation in June 2005 with a greatly strengthened balance sheet and an impressive financial turnaround under its belt. However, instead of consolidating and building on those successes, Hawaiian is finding itself having to deal with significant competitive challenges in virtually all of its markets.

First of all, markets between the US mainland and Hawaii, which accounted for 63% of Hawaiian's passenger revenues in 2005, have seen a 34% increase in total seats since 2000. All of the large network carriers - American, United, Northwest, Delta and Continental - have added capacity, while new entrants such as ATA, Southwest and US Airways have joined the fray. Just like international destinations, the long-haul domestic routes to Hawaii have proved an attractive place where to put the capacity removed from mainland domestic service.

Second, the inter-island markets, which accounted for 29% of Hawaiian's passenger revenues in 2005, are in a state of flux following Mesa's entry with its new low-fare subsidiary "go!" on June 9. The highly profitable, cash-rich US regional airline has introduced service with five 50-seat CRJ-200s, with plans to add 90-seat RJs later, in four major inter-island markets, cutting prevailing fare levels in half and offering limited introductory fares of $19 one-way. The main established operators, Hawaiian and Aloha, have matched the fares. Overall, inter-island capacity is up by about 20% this month from the year-ago level.

The escalated competition has meant that Hawaiian's yields and unit revenues are under pressure - just as revenue trends on the US mainland have turned positive, enabling mainland carriers to better cope with the high fuel prices.

All of this is a pity because Hawaiian deserves some mainstream Wall Street coverage following its successful Chapter 11 reorganisation. Currently the stock is only covered by some smaller brokerages or boutique investment banks. In mid-May, Caris & Company, a new Wall Street investment bank that aims to cater for the "longer term investor with a minimum of a 12-month time horizon", started Hawaiian Holdings with a "buy" recommendation.

But perhaps things will change because Hawaiian's leadership is at least now getting invited to speak at investor conferences. Most recently, CEO Mark Dunkerly (ex-COO of Sabena and before that at BA) and CFO Peter Ingram (ex-AMR) gave a comprehensive presentation at Merrill Lynch's annual transportation conference in mid-June. Dunkerley also spoke at Calyon Securities' airline conference in December 2005.

Hawaiian cannot be ignored for several reasons. First, it has been among the most profitable US airlines in the past three years, achieving operating margins similar to Southwest's and AirTran's. Second, it has one of the strongest balance sheets in the industry. Third, it has top operational performance, great customer service and a strong brand. Fourth, it is poised for long-haul growth with four additional 767s due to join the fleet later this year.

But there is a question mark over Hawaiian's cost structure, which the Chapter 11 process did not adequately address. Is the airline a long-term survivor with a CASM of 10.50 cents?

Mesa has frequently cited Hawaiian's high cost structure and Aloha's weak cash position (though Aloha achieved low unit costs through its Chapter 11 restructuring, completed in February 2006), as reasons why it thought Hawaii presented a good opportunity. But to what extent is the Hawaiian market different? Could the encumbents win thanks to their stronger market position, customer service and expertise in a market described as insular or, as Hawaiian's leadership put it, "unusual and quirky"?

Hawaiian is one of the oldest US airlines, having operated continuously since 1929, when it was founded as Inter-Island Airways. The present name was adopted in 1941. The airline currently operates 135 daily departures with an all-leased fleet of 25 aircraft - 14 767-300ERs and 11 717-200s -that has an average age of six years.

Neither a network carrier nor an LCC, Hawaiian describes itself as a "destination carrier". The focus is exclusively on the Hawaii state, with little ambition to become more broadly based. The strategy is to "leverage Hawaii's culture as a competitive advantage" and design the schedule and product specifically for Hawaii customers.

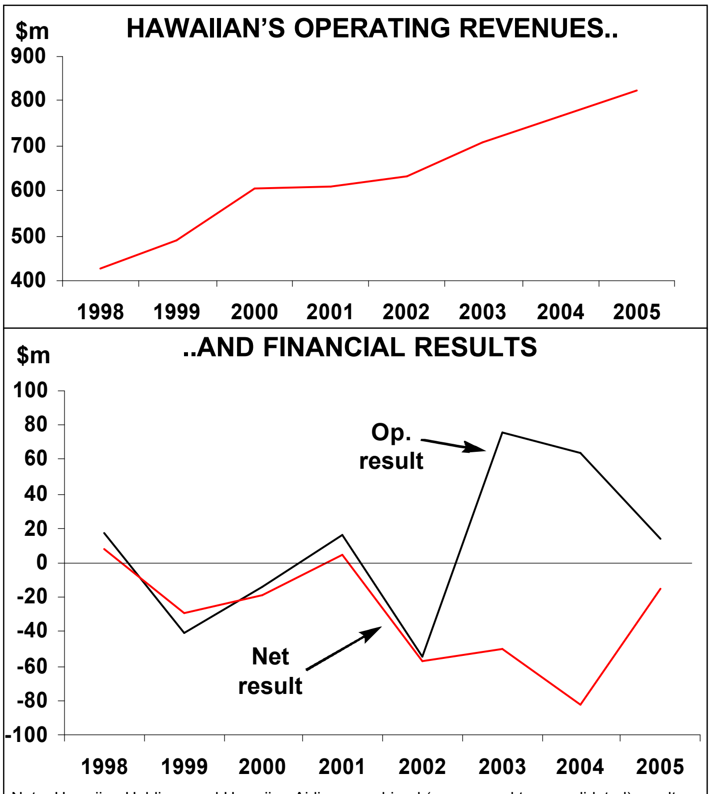
In addition to its Hawaii-US mainland and inter-island operations, Hawaiian has a modest South Pacific network (American Samoa, Tahiti and Australia), which accounts for 7% of revenues. The airline also operates public charter services to Anchorage (Alaska) and other ad hoc charters.

Like other leisure-oriented carriers, Hawaiian has always had strong load factors - last year's was an industry-leading 87.5% - but limited pricing power. However, until recent years, maintaining fares at economic levels was always a struggle in the inter-island market, due to price sensitivity of the traffic and competition.

Because of those and cost issues, up to and including 2002 Hawaiian was a chronically unprofitable airline. It failed to turn in operating profits even in the industry's boom years.

Chapter 11 accomplishments

Hawaiian Airlines filed for Chapter 11 in March 2003 to facilitate the renegotiation of its aircraft leases. In addition to securing concessions from its three aircraft lessors and other suppliers, the airline restructured key labour contracts, increased aircraft utilization and dramatically improved operational performance. On the revenue side, the accomplishments included enhanced yield management, marketing and distribution.



Note: Hawaiian Holdings and Hawaiian Airlines combined (as opposed to consolidated) results (due to Chapter 11, consolidated results are not comparable on a historical basis).

In many ways, it was a much less brutal Chapter 11 restructuring than the ones implemented by the large network carriers. On the labour front, Hawaiian focused on productivity improvements rather than take-home pay. This may have left it with a higher-than-desirable cost structure, but it helped preserve the good will of employees - something that the management considers a key aspect of Hawaiian's competitive advantage.

It was a particularly smart move to focus on the operational metrics. Hawaiian has been ranked the nation's top airline for on-time performance for 30 consecutive months (since November 2003). For the past year or so, the airline has also been number one in terms of fewest cancellations and least mishandled baggage. These are key aspects of service that can inspire loyalty among passengers.

Significantly, Hawaiian maintained value for creditors and shareholders. Creditors - even those with unsecured claims - were paid in full, while shares in the old company retained value. The latter was possible because the parent company, Hawaiian Holdings, did not file for Chapter 11 - only the airline did. However, while Holdings retained its equity interest in the airline, new shares were issued to creditors to help pay for the claims, which resulted in some dilution. The Chapter 11 exit in June 2005 was accounted for as a business combination, with Hawaiian merging into HHIC, a wholly owned unit of Holdings, and HHIC then changing its name to Hawaiian Airlines Inc.

The claims were settled through a combination of $126.4m in cash payments and the issuance of $87m of common stock. The exit financing transactions also included a $50m senior secured credit facility, a $25m junior secured term loan and a private placement of $60m of convertible notes.

In March and April this year Hawaiian completed a balance sheet restructuring that was really a culmination of the financing activities associated with the Chapter 11 exit. The two loan facilities were increased by $90m, which provided funds for the acquisition of four used 767s and the redemption of the $60m convertible notes, which needed to be refinanced before June 1 to avoid a significant dilution to shareholders.

As a result of all that, Hawaiian's balance sheet is in good shape, with unrestricted cash of $153.7m at the end of March - about 19% of 2005 revenues - and an acceptable level of debt. The company believes that it is well positioned to face the competitive challenges in the two areas and take advantage of opportunities that may arise.

Hawaiian's ownership structure will become more conventional as RC Aviation, an investment vehicle controlled by Holdings' chairman Lawrence Hershfield, and other Chapter 11 backers, including ex-AMR chief Don Carty (also on Hawaiian's board), reduce their holdings, thus increasing the free float. RC Aviation held 36% of Hawaiian's common stock when the company emerged from bankruptcy. Hawaiian is listed on the American Stock Exchange (Amex).

In early June Hawaiian strengthened its board with the addition of five new members. The 12-member board includes seven independent directors, including three employee designees (ALPA, AFA and IAM).

Financial turnaround

The dramatically improved operational performance, enhancements to yield management and other revenue measures implemented in Chapter 11 paid quick dividends, enabling Hawaiian to start benefiting from unit revenue improvements a couple of years before the rest of the industry. The airline's RASM surged by 10.2% in 2003 and 7.3% in 2004.

As a result, Hawaiian became profitable in 2003, achieving 8-9% operating margins in both 2003 and 2004 - years when only a few US airlines had positive margins. 2005 was a tougher year, with only 1.4% RASM growth, but Hawaiian still achieved a 1.7% operating margin. These results were impressive not just in light of the fuel price trend - Hawaiian's average price per gallon doubled from 93 cents to $1.81 - but given the dramatic industry capacity increase in transpacific markets.

In absolute terms, 2005 saw a $14.1m operating profit and a $15.1m net loss on revenues of $825.5m. The net loss reflected an unusual $41m income tax provision, driven by the reconsolidation of Hawaiian and Holdings.

The first quarter of 2006, one of Hawaiian's seasonally weakest periods, saw operating and net losses of $4.6m and 12.3m, respectively, on revenues of $210m. This was despite slightly stronger 5.1% RASM growth in the three-month period.

The recent financial statements are hard to read in that they reflect some very complex accounting, primarily relating to the emergence from Chapter 11. When Hawaiian was reconsolidated into Holdings, it was done on the basis of purchase accounting, which meant that all assets had to be revalued to market value. This led to the creation of intangible assets and a significant increase in amortisation expenses in 2005.

Importantly, virtually all of the increase in Hawaiian's unit costs in 2005 and 1Q06 was due to higher fuel prices and accounting adjustments.

Hawaiian's top executives said at the ML conference that various cost and revenue measures are under way aimed at restoring healthy profitability. Much of the effort focuses on IT - an area where the airline believes it already is a leader.

The executives also shed some light on the special challenges that Hawaiian faces on the CASM front, namely that the geography of the Hawaii islands limits the ability to get decent aircraft utilisation rates.

The inter-island services have impressive 25-minute turns, but because the average stage length is also only 25 minutes, in any 24-hour period the theoretical maximum daily utilisation that Hawaiian can get out of its 717s is only six hours. This problem is shared with competitors in those markets. On the Hawaii-West Coast routes, in turn, the distance allows just one rotation per day.

Within those constraints, however, Hawaiian has managed to increase fleet utilisation by reducing maintenance out-of-service times. The airline does not disclose the figures, but according to ESG's Airline Monitor publication, in 2004 Hawaiian's average daily aircraft utilisation was 7.05 hours. This compared with a range of 8.2 to 9.6 hours for most other US airlines, suggesting a fairly significant disadvantage.

In terms of unit costs, Hawaiian's 9.82 cents in 2004 was similar to American's, Continental's and United's CASM, and the yields were also almost identical. This was despite the fact that Hawaiian's average stage length, at 619 miles, was only half of the network carriers'. In other words, although Hawaiian's CASM did not at first glance look bad for an extreme short haul carrier, its yield is so low that it needs a lower cost structure.

Transpacific focus

Despite the increased seat capacity and competition, the US mainland-Hawaii routes have proved lucrative for most of the carriers. Hawaiian, which is the second largest operator after United with a market share "in the high teens", has grown its share since 2000, continues to achieve high load factors and last year saw little change in the yield.

The airline offers comprehensive coverage of the US West Coast, operating nonstop service to as many as nine cities (Seattle, Portland, Sacramento, San Francisco, San Jose, Las Vegas, Los Angeles, Phoenix and San Diego).

Reflecting its confidence about the potential of the transpacific business, Hawaiian recently purchased four ex-Delta 767-300s in order to boost frequencies on five existing routes to the West Coast from September - obviously very low-risk expansion. As a result, the airline's ASMs will increase by around 15% in the fourth quarter, and 2007 will also see double-digit growth.

The four 767-300s were obtained for a bargain price of $31.8m, because there is less demand for the non-ER version. The aircraft are well suited for the Hawaii-West Coast markets and were a bargain even though Hawaiian has to spend an additional $34m on ETOPS modifications. The airline has said in recent months that it may be in the market for additional aircraft of that type for growth or to replace other more expensive aircraft.

That said, transpacific market shares and yields are under growing pressure due to near-term excess capacity. There has been a surge in low-cost carrier activity. US Airways entered the market in late 2005, while ATA and Southwest continue to add service. Aloha also now serves multiple mainland cities from Hawaii.

United, the market leader, added 21 weekly flights to Hawaii in its summer schedule, including new routes from Seattle and Portland to Honolulu that compete head-to-head with Hawaiian's flights.

Hawaiian intends to continue to focus heavily on Honolulu, because it does not have the hinterland feed enjoyed by the mainland network carriers, which have added much service to the other islands. For example, United generates so much flow traffic that it can schedule up to 11 nonstop daily flights from San Francisco to

Oahu, Maui, Kauai and the Big Island, whereas Hawaiian, without feed (and despite its numerous alliances) could only offer one daily flight. But the Honolulu focus allows Hawaiian to serve some secondary markets on the mainland that competitors cannot, such as Sacramento.

Hawaiian also tries to differentiate itself by designing its schedule and product specifically for people who live in the cities it serves. For example, its flights are timed to suit the city's residents, not connecting traffic.

The airline believes that its exclusive focus on Hawaii and superior market knowledge give it a competitive advantage and that the smaller size makes it more responsive. Under one recent initiative, it picks up bags at hotels for a small fee.

Hawaiian enjoys strong brand awareness. One recent survey indicated that it is the most recognised airline brand to Hawaii among West Coast residents. Hawaiian has won numerous "best airline to Hawaii" type awards, which is impressive considering that it is a predominantly leisure carrier and its competitors cater much more for the business traveller.

The inter-island challenge

Inter-island traffic has declined by 21% in the past five years, from about 10m passengers in 2000 to 7.9m in 2005. Mesa argues that this is because the markets are overpriced, noting that the average one-way fare has more than doubled to over $100, and that the market could grow again with a lower fare structure. Mesa has reported strong initial bookings.

However, Hawaiian argues that the traffic decline is structural and permanent and that it has two causes. First, an increase in direct flights from the US mainland to Oahu's neighbour islands by competitors has meant that fewer people today need to change aircraft in Honolulu. Second, infrastructure in the neighbour islands is also developing, reducing the need to travel to Honolulu. For example, there is now a Home Depot store in Maui.

By Heini Nuutinen

Therefore, in Hawaiian's view, the inter-island markets are not underserved and could not be stimulated in the mid-to-long term. The markets will continue to shrink. The incumbent carriers have also pointed out that fares were at unprofitable levels in the past.

Mesa believes that it can be profitable with $52-53 average fares because of its lower cost structure. However, the incumbents operate aircraft that are much more suitable than RJs for the large markets - Hawaiian has 717s and Aloha 737-200s.

Almost 70% of the total inter-island flights are in just four markets, which are among the 20 largest O&D markets in the US; for example, Honolulu-Maui is larger than New York-Boston.

With its 10% inter-island market share, Mesa would not be challenging Hawaiian's and Aloha's dominance, each of which would have a 40% market share, with turboprop operator Island Air accounting for the remaining 10%. However, load factors and yields can be expected to be negatively affected.

Clearly, Aloha is in a much weaker position to withstand a prolonged period of price cutting. There has been much speculation that Mesa's real motive is to drive Aloha out of business.

Hawaiian filed a lawsuit against Mesa in February, alleging that Mesa misused the bankruptcy process, in violation of confidentiality agreements it signed, to learn about Hawaiian's inter-island business and then use that information to develop its own business plans for the market. The case is yet to be heard in court, but many lawyers predict that Hawaiian will win the lawsuit.

Otherwise, Hawaiian has said that it intends to continue competing vigorously in the inter-island market, which "remains an integral component of our overall business", and that it is well positioned to win the market share battles. However, new growth will focus on the transpacific - the expansion planned for later this year will reduce inter-island's share of total revenues below the current 29%.

THY Turkish Airlines: Big ambitions, tricky politics

THY Turkish Airlines has ambitious expansion plans to become one of the world's 10 leading airlines. But can an airline on the periphery of Europe and with a government owner still committed to retaining a controlling interest ever hope to fulfil such an aspiration?

THY (Turk Hava Yollari) was founded back in 1933 and today operates to 28 domestic and 79 international destinations. Many of those routes have been added in the last few years following the emergence from a tough period since the late 1990s. Turkey's flag carrier dipped into operating losses in 1997 and 1998 (see *Aviation Strategy*, July 1999) and was then hit by the macro shocks of the early 2000s - the Gulf war, SARS and the Istanbul bomb attacks.

However, THY has posted both operating and net profits for the last four years (see chart, page 14 - although accounting financial results are affected by significant exchange rate fluctuations of the Turkish Lira against the US Dollar, THY is largely hedged against Lira deprecation since approximately 84% of its revenue comes in the form of Euros, Dollars and other non-Turkish currency). Much of this profitability has been driven by the booming Turkish economy. After Turkey's GNP shrank by a massive 9.5% in 2001, the economy recovered fast in 2002 and 2003 and then raced ahead in the next two years, with GNP growth of 9.9% in 2004 and 7.6% in 2005.

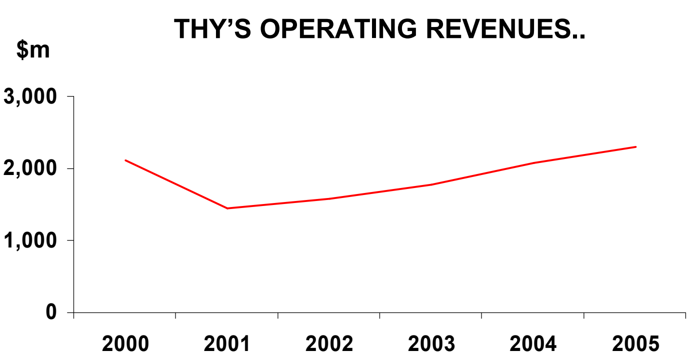
This has translated directly into increased passenger traffic. Although over the 1990-2004 period Turkey experienced a CAGR of 7.4% in domestic passenger traffic and 9.7% in international passenger traffic, it was in 2004 that aviation demand increased dramatically. International passenger traffic to/from Turkey rose by 21% in 2004 compared with 2003, but this was overshadowed by a massive 58% rise in domestic traffic as the economy boomed and competitors to THY emerged following the ending of the flag carrier's monopoly and a realisation that Turkey's population of 70m was relatively underserved by both domestic and international air links.

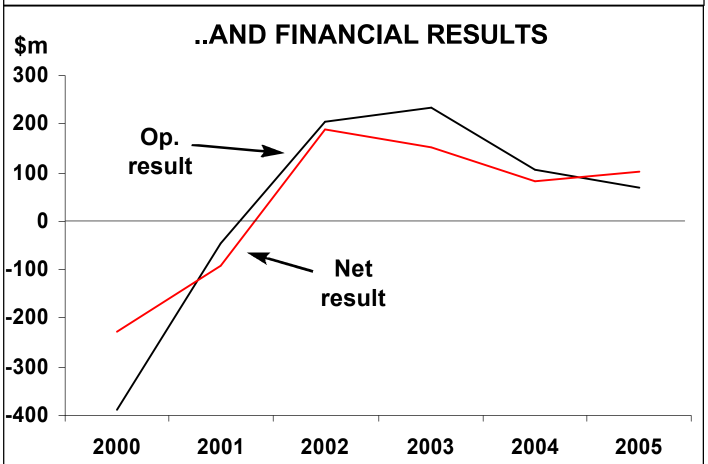
That market growth continued into 2005 and, according to IATA, Turkey will be the fifth fastest growing market in the world between 2005 and 2009 in terms of passenger traffic. Turkey's forecast passenger traffic CAGR of 8.9% over that period is beaten only by Poland, China, the Czech Republic and Qatar. Despite a growing current deficit, the Turkish economy is expected to continue its growth over the next few years, and in the longer term a further boost will come from the expectation that Turkey will join the EU now that membership negotiations have started formally.

Another key driver is growing tourism to Turkey. Last year the country's tourism revenue grew 14% to $18.2bn, and it is forecast to top $20bn in 2006. More than 21m tourists visited Turkey in 2005, and a quarter of them came from Germany, followed by British and Dutch tourists. The VFR market is also large, thanks to a large ethnic Turkish populations in Europe, and in particular the large Turkish gastenarbeiter workforce in Germany.

THY ambitions

Given these factors, THY believes it is the right time to undergo a significant expansion phase. In February 2006 THY announced it aimed to increase passengers flown by 35% a year over 2006-2008 as part of an expansion plan that will see its fleet expand from 94 at present (see table, page 10) to 128 aircraft over the same period, with a target of 18m passengers carried in 2008. This expansion will take advantage of a new terminal at Ankara that will open in October and will enable the airport to handle up to 15m domestic and international passengers a year; there are also unconfirmed plans for





Note: According to IFRS

another airport at Istanbul, probably to be built on the European side of the city.

THY's fleet was effectively frozen in the 2000-2004 period at around the 65 aircraft mark, but a major renewal programme was launched in 2004 and aimed at not only replacing older aircraft but also putting in place capacity growth. A total of 57 aircraft were ordered in 2004, for delivery by 2009 and at a capital cost of more than $2.7bn. That figure understates the cost of fleet renewal to THY, as it excludes operating leases costs; at present less than 15 aircraft are owned by THY, with more than half its fleet on operating leases and the remainder on finance leases.

THY'S FLEET

	Fleet	Orders
A300	1	
A310	7	
A320	14	17
A321	7	12
A330	2	3
A340	7	
737-400	17	
737-800	32	17
MD-83	3	
Avro RJ100ER	4	
Total	**94**	**49**

As replacements for 737-400s and after being attracted to the "operational flexibility" of the 737-800, THY ordered 15 737-800s in 2004 and then exercised options for another eight aircraft in August 2005. The first of these 23 aircraft arrived in December 2005, and at present 17 are still outstanding - nine will be delivered through 2006 and eight in 2008.

At the time the new aircraft orders were being finalised, the Turkish government was being put under intense political pressure from the EU to order more Airbus aircraft for THY, a move that would help ease resistance from France to Turkey's potential EU membership. Indeed in 2004 the German foreign minister was reported as telling a senior Turkish politician that: "Let 80% of the aircraft you purchase be Airbus - you must do this".

Whether that pressure directly led to changes in the fleet orders is impossible to tell, but in 2004 THY ordered 36 Airbus aircraft - five A330s-200s, 19 A320s and a dozen A321s. The first of the A330s arrived in December 2005 to boost the long-haul fleet of seven A340s. The A330s will be used for expansion to the North America and the Asia-Pacific region, with the US a prime expansion target. THY currently operates to New York JFK and Chicago O'Hare, but would like to launch routes to Los Angeles and Washington Dulles and Toronto. The next priority is routes to the Asia/Pacific region. A service to Melbourne and/or Sydney is likely, both of which have large ethnic Turkish populations, and served via Singapore or Bangkok. THY currently operates to 14 destinations in the Asia Pacific region, 10 in the Middle East, five in North Africa, two in North America and 48 in Europe. The existing long-haul network is an eclectic mix, and suffers because of no linkage into a global alliance, but THY is currently upgrading its long-haul premium product through installing in-flight entertainment systems and 60 inch seat pitches, while all its aircraft received a new livery in 2005.

THY also has four Avro RJ100s (run down from an original fleet of 10), but these will be phased out by the end of 2006 and replaced by up to eight 70-90 seat regional aircraft. A319s were considered as replacements last year, but the Embraer 170 and the Bombardier CRJ are now believed to be the joint favourites for an order that is expected to be placed some time this spring or summer. THY is also believed to be analysing an order for up to 20 787s.

Altogether 22 aircraft will be delivered in 2006, 12 in 2007 and 19 in 2008, and by 2008 the fleet's average age will come down from the current nine years to under six years - which will give THY the youngest fleet of any European airline at that time, THY claims.

International focus

In 2006 alone another 23 destinations will be added to the route network, including Dublin, Osaka, St. Petersburg, Bombay, Venice, Helsinki Addis Ababa and Lagos, bringing total destinations served to 130 by the end of this year, and operated by a fleet of 100.

Most of the expansion will be on the international network, and it's clear that THY is prioritising international growth over the domestic market. That's partly because in 2005 although just 46% of all THY passengers carried were on international services (with 50% being domestic, 2% charter and 2% classified as "pilgrims"), no less than 75% of revenue came from international passengers - and the difference in the profit contribution is probably much greater. Of all scheduled revenue in 2005, 43% came from Europe, 25% from the domestic market, 15% from the Asia/Pacific region, 10% from the Middle East, 5% from North America and 3% from North Africa.

The other reason - though related - for the shift in THY focus is essentially negative: because it is THY's domestic traffic that is coming under most competitive pressure. Turkey is too distant for Europe's two largest LCCs to have much of a presence - Ryanair has no routes and easyJet will launch routes to Istanbul from London Luton in June and from Basel-Mulhouse in May. However, intriguingly, sources at easyJet suggest that it is looking at either acquiring a Turkish airline or even launching an airline there in order to tap into the domestic market.

Among a myriad of Turkish-based competitors are Atlasjet Airlines, which operates 19 aircraft on charter routes but which now plans to turn into a scheduled operator; MNG Airlines, which operates 23 aircraft on long-haul and short-haul scheduled and charter routes; and Pegasus Airlines, a 13-aircraft strong charter carrier that launched low-fare domestic services in November 2005. But the biggest domestic challenge comes from Onur Air, whose fleet of 28 aircraft operates international charter and low-fare domestic flights out of Istanbul. Launched in 1992 by three Turkish entrepreneurs, Onur is now expanding its fleet by replacing A300B4-200s with A300-600s, adding a couple of A320s, and - most problematically for THY - putting four more MD-83s onto domestic routes, where they will be fitted with leather seats and extra leg-room.

Proposed start-ups in 2006 include Golden International Airlines, which plans to operate to the UK and Germany with A321s; Izmir Hava Yollari, which will fly to destinations across Europe with 737s or A320s; and TT Airlines, which will use 737-400s on international and domestic routes.

In 2004 the emergence of competition from Turkish airlines forced THY to cut domestic fares by as much as 25% and international fares by around 10%, but the fare reductions have not prevented THY from losing market share. In 2004 THY had a 43.2% market share of scheduled international traffic to/from Turkey and a 75.4% share of scheduled domestic traffic, but in January-September 2005, while international market share slipped only slightly, to 43%, THY's domestic share fell by more than 11 percentage points, to 64.3%.

This is doubly worrying for THY as market share erosion is occurring at the same time as the whole market domestic market is booming, meaning that competitors are establishing a firm foothold in the Turkish market. While the Turkish domestic market grew by 58% in 2004, THY saw just a 16% rise in passengers carried. In 2005 the overall domestic market grew by another massive 38%, but again THY's domestic passenger traffic lagged behind in rising by 23%, while domestic revenue increased by

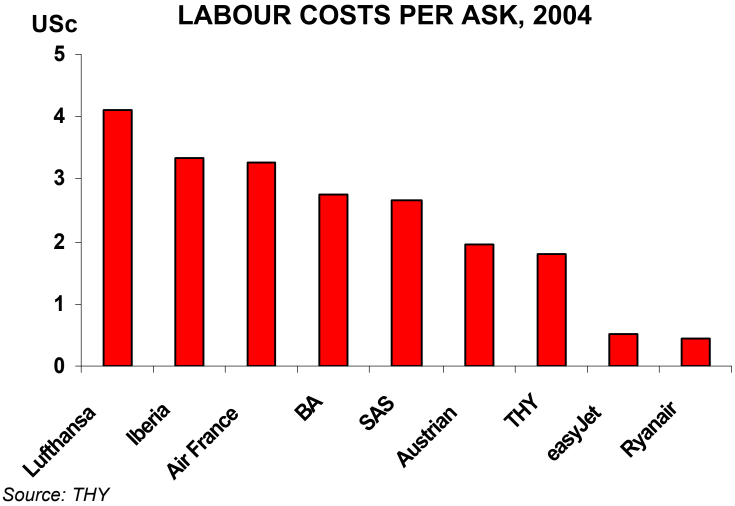
THY'S OPERATING COST BREAKDOWN

$m	2004	%	2005	%
Labour	461	23%	536	24%
Fuel	386	20%	544	24%
Sales & marketing	241	12%	255	11%
Depreciation	224	11%	223	10%
Landing expenses	179	9%	183	8%
Ground handling	121	6%	117	5%
Passenger services	96	5%	109	5%
Other	267	14%	278	12%
Total	1,975	100%	2,245	100%

just 20%. And while many of THY's domestic routes are believed to be loss making, competitors are - naturally - targeting the most profitable ones.

THY also owns 50% of Anatalya-based SunExpress, which was launched in 1990 as a 50:50 joint venture with Lufthansa (the stake is now owned by Thomas Cook AG). Today its 580 staff operate nine 737-800s and a single 757-200 on scheduled and charter flights to eight domestic and 89 international destinations (of which 24 are in Germany). For 2005, although revenue rose 21% to $241m, net profit fell by 11% compared with 2004, to $16m. In 2005 passengers carried rose 30% to 1.8m, and SunExpress had a passenger load factor of 81% (compared with 83% in 2004). Anatalya-based SunExpress plans to increase its fleet to 20 aircraft by 2009 and opened a base at Izmir in March 2006, serving eight domestic destinations as well as seven international routes (six in Germany, plus Zurich). However THY is looking to sell its stake in SunExpress, although the government has so far refused permission.

LABOUR COSTS PER ASK, 2004



Source: THY

Low costs?

In response to increasing competition, THY is aiming to launch a LCC called Turkish Express on October 2006, with routes planned domestically and to Germany, France and the Netherlands. THY will transfer all its 737-400s (which number 17 at present, although some will be returned to lessors in the summer) and a handful of 737-800s, giving the LCC an initial fleet of up to 20 aircraft. THY believes it can lower units costs at Turkish Express by 15% compared with mainline operations thanks to implementing a series of typical LCC practices, such as by increasing the number of seat s per aircraft and through a no-frills onboard service. THY has also bought a "Low Fare Manager" module from US software company Sabre to manage pricing and revenue at the new LCC.

The lower costs will enable fares to be similarly reduced, says THY, although how much of an impact this will have in stemming THY's loss in domestic market share is unknown.

In this context, the switch in emphasis to international routes looks sound strategically, particularly as THY believes its costs relative to European competitors are low. Turkish airline salaries are between one third and one-half of EU averages, although the gap will close fast once Turkey joins the EU, and after tortuous negotiations between management and unions in the first half of 2005, THY avoided strike action by the Aviation Workers Union only after agreeing a two-year pay deal with workers in July 2005. This included a 10% salary rise in the first year and a 3% rise in the second.

Nevertheless THY claims that it has the lowest labour unit cost of any mainline European airline (see chart, left). THY's labour costs as a proportion of total costs remain less than a quarter (see table, above), but this is due not only to lower structural costs in Turkey but also to relatively good productivity (in aviation terms) among THY's staff.

As at the end of December 2005 THY had 11,121 employees, just 2.5% up on December 2004, and these include 2,780 pilots and cabin crew. THY has been working hard to increase productivity: passengers carried per employee rose from 945 in 2002 to 1,271 in 2005, due to a 36% increase in passengers carried over the period handled by virtually the same staff base (with employees up just 1.2% over the same period). Labour cost cutting was done primarily in 2001-2003, with 2,241 employees - representing 18% of staff as at 2000 - leaving THY in those three years. In comparison, passengers carried per employee works out at 556 for Lufthansa, 722 for BA, 1,075 for SAS and 1,137 for Iberia - although THY is behind Air France/KLM, at 1,704 passengers per employee, and significantly behind easyJet (7,639) and Ryanair (10,158). And by another measure - employees per aircraft - THY at 134 is again ahead of Iberia (159), BA (171) and Lufthansa (214), but again behind Air France/KLM (57) and Ryanair (31) - while THY's lost baggage ratio is among the lowest of all AEA airlines.

THY has also been working on non-labour cost reductions in the last few years, but says there is "room for further cost reductions". In particular, THY has much work to do on distribution, as more than 80% of revenue comes via travel agents, with internet and telephone sales lagging behind. E-ticketing will not be introduced fully at all GSAs until 2007, as mandated by IATA. And there is further room for improvement in aircraft productivity, with flight hours per aircraft per day growing from 9.5 hours in 2002 to 10.2 hours in 2005, a CAGR increase of just 2.4%.

Long-term outlook

The need to cut non-labour costs becomes more important given that THY's margins are under pressure - the EBITDAR margin has fallen for the last two years (from 27% in 2003 to 17% in 2005). That's less than almost of the major European airlines that THY is trying to emulate. THY's EBIT margin has fallen too, from 13% in 2002 to just 3% in 2005.

In 2005 revenue rose 11.1% to $2.3bn, based on an 18% increase in passengers flown, to 14.1m. Capacity growth of 12.6% in 2005 was outstripped by a 14.6% rise in RPKs, resulting in a 1.3% percentage point rise in passenger load factor, to 71.5%. But although net profit for 2005 rose by 28.8% to $103m, operating profit fell 34% to $70m, due largely to a 41% rise in fuel costs in 2005, equivalent to an extra $158m in costs. In 2005 fuel accounted for 24% of THY's total operating costs, compared with 20% in 2004.

However, financially THY is relatively strong. As at December 31st 2005 THY had long-term debt of just $796m (compared with $1.2bn as at December 2001), with $638m of that being long-term aircraft lease obligations (which have reduced from $1.1bn in lease obligations in 2001). Cash and cash equivalents as at the end of 2005 totalled $360m, a considerable improvement on the $65m cash position in 2001

The airline is targeting revenue of $3bn in 2006 and a net profit of $150m, but this appears optimistic given the growth in competition. Assuming non-labour costs cannot be cut significantly, THY's future depends largely on successful revenue growth, which is the rationale for its ambitious expansion programme.

Outside of this expansion, THY is also looking to increase non-passenger revenue (which comprised 15% of total revenue in 2005). In maintenance THY is investing $200m in "Project Habom" via a partnership with ST Aerospace. A new facility at Istanbul's Sabiha Gokcen airport will turn THY's maintenance unit into a major service provider in the region, with forecast third-party revenue of $500m a year from 2011 onwards. And though cargo revenues are relatively small ($209m in 2005, 11.2% up on 2004), THY believes it has potential for much greater growth, particularly once Turkey join the EU.

Strategically, one of most important decisions THY has to make this year is which global alliance it will join. Since the early 2000s - after the collapse of Qualiflyer - THY has operated independently from global alliances, but some of THY's senior management hold the view that the airline misses the credibility of being a global alliance member - particularly among the crucial business market - and that it is simply losing out on tens of millions of dollars worth of transfer passengers.

Star and SkyTeam were believed to be the preferred options for THY, but recent reports out of Turkey indicate that oneworld has now become a possibility as well. Nevertheless Star, thanks to Lufthansa's strong links with THY via SunExpress (see above) is still the most likely candidate, although a SkyTeam link-up would find favour with politicians eager to court favour with France over EU accession.

Although no executive wants to go on the record, THY's management are believed to have to dissuaded from joining an alliance post-Qualiflyer by Privatization Administration (PA) - the government's official privatisation arm, and the entity that has owned the state's equity in THY since 1994. PA's rationale was that if THY joined an alliance, it would put off potential bids from airlines in the other alliances during THY's privatisation process (see below). THY's executives apparently disagreed, and although there has now been a rethink of that strategy, the difference in opinion is indicative of the reportedly difficult relationship between PA and the airline.

State shadow

Although 1.83% of THY was floated in 1990, privatisation came onto the agenda seriously in 2000 when the government said it would sell up to 51% of THY - although the state would still retain a "Golden Share", enabling it to retain majority control. An attempted sale in the spring of 2001 failed due to lack of interest, but in 2004, in order to secure further funding from the IMF, the Turkish government pledged/was forced to raise up to $3bn from privatisation of state assets. In December 2004 the government sold a 23% stake in THY on the Istanbul stock exchange for $199m (bringing the free float to 24.8%), and the equity was five-times oversubscribed. In late May Turkey offered another 25% with a further 3.75% available. The offering was 1.6 times over-subscribed and the government stake in THY now stands at 46.43% and there is a free float of 53.57% in THY. The country's Privatization Administration says that it will generate 310m new Turkish Lira ($150m) from the sale of the stake.

Now the government needs to get rid of its Golden Share provision if the airline is to be considered as a serious player in the European aviation industry. This may be tricky politically, but is the price that the government will need to pay if it truly wants THY to become one of the world's leading airlines - or more realistically attract equity investment from one of the major European airlines.

Although legally foreign companies can hold up to 40% of THY, they are highly unlikely to want to come near THY while the government is committed to its Golden Share. It may be an unduly harsh assessment, but although Turkey is situated between Europe and Asia, in terms of aviation geography Turkey is largely irrelevant, and Istanbul is simply not needed as a east-west hub. That's not to say THY cannot build itself up a strong niche carrier in Europe, based on VFR, tourism and business traffic.

That alone may make THY attractive for an airline investor (and in particular Lufthansa) and thereby secure its long-term future, but to secure significant external investment the government will have to give up control.

Freighter values and lease rates

FREIGHTER VALUES (US$m)

	New	5 years old	10 years old	20 years old
A310-300F			25.1	
A300-600RF	70.7	55.4	40.2	
737-300QC			14.70	7.9
747-200M				5.8
747-400M		101.1	74.9	
747-400F	149.7	121.3	92.9	
747-400ERF	158.9	132.4	105.8	
757-200PF		35.8	29.7	
767-300F		58.30	41.8	
MD-11C			40.9	
MD-11F			49.0	

FREIGHTER LEASE RATES (US$000's per month)

	New	5 years old	10 years old	20 years old
A310-300F			256	
A300-600RF	528	445	376	
737-300QC			183	139
747-200M				191
747-400M		833	697	
747-400F	1,434	1,199	970	
747-400ERF	1,523	1,308	1,106	
757-200PF		292	282	
767-300F		496	463	
MD-11C			437	
MD-11F			571	

Note: As assessed at end April 2006
Source: AVAC

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group employees
Alaska	Year 2004	2,724	2,804	-80	-15	-2.9%	-0.6%	35,849	26,121	72.9%	16,295	9,968
	Jan-Mar 05	643	723	-81	-80	-12.6%	-12.4%	8,642	6,271	72.6%	3,851	9,219
	Apr-Jun 05	756	747	9	17	1.2%	2.2%	8,920	6,947	77.9%	4,232	9,144
	Jul-Sep 05	689	609	80	82	11.6%	11.9%	9,369	7,399	79.0%	4,632	8,961
	Year 2005	2,975	2,983	-8	-6	-0.3%	-0.2%	35,875	27,221	75.9%	16,759	9,065
	Jan-Mar 06	735	861	126	-80	17.1%	-10.9%	8,914	6,566	73.7%	3,905	8,988
American	Year 2004	18,645	18,789	-144	-761	-0.8%	-4.1%	280,042	209,473	74.8%	91,570	90,700
	Jan-Mar 05	4,750	4,727	23	-162	0.5%	-3.4%	68,965	52,024	75.4%		88,500
	Apr-Jun 05	5,309	5,080	229	58	4.3%	1.1%	72,447	57,605	79.5%		88,500
	Jul-Sep 05	5,485	5,446	39	-153	0.7%	-2.8%	73,405	59,584	81.2%		88,500
	Year 2005	20,657	21,008	-351	-892	-1.7%	-4.3%	283,417	222,685	78.6%	98,040	87,200
	Jan-Mar 06	5,344	5,229	115	-92	2.2%	-1.7%	68,801	53,131	77.2%		86,600
America West	Year 2004	2,339	2,357	-18	-90	-0.8%	-3.8%	48,525	37,550	77.4%	21,132	11,904
	Jan-Mar 05	723	673	50	34	6.9%	4.7%	11,749	9,126	77.7%	5,172	11,869
	Apr-Jun 05	833	803	30	14	3.6%	1.7%	12,480	10,277	82.3%	5,752	12,200
	Jul-Sep 05	846	904	-58	-71	-6.9%	-8.4%	12,673	10,192	80.4%	5,802	12,179
	Year 2005	3,254	3,374	-120	-195	-3.7%	-6.0%	49,088	39,042	79.5%	22,130	12,100
	Jan-Mar 06	859	776	83	58	9.7%	6.8%	13,463	10,472	77.8%	6,730	12,828
Continental	Year 2004	9,744	9,973	-229	-363	-2.4%	-3.7%	153,015	117,722	77.6%	42,743	38,255
	Jan-Mar 05	2,505	2,676	-171	-184	-6.8%	-7.3%	37,955	29,148	76.8%	14,122	
	Apr-Jun 05	2,857	2,738	119	100	4.2%	3.5%	36,138	29,041	80.4%	11,465	
	Jul-Sep 05	3,001	2,892	109	61	3.6%	2.0%	37,450	31,185	81.7%	11,642	
	Year 2005	11,208	11,247	-39	-68	-0.3%	-0.6%	163,537	129,064	78.9%	61,015	42200
	Jan-Mar 06	2,947	2,936	11	-66	0.4%	-2.2%	37,070	28,996	78.2%	11,486	
Delta	Year 2004	15,002	18,310	-3,308	-5,198	-22.1%	-34.6%	244,097	182,351	74.7%	110,000	69,150
	Jan-Mar 05	3,647	4,604	-957	-1,071	-26.2%	-29.4%	60,955	45,344	74.4%	29,230	66,500
	Apr-Jun 05	4,185	4,314	-120	-382	-2.9%	-9.1%	65,136	50,957	78.2%	31,582	65,300
	Jul-Sep 05	4,216	4,456	-240	-1,130	-5.7%	-26.8%	66,054	52,323	79.2%	30,870	58,000
	Year 2005	16,191	18,192	-2,001	-3,818	-12.4%	-23.6%	252,327	193,042	76.5%	118,853	
	Jan-Mar 06	3,719	4,204	-485	-2,069	-13.0%	-55.6%	55,685	42,460	76.3%	25,531	53,735
Northwest	Year 2004	11,279	11,784	-505	-848	-4.5%	-7.5%	147,055	117,981	80.2%	55,374	39,342
	Jan-Mar 05	2,798	3,090	-292	-450	-10.4%	-16.1%	36,636	29,238	79.8%	13,502	39,105
	Apr-Jun 05	3,195	3,375	-180	-217	-5.6%	-6.8%	38,256	32,218	84.2%	15,145	38,348
	Jul-Sep 05	3,378	3,545	-167	-469	-4.9%	-13.9%	38,881	32,889	84.6%	14,984	33,755
	Year 2005	12,286	13,205	-919	-2,533	-7.5%	-20.6%	147,694	122,017	82.6%	56,470	32,460
	Jan-Mar 06	2,890	2,905	-15	-1,104	-0.5%	-38.2%	35,757	29,432	82.3%	15,700	31,318
Southwest	Year 2004	6,530	5,976	554	313	8.5%	4.8%	123,693	85,966	69.5%	70,903	31,011
	Jan-Mar 05	1,663	1,557	106	76	6.4%	4.6%	32,559	21,304	65.4%	17,474	30,974
	Apr-Jun 05	1,944	1,667	277	159	14.2%	8.2%	34,341	24,912	72.5%	20,098	31,366
	Jul-Sep 05	1,989	1,716	273	227	13.7%	11.4%	35,170	26,336	74.9%	20,638	31,382
	Year 2005	7,584	6,764	820	548	10.8%	7.2%	137,069	96,917	70.7%	77,693	31,729
	Jan-Mar 06	2,019	1,921	98	61	4.9%	3.0%	35,532	24,591	69.2%	19,199	31,396
United	Year 2004	16,391	17,168	-777	-1,644	-4.7%	-10.0%	233,929	185,388	79.2%	70,914	58,900
	Jan-Mar 05	3,915	4,165	-250	-1,070	-6.4%	-27.3%	55,133	43,103	78.2%	15,667	56,300
	Apr-Jun 05	4,423	4,375	48	-1,430	1.1%	-32.3%	56,538	47,156	83.4%	17,150	55,600
	Jul-Sep 05	4,655	4,490	165	-1,172	3.5%	-25.2%	58,123	48,771	83.9%	17,448	54,600
	Year 2005	17,379	17,598	-219	-21,176	-1.3%	-121.8%	225,785	183,898	81.4%	67,000	
	Jan-Mar 06***	4,465	4,636	-171	22,628	-3.8%	506.8%	61,511	48,739	79.2%	16,267	53,600
US Airways	Year 2004	7,117	7,495	-378	-611	-5.3%	-8.6%	98,735	72,559	73.5%	55,954	24,628
	Jan-Mar 05	1,628	1,829	-201	-191	-12.3%	-11.7%	24,976	17,779	71.2%	14,068	23,696
	Apr-Jun 05	1,945	1,904	41	-62	2.1%	-3.2%	26,547	20,165	76.0%	15,826	21,396
	Jul-Sep 05	926	997	-71	-87	-7.7%	-9.4%	21,281	16,503	77.5%	10,109	
	Year 2005**	7,212	7,425	-213	160	-3.0%	2.2%	82,908	62,594	75.5%	39,977	21,486
	Jan-Mar 06	2,648	2,523	125	65	4.7%	2.5%	35,226	26,372	74.9%	13,591	
JetBlue	Year 2004	1,266	1,153	113	47	8.9%	3.7%	30,434	25,315	83.2%	11,783	6,413
	Jan-Mar 05	374	349	26	7	7.0%	1.9%	8,318	7,136	85.8%	3,400	6,797
	Apr-Jun 05	430	390	39	12	9.1%	2.8%	9,408	8,247	87.7%	3,695	7,284
	Jul-Sep 05	453	439	14	3	3.1%	0.7%	10,190	8,825	86.6%	3,782	7,452
	Year 2005	1,701	1,653	48	-20	2.8%	-1.2%	38,145	32,508	85.2%	14,729	8,326
	Jan-Mar 06	490	515	-25	-32	-5.1%	-6.5%	10,584	8,909	84.2%	4,335	9,039

** = Predecessor company, 9 months to 30/09/05; Successor company, 3 months to 31/12/05

*** = Including reorganisation items - net loss of $311m without

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation. 1 ASM = 1.6093 ASK. All US airline Financial Year Ends are 31/12.

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group employees
Air France/ KLM Group YE 31/03	Apr-Jun 04	5,394	5,205	189	115	3.5%	2.1%	48,944	38,025	77.7%		
	Jul-Sep 04	6,328	5,964	364	248	5.8%	3.9%	57,668	46,767	81.1%		
	Oct-Dec 04	6,628	5,745	883	83	13.3%	1.3%	54,144	42,042	77.6%	15,934	
	Year 2004/05	**24,641**	**21,744**	**641**	**453**	**2.6%**	**1.8%**	**214,606**	**168,998**	**78.7%**	**64,075**	**102,077**
	Apr-Jun 05	6,257	5,982	275	135	4.4%	2.2%	57,936	46,041	79.5%	17,948	101,886
	Jul-Sep 05	6,790	6,154	636	864	9.4%	12.7%	60,472	50,961	84.2%	18,705	
	Oct-Dec 05	6,430	6,205	225	91	3.5%	1.4%	58,266	46,644	80.0%	17,120	102,291
	Year 2005/06	**25,901**	**24,771**	**1,136**	**1108**	**4.4%**	**4.3%**	**234,669**	**189,253**	**80.6%**	**70,020**	**102,422**
BA YE 31/03	Apr-Jun 04	3,479	3,208	271	127	7.8%	3.7%	36,150	27,083	74.9%	9,288	46,280
	Jul-Sep 04	3,645	3,213	432	221	11.9%	6.1%	36,639	28,749	78.5%	9,822	46,179
	Oct-Dec 04	3,801	3,589	212	94	5.6%	2.5%	35,723	25,999	72.8%	8,428	45,888
	Jan-Mar 05	3,549	3,474	96	17	2.7%	0.5%	35,677	26,062	73.0%	8,178	45,914
	Year 2004/05	**14,681**	**13,666**	**1,015**	**472**	**6.9%**	**3.2%**	**144,189**	**107,892**	**74.8%**	**35,717**	**46,065**
	Apr-Jun 05	3,716	3,398	318	162	8.6%	4.4%	36,706	27,768	75.6%	9,177	46,079
	Jul-Sep 05	3,887	3,427	460	301	11.8%	7.7%	37,452	29,812	79.6%	9,767	46,144
	Oct-Dec 05	3,664	3,362	301	212	8.2%	5.8%	37,119	27,499	74.1%	8,530	45,624
	Jan-Mar 06	3,692	3,530	162	144	4.4%	3.9%	36,657	26,780	73.1%	8,160	45,171
	Year 2005/06	**14,813**	**13,588**	**1,227**	**812**	**8.3%**	**5.5%**	**147,934**	**111,859**	**75.6%**	**35,634**	**47,012**
Iberia YE 31/12	Apr-Jun 04	1,461	1,371	90	95	6.2%	6.5%	14,743	11,106	75.3%	6,913	
	Jul-Sep 04	1,593	1,452	141	110	8.9%	6.9%	16,053	12,699	79.1%	7,314	25,839
	Oct-Dec 04	1,660	1,605	55	74	3.3%	4.5%	15,700	11,398	72.6%	6,329	24,783
	Year 2004	**5,895**	**5,663**	**232**	**230**	**3.9%**	**3.9%**	**61,058**	**45,924**	**75.2%**	**26,692**	**24,993**
	Jan-Mar 05	1,531	1,571	-40	-21	-2.6%	-1.4%	15,261	11,421	74.8%	6,181	24,044
	Apr-Jun 05	1,466	1,392	74	54	5.0%	3.7%	15,843	11,939	75.4%	7,242	24,435
	Jul-Sep 05	1,439	1,368	71	53	4.9%	3.7%	16,659	13,619	81.8%	7,656	25,069
	Oct-Dec 05	1,451	1,504	-53	-7	-3.7%	-0.5%	15,864	12,082	76.2%	6,596	23,845
	Year 2005	**5,808**	**5,712**	**96**	**608**	**1.7%**	**10.5%**	**63,628**	**49,060**	**77.1%**	**27,675**	**24,160**
Lufthansa YE 31/12	Apr-Jun 04	5,269	5,045	224	-28	4.3%	-0.5%	36,440	26,959	74.0%	13,336	
	Jul-Sep 04	5,511	5,164	347	154	6.3%	2.8%	38,115	28,883	75.8%	14,053	
	Year 2004	**25,655**	**24,285**	**1370**	**551**	**5.3%**	**2.1%**	**140,648**	**104,064**	**74.0%**	**50,300**	**34,700**
	Jan-Mar 05	5,041	5,079	-38	-150	-0.8%	-3.0%	32,477	23,793	73.3%	11,190	
	Apr-Jun 05	5,487	5,138	349	140	6.4%	2.6%	37,700	28,178	74.7%	13,583	
	Jul-Sep 05	5,798	5,411	387	501	6.7%	8.6%	38,967	30,466	78.2%	14,203	
	Year 2005	**21,397**	**20,545**	**852**	**725**	**4.0%**	**3.4%**	**144,182**	**108,185**	**75.0%**	**51,260**	**37,042**
	Jan-Mar 06	5,369	5,460	-91	-118	-1.7%	-2.2%	33,494	24,044	71.8%	11,442	
SAS YE 31/12	Apr-Jun 04	2,007	1,979	27	13	1.3%	0.6%	13,456	8,960	66.6%	8,879	
	Jul-Sep 04	2,099	1,860	239	9	11.4%	0.4%	13,557	9,198	67.8%	8,591	
	Oct-Dec 04	2,271	2,293	-22	-96	-1.0%	-4.2%	12,667	7,649	60.4%	7,645	32,600
	Year 2004	**8,830**	**8,967**	**-137**	**-283**	**-1.6%**	**-3.2%**	**43,077**	**28,576**	**64.0%**	**32,354**	**32,481**
	Jan-Mar 05	1,842	1,990	-148	-137	-8.0%	-7.4%	12,465	7,342	58.9%	7,299	31,797
	Apr-Jun 05	2,046	1,925	121	64	5.9%	3.1%	13,810	9,259	67.0%	9,357	32,285
	Jul-Sep 05	2,140	2,036	104	68	4.9%	3.2%	13,599	9,838	72.3%	9,325	
	Oct-Dec 05	2,050	1,966	84	25	4.1%	1.2%	12,880	8,646	67.1%	8,945	
	Year 2005	**7,789**	**7,717**	**173**	**32**	**2.2%**	**0.4%**	**38,454**	**26,487**	**68.9%**	**23,799**	**32,363**
Ryanair YE 31/03	Apr-Jun 04	366	288	78	64	21.3%	17.5%			83.0%	6,600	2,444
	Jul-Sep 04	516	305	211	181	40.9%	35.1%			90.0%	7,400	2,531
	Oct-Dec 04	402	335	68	47	16.9%	11.7%			84.0%	6,900	2,671
	Year 2004/05	**1,727**	**1,301**	**426**	**345**	**24.7%**	**20.0%**	**36,611**	**31,205**	**84.0%**	**27,593**	
	Apr-Jun 05	488	392	96	84	19.7%	17.2%			83.4%	8,500	2,764
	Jul-Sep 05	652	409	244	208	37.4%	31.9%				9,500	2,987
	Oct-Dec 05	439	381	58	44	13.2%	10.0%			83.0%	8,600	2,963
easyJet YE 30/09	**Year 2002/03**	**1,553**	**1,472**	**81**	**54**	**5.2%**	**3.5%**	**21,024**	**17,735**	**84.1%**	**20,300**	**3,372**
	Oct-Mar 04	803	861	-58	-36	-7.2%	-4.5%	10,991	9,175	83.3%	10,800	
	Year 2003/04	**1,963**	**1,871**	**92**	**74**	**4.7%**	**3.8%**	**25,448**	**21,566**	**84.5%**	**24,300**	**3,727**
	Oct-Mar 05	1,039	1,116	-77	-41	-7.4%	-3.9%	14,526	12,150	83.8%	13,500	
	Year 2004/05	**2,364**	**2,278**	**86**	**76**	**3.6%**	**3.2%**	**32,141**	**27,448**	**85.2%**	**29,600**	**4,152**

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation.

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group employees
ANA												
YE 31/03	**Year 2002/03**	**10,116**	**10,137**	**-22**	**-235**	**-0.2%**	**-2.3%**	**88,539**	**59,107**	**66.7%**	**50,916**	**28,907**
	Year 2003/04	**11,529**	**11,204**	**325**	**234**	**2.8%**	**2.0%**	**87,772**	**55,807**	**63.6%**	**44,800**	**28,870**
	Year 2004/05	**12,024**	**11,301**	**723**	**251**	**6.0%**	**2.1%**	**85,838**	**55,807**	**65.0%**		**29,098**
Cathay Pacific	**Year 2003**	**3,810**	**3,523**	**287**	**168**	**7.5%**	**4.4%**	**59,280**	**42,774**	**72.2%**	**12,322**	**14,673**
YE 31/12	Jan-Jun 04	2,331	2,046	285	233	12.2%	10.0%	35,250		76.1%	6,404	
	Year 2004	**5,024**	**4,350**	**674**	**581**	**13.4%**	**11.6%**	**74,062**	**57,283**	**77.3%**	**13,664**	**15,054**
	Jan-Jun 05	3,074	2,799	275	225	8.9%	7.3%	39,535		78.1%	7,333	15,400
	Year 2005	**6,548**	**6,015**	**533**	**424**	**8.1%**	**6.5%**	**82,766**	**65,110**	**78.7%**	**15,440**	**15,447**
JAL												
YE 31/03	**Year 2002/03**	**17,387**	**17,298**	**88**	**97**	**0.5%**	**0.6%**	**145,944**	**99,190**	**68.0%**	**56,022**	
	Year 2003/04	**18,398**	**19,042**	**-644**	**-844**	**-3.5%**	**-4.6%**	**145,900**	**93,847**	**64.3%**	**58,241**	
	Year 2004/05	**19,905**	**19,381**	**524**	**281**	**2.6%**	**1.4%**		**102,354**	**67.4%**	**59,448**	
Korean Air												
YE 31/12	**Year 2003**	**5,172**	**4,911**	**261**	**-202**	**5.0%**	**-3.9%**	**59,074**	**40,507**	**68.6%**	**21,811**	**15,352**
	Year 2004	**6,332**	**5,994**	**338**	**414**	**5.3%**	**6.5%**	**64,533**	**45,879**	**71.1%**	**21,280**	**14,994**
	Year 2005	**7,439**	**7,016**	**423**	**198**	**5.7%**	**2.7%**	**66,658**	**49,046**	**71.4%**	**21,710**	
Malaysian												
YE 31/03	**Year 2002/03**	**2,350**	**2,343**	**7**	**89**	**0.3%**	**3.8%**	**54,266**	**37,653**	**69.4%**		**21,916**
	Year 2003/04	**2,308**	**2,258**	**50**	**121**	**2.2%**	**5.2%**	**55,692**	**37,659**	**67.6%**	**15,375**	**20,789**
	Year 2004/05	**2,882**	**2,798**	**84**	**86**	**2.9%**	**3.0%**	**64,115**	**44,226**	**69.0%**	**17,536**	**22,513**
Qantas												
YE 30/06	**Year 2001/02**	**6,133**	**5,785**	**348**	**232**	**5.7%**	**3.8%**	**95,944**	**75,134**	**78.3%**	**27,128**	**33,044**
	Jul-Dec 02	3,429	3,126	303	200	8.8%	5.8%	50,948	40,743	80.0%	15,161	34,770
	Year 2002/03	**7,588**	**7,217**	**335**	**231**	**4.4%**	**3.0%**	**99,509**	**77,225**	**77.6%**	**28,884**	**34,872**
	Jul-Dec 03	4,348	3,898	450	269	10.3%	6.2%	50,685	40,419	79.7%	15,107	33,552
	Year 2003/04	**7,838**	**7,079**	**759**	**448**	**9.7%**	**5.7%**	**104,200**	**81,276**	**78.0%**	**30,076**	**33,862**
	Jul-Dec 04	5,017	4,493	524	358	10.4%	7.1%	57,402	43,907	76.5%	16,548	35,310
	Year 2004/05	**9,524**	**8,679**	**845**	**575**	**8.9%**	**6.0%**	**114,003**	**86,986**	**76.3%**	**32,660**	
	Jul-Dec 05	4,999	4,626	373	258	7.5%	5.2%	59,074	45,794	77.5%	17,260	35,158
Singapore												
YE 31/03	**Year 2003/04**	**5,732**	**5,332**	**400**	**525**	**7.0%**	**9.2%**	**88,253**	**64,685**	**73.3%**	**13,278**	**14,010**
	Year 2004/05	**7,276**	**6,455**	**821**	**841**	**11.3%**	**11.6%**	**104,662**	**77,594**	**74.1%**	**15,944**	**13,572**
	Year 2005/06	**6,201**	**5,809**	**392**	**449**	**6.3%**	**7.2%**	**109,484**	**82,742**	**75.6%**	**17,000**	**13729**

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation. 1 ASM = 1.6093 ASK

AIRCRAFT AVAILABLE FOR SALE OR LEASE - MONTH END

	Old narrowbodies	Old widebodies	Total old	New narrowbodies	New widebodies	Total new	Total
Dec-2000	302	172	474	160	42	202	676
Dec-2001	368	188	556	291	101	392	948
Dec-2002	366	144	510	273	102	375	885
Dec-2003	275	117	392	274	131	405	797
Dec-2004	185	56	241	194	48	242	483
Dec-2005	145	51	196	258	45	303	499
Apr-06	200	62	262	237	45	282	544

AIRCRAFT SOLD OR LEASED

	Old narrowbodies	Old widebodies	Total old	New narrowbodies	New widebodies	Total new	Total
2000	475	205	680	895	223	1,118	1,798
2001	286	142	428	1,055	198	1,253	1,681
2002	439	213	652	1,205	246	1,451	2,103
2003	408	94	502	1,119	212	1,331	1,833
2004	321	177	498	1,815	325	2,140	2,638
2005	321	114	435	1,653	346	1,999	2,434
Apr-06	18	7	25	151	29	180	205

Source: *BACK* **Notes:** *As at end year; Old narrowbodies = 707, DC8, DC9, 727,737-100/200, F28, BAC 1-11, Caravelle; Old widebodies = L1011, DC10, 747-100/200, A300B4; New narrow-bodies = 737-300+, 757. A320 types, BAe 146, F100, RJ; New widebodies = 747-300+, 767, 777. A600, A310, A330, A340.*

EUROPEAN SCHEDULED TRAFFIC

	Intra-Europe			North Atlantic			Europe-Far East			Total long-haul			Total Int'l		
	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %
1998	188.3	120.3	63.9	194.2	149.7	77.1	135.4	100.6	74.3	453.6	344.2	75.9	673.2	484.8	72
1999	200.0	124.9	62.5	218.9	166.5	76.1	134.5	103.1	76.7	492.3	371.0	75.4	727.2	519.5	71.4
2000	208.2	132.8	63.8	229.9	179.4	78.1	137.8	108.0	78.3	508.9	396.5	77.9	755.0	555.2	73.5
2001	212.9	133.4	62.7	217.6	161.3	74.1	131.7	100.9	76.6	492.2	372.6	75.7	743.3	530.5	71.4
2002	197.2	129.3	65.6	181.0	144.4	79.8	129.1	104.4	80.9	447.8	355.1	79.3	679.2	507.7	74.7
2003	210.7	136.7	64.9	215.0	171.3	79.7	131.7	101.2	76.8	497.2	390.8	78.6	742.6	551.3	74.2
2004	220.6	144.2	65.4	224.0	182.9	81.6	153.6	119.9	78.0	535.2	428.7	80.1	795.7	600.7	75.5
2005	309.3	207.7	67.2	225.9	186.6	82.6	168.6	134.4	79.7	562.6	456.4	81.1	830.8	639.3	76.9
Apr-06	25.9	18.6	71.8	18.9	15.9	84.5	14.8	12.0	81.0	47.7	39.5	82.8	70.7	56.3	79.6
Ann. change	1.5%	9.8%	5.4	2.6%	5.7%	2.5	9.3%	11.9%	1.9	4.5%	8.7%	3.2	4.5%	9.9%	3.9
Jan-Apr 06	97.6	62.7	64.2	68.3	53.8	78.7	58.9	47.1	79.9	185.1	148.6	80.2	271.0	204.7	75.5
Ann. Change	2.5%	5.6%	1.9	0.8%	0.5%	-0.2	10.9%	12.9%	1.4	5.0%	5.9%	0.7	4.5%	6.1%	1.1

Source: AEA

US MAJORS' SCHEDULED TRAFFIC

	Domestic			North Atlantic			Pacific			Latin America			Total Int'l		
	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %
1998	960.8	678.8	70.7	150.5	117.8	78.3	112.7	82.5	73.2	83.5	52.4	62.8	346.7	252.7	72.9
1999	1,007.3	707.5	70.2	164.2	128.2	78.1	113.2	84.7	74.8	81.3	54.3	66.8	358.7	267.2	74.5
2000	1,033.5	740.1	71.6	178.9	141.4	79.0	127.7	97.7	76.5	83.0	57.6	69.4	380.9	289.9	76.1
2001	1,025.4	712.2	69.5	173.7	128.8	74.2	120.1	88.0	73.3	83.4	56.9	68.2	377.2	273.7	72.6
2002	990.0	701.6	70.9	159.0	125.7	67.2	103.0	83.0	80.5	84.1	56.8	67.5	346.1	265.5	76.7
2003	963.1	706.6	73.4	148.3	117.6	79.3	94.8	74.0	80.5	84.2	59.3	70.5	327.2	251.0	76.7
2004	1,014.5	763.6	75.3	164.2	134.4	81.8	105.1	87.6	83.4	96.4	68.0	70.5	365.6	289.8	79.3
2005	1,004.4	783.7	78.0	174.6	143.3	82.1	116.8	96.0	82.2	105.0	76.6	72.9	396.4	315.9	79.7
Apr 06	81.1	66.5	82.0	14.9	12.4	83.0	9.9	7.8	78.3	9.2	7.2	77.8	34.1	27.3	80.2
Ann change	-3.0%	2.6%	4.5	6.6%	6.4%	-0.2	5.2%	6.0%	0.6	1.8%	12.0%	7.1	4.8%	7.7%	2.1
Jan-Apr 06	318.3	250.4	78.7	54.5	42.0	77.2	38.2	31.2	81.5	37.7	28.6	75.7	130.4	101.8	78.0
Ann change	-3.4%	0.7%	3.2	4.6%	2.6%	-1.5	2.6%	3.9%	1.1	2.1%	5.7%	2.6	3.3%	3.9%	0.4

Note: US Majors = Aloha, Alaska, American, Am. West, American Transair, Continental, Cont. Micronesia, Delta, Hawaiian JetBlue, MidWest Express, Northwest,Southwest, United and US Airways **Source**: ATA

JET ORDERS

	Date	Buyer	Order	Delivery	Other information/engines
Boeing	12 June	Virgin Blue	9 x 737-800	2008 onwards	converted options
	13 June	Nippon Cargo	2 x 747-400F	2008/09	
	22 June	Cathay Pacific	6 x 747-400ERF	2008 onwards	
Airbus					
Embraer					
Bombardier					

Note: Only firm orders from identifiable airlines/lessors are included. *Source: Manufacturers*

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