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North Atlantic trends

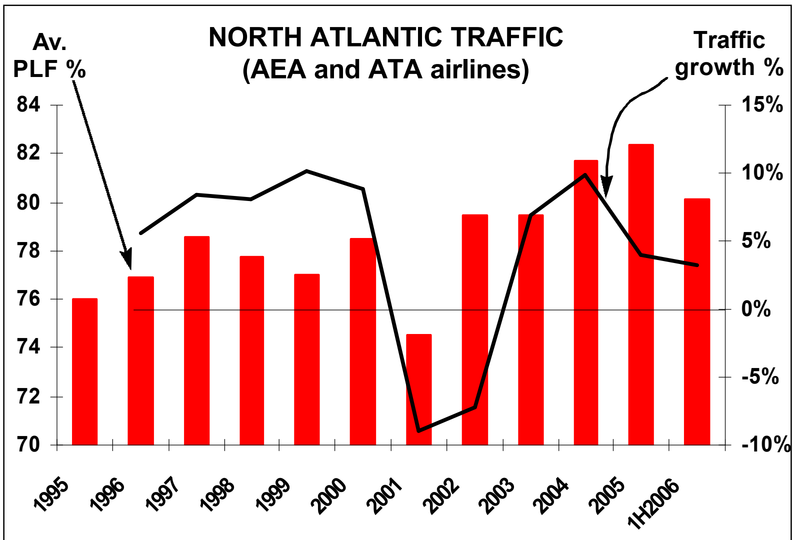
Two trends emerge from the latest, first half 2006, traffic numbers for the North Atlantic. First, while the market is growing only slowly (around 3%), and, despite the 2004 rebound, there is little evidence of a return to the pre-September 11 trend. Second, load factors remain very high - this year will again see average loads on the Atlantic around 82%, about five percentage points up on the late 90s average.

Capacity constraint among the US Legacies and intercontinental hub rationalisation by the Euro-majors lies behind the tight supply/demand balance, and this is translating into some good bottom-line results. BA's 20% increase in first quarter (April-June) operating profit was attributed to "record load factors and better cabin mix".

Not everyone, however, can make money in this environment. United has just announced the sale of its daily New York JFK - London LHR route to Delta, which will operate it from Gatwick, for a relatively modest $21m. It is perhaps surprising that United has failed to make this prestigious route work, but it has apparently not been able to achieve the same average yields as its competitors, which is partly due to its low frequency compared to the multiple frequencies offered by BA and Virgin Atlantic, an element that business travellers and corporations value highly.

This may also raise a question about the strategies of the new business-only transatlantic operators like Eos and MaxJet, whose offering appears to have been well received, especially by the independent business traveller, but whose low frequencies leave them exposed when they have to cancel or postpone a flight.

In the background European and US LCCs are observing the Atlantic market with increasing interest. But it will probably take a technological step to induce them to expand intercontinentally - such as transferring 787 operating economics to a 737 model.



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Lufthansa: Network reorganisation and product differentiation

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Initially, the response of the flag carriers to the LCCs was mixed, with some recognising the LCC threat and responding, while others went into denial. Today, however, almost all of the world's network airlines have developed sophisticated strategies to combat the LCC threat, and in this survey *Aviation Strategy* looks at the different responses of three airlines - Lufthansa, British Airways and Qantas.

Lufthansa's response to the LCCs is still evolving, but for the moment is based primarily on network reorganisation (including depeaking at hubs and regional flights ping-ponging between non-hub airports) combined with a greater role for Germanwings as part of a strategy of clear product differentiation and lower fares (including "Economy Budget" at the mainline and a no-frills product from Germanwings).

Hub modifications

Starting in 2004, Lufthansa has been smoothing peaks and fattening troughs at its two main hubs - Frankfurt and Munich - via simplifying scheduling complexity and aircraft rotations, as well as reorganising regional flights via its Lufthansa Regional unit, based on waves of feeder flights into Frankfurt and Munich.

However, depeaking at the two hubs has not been radical - for example, at Frankfurt Lufthansa has moved no more than 20-30 flights per day from peaks around 9am, midday, 4-5pm and 9-10pm to other times, and the vast majority of those have been to times that are on peak shoulders, rather than the least busy times of day. There are three peaks at Munich, but comparable changes have been made there too. This year, Lufthansa is aiming to "maximise profitability" at the Frankfurt hub and grow at its Munich hub, and - overall - Lufthansa has increased short-haul summer capacity by 4.6% this year compared with 2005 (and compared with zero growth for long-haul flights this summer).

Lufthansa's mainline and Regional flights have realigned to a new strategy that assigns 737s on all mainline routes and CRJs on regional routes. Crucially, beginning in 2003 most non-hub flights have been operating a "ping-pong" strategy, enabling aircraft to fly back and forth between two airports all day in a regular pattern, thus minimising crew planning and schedule complexity. Lufthansa says is does not introduce ping-pong flights for scheduling reasons alone - there has to be sufficient city-pair demand as well - but this tactic appears successful: non-hub turnaround times have now reduced from an average of 30 minutes to 25 minutes, and overall productivity is up by 11% thanks to "more efficient use" of cockpit & cabin crew. Lufthansa has backed up this success up via the launch of its largest ever "non-hub" flight marketing campaign.

Combined with this hub/non-hub change in strategy, Lufthansa has revamped its management structure. In 2005 Lufthansa established "hub management" teams at Frankfurt and Munich, dedicated to the needs of each particular hub and with specific regard to quality, costs and suppliers. And from October 2005, all point-to-point services from Lufthansa's other 11 German airports have been run by a separate unit within the airline, analogous to the units at Frankfurt and Munich, with responsibility for everything from pricing to strategy. This unit is also responsible for the commercial and operational running of Lufthansa Regional.

In October 2005 Lufthansa spent €170m in buying a 4.95% stake in Fraport, the operator of Frankfurt airport (Lufthansa's biggest hub), which it increased to 9.1% in March 2006. This gives Lufthansa some opportunity to influence Frankfurt airport strategy. Moreover Fraport owns a 65% stake in Frankfurt-Hahn GmbH, the operator of Hahn airport, which is the German base of Ryanair. Lufthansa has previously complained about the low fees Ryanair pays there, but any attempt to influence the charging structure would provoke the usual temperate reaction from Michael O'Leary.

Germanwings

In December 2005 the European Commission gave approval for Lufthansa to take operational control of Eurowings (it already held a 49% equity stake) - which owns Germanwings - through acquiring a majority of voting rights, but conditional on the surrender of slots at Vienna and Stuttgart.

With a staff of 700, Germanwings is now clearly positioned as the no-frills part of the Lufthansa group, and the airline's operation is based on has four hubs - although most of these are primary airports, so they are not classically low cost.

• Cologne/Bonn (the main hub) attracts passengers to/from the west of Germany, with 41 international and four domestic routes. Eleven aircraft are stationed there.
• Stuttgart covers the south-west, with 21 international and four domestic routes. Seven aircraft are stationed there.
• Berlin Schonefeld is the hub for the north-east, with nine international and four domestic routes. Two aircraft are stationed there.
• Hamburg (launched in November 2005), covers the north of Germany, with nine international and three domestic routes. Two aircraft are stationed there.
• In addition, the airline is looking at a fifth base, with Nuremberg, Zurich and Basel the prime candidates.

Germanwings is targeting a 30% passenger market share at its hub airports, and the Berlin and Hamburg bases are being expanded significantly, although extra destinations will be added out of Cologne/Bonn and Stuttgart as well. Germanwings' expansion targets are aggressive, and although turnover rose 60% to €400m in 2005 (with a "positive" operating result), it is aiming for another substantial revenue increase in 2006, to €570m. The airline had a load factor of 83% and carried 5.5m passengers in 2005 (57% up on 2004), and expects to carry 7.5m passengers in 2006 and 10m in 2007.

Germanwings operates to 54 destinations with a fleet of 19 A319s, two leased from Lufthansa and the rest from GECAS, and three A320s leased from ILFC. 18 156-seat A319s are on order, for delivery in September 2006 - June 2008, when the fleet will grow to around 40 aircraft (the airline also has 12 A319 options).

LUFTHANSA FLEETS

		Fleet	Orders (Options)
Lufthansa	A300	12	
	A319	18	
	A320	36	
	A321	26	(6)
	A330	12	
	A340	39	7
	A380		15
	737	62	
	747	30	
	CRJ		12
	Total	**236**	**23 (6)**
Lufthansa Cityline	CRJ	59	
	Avro	18	
	Total	**77**	
Germanwings	A319	17	18 (12)
	A320	3	
	Total	**20**	**18 (12)**

Germanwings' main distribution channel is its website (it has no travel agent distribution), although it is looking at other innovative distribution methods, such as via mobile phones. Its fares are typically around €60-€80 per return trip, with 10-15% of seats offered within the €19-€29 range. 40%-50% of the airline's passengers are business customers, many of them attracted by Germanwings' "corporate deals", with reduced fares, the ability to cancel flights (for a fee), and free online flight alterations if companies guarantee a minimum level of business over a six-month period. Another attraction to business travellers is that in January 2006 Germanwings became Europe's first LCC to offer an FFP - called the 'Boomerang Club' - which the airline says is a low cost way of encouraging loyalty.

With such ambitious growth targets at Germanwings, Lufthansa will probably "outsource" more of its operations to the subsidiary. Lufthansa has a presence at all of Germanwings' hubs, and at Cologne/Bonn overlaps on the Munich route (with 65 return flights per week for Lufthansa and 20 for Germanwings), while Condor (of which Lufthansa owns 10%) overlaps on routes to Anatalya, Munich and to Palma (Mallorca). At Stuttgart, Lufthansa overlaps with Germanwings on the Hamburg route (44 return flights per week for Lufthansa, 19 for

Germanwings) and Condor overlaps on routes to Anatalya and Palma. At Hamburg Lufthansa overlaps on the route to Stuttgart (48 return flights per week for Lufthansa and 17 for Germanwings), while Condor overlaps on flights to Munich; while at Berlin Schonefeld there is overlap only between Condor and Germanwings flights to Munich.

Outside Germany, there are fewer opportunities for rationalisation. In 2005 Germanwings considered axing Gatwick at its main London airport in favour of London Stansted (it currently operates to both, which it says is "not useful"). Lufthansa, however, operates to London Heathrow and London City.

Nevertheless, rationalisation/outsourcing looks an attractive option, and - helpfully - Germanwings' pilots are covered by a Lufthansa "low-cost chapter" collective agreement with pilot union Vereinigung Cockpit, which includes pilots of Germanwings and Condor. This enables the Lufthansa Group to establish a two-tier pay structure within the Group, and allows mainline pilots with to switch to a more senior position at Germanwings, although on a lower salary structure (e.g. a Lufthansa first officer to captain at Germanwings).

Differentiation

Lufthansa's overall strategy is based on product differentiation, with product lines in all segments. It has four classes: Business (with flexibility & extra cabin space); Economy (with flexibility), new Economy Budget (on mainline Lufthansa and differentiated from no-frills), and No Frills (via Germanwings).

The first three classes are designed not to "dilute the [Lufthansa] brand", and Lufthansa has been enhancing these products in order to emphasise differentiation. In Business new seats have been introduced (with one inch extra legroom) in a four abreast layout (instead of six or five abreast as before), as well as fast-tracking of passengers through airports, more lounges at domestic airports, "better onboard service" (i.e. catering) and a "Hon Circle" scheme for very frequent fliers.

These changes have achieved results, as business class erosion now halted - Lufthansa's market share of domestic point-to-point business class passengers fell from 32% in 2001 to 27% in 2002 and 18% in 2003, but since the revamped seating was introduced in April 2004, the share has remained constant at 18% to the end of 2005. Lufthansa aims to keep up the business passenger push by a whole host of other innovations, including FlyNet (onboard internet) and biometric boarding passes.

Economy prices have now been simplified to two levels of flexibility - Flex (refundable, with no rebooking charge) and Basic (non-refundable, with a €25 rebooking charge). While Economy remains the core mainline Lufthansa product, Economy Budget is the new bargain fare concept (also known as E-class), and was introduced on new Economy Budget flights launched out of Hamburg airport in October 2005 under the "BetterFly" tag. Although Hamburg is also a new hub for Germanwings, Hamburg was chosen primarily as an attempt to stop easyJet setting up a hub there. Lufthansa launched six new destinations out of Hamburg (Budapest, Gothenburg, Madrid, Nice, Prague and Rome) - bringing total destinations offered from the airport to 23. The new routes are operated by five 737s released by the restructuring of Lufthansa's European flight operations for this purpose (around 50 aircraft are now stationed at Hamburg). On all these 23 routes "E-class" is available on 20% of each flight's seats and offers €99 return fares inclusive of taxes, with a waiving of almost all conditions. Lufthansa claims the difference in fare between E-class (i.e. Economy Budget) and Budget is relatively low (e.g. €25 on Hamburg-Rome).

Lufthansa says Hamburg has been very successful, with a 40%-50% increase in passengers flown - which is higher than capacity increase - and yields "higher than projected". The proportion of internet sales on Hamburg routes are up from 15% to 40%; and the key aim of Lufthansa appears to have been achieved - easyJet's major expansion plans for Hamburg now appear to be on hold, while Hapag Lloyd Express has withdrawn capacity from Hamburg. Lufthansa may therefore extend the Hamburg "Economy Budget" concept/trial to other non-major hubs, with Dusseldorf earmarked as the first candidate, to be followed by Stuttgart. The draft Dusseldorf plan includes four extra aircraft to support new flights and routes.

It's possible that Lufthansa will allow Germanwings to take over many of Lufthansa's non-hub flights in the future. However, feed to Frankfurt and Munich (Lufthansa's key hubs) is likely to continue to be supplied by the mainline operation - with its inherent higher cost basis - in at least the short- and medium-term in order to secure the majority of business passengers that are - for the moment - not prepared to fly on a LCC.

BA: Distribution reform and cost cutting

BA's response to the LCC threat has been a combination of network rationalisation (i.e. cutting its exposure to the most heavily loss-making short-haul sectors), distribution reform (essentially copying the direct strategy of the LCCs), product repositioning and - most importantly of all - a continuation of cost cutting.

Network

Short-haul has traditionally made large losses for BA and, in the face of increasing competition from LCCs, in the early 2000s BA decided to make significant changes to short-haul strategy, mainly through network rationalisation and cutting costs.

Previously BA didn't have a seamless short-haul business, but a collection of strategically diverse carriers such as Go, Deutsche BA, Air Liberté, British Airways mainline, BRAL, Brymon and CityFlyer Express, each of which was an independent/quasi-autonomous business with a separate management and sales structure etc. As part of a strategy to reduce exposure to short-haul, Go was sold (as it cannibalised BA sales and restricted management's ability to cut costs at the core airline), as were other short-haul assets such as Air Liberté and Deutsche BA.

Just as importantly, BA "realigned" capacity with demand - e.g. by replacing 767s on the route to Oslo with A320s or by closing routes to secondary airports on the continent. As a result of these moves, BA's short-haul capacity is now 20-21% of total ASKs, compared with 23% in 2001/02.

After this initial wave of rationalisation, in 2005 BA reviewed its remaining short-haul operations once again. Gatwick routes are becoming "more leisure focused", although they will retain a two-class service (as will Heathrow routes). However, the key changes are to non-London services, and in January 2006 BA CitiExpress - the loss-making UK regional airline - was renamed BA Connect in an effort to make it more "distinct" in the market place.

On all routes apart from out of London City, this includes: single-class cabins; a reduction in one-way fares by 40%, with no seating restrictions; a replacement of Club Europe by a BA Connect Club, with lounge access, choice of seating and FFP points; and no inclusive meals (replaced by a pay-on-board service - although Club Europe cabins and free in-flight meals remain on London City routes). BA estimates these BA Connect changes will generate double digit increases in demand, although yield will fall by at least 5%. BA Connect is targeting a load factor of 70% (i.e. not the 85%+ load factors of LCCs), as BA says "frequency is more important than capacity and load factor".

BA Connect is also making modest changes to its network, with some additions and some reductions, particularly out of its main bases at Birmingham, Bristol, Edinburgh, London City, Manchester and Southampton. BA Connect's fleet has also reduced by 40 since 2001, with aircraft types going down from nine to three, and bases from 15 to eight (as of 2005).

The total BA short-haul fleet has already reduced from 234 in 2001 to 179 in 05 and 166 as at early 2006, and total short-haul capacity is approximately 25% lower than at its peak - although this is largely due to exits from Air Liberté, Deutsche BA, Brymon etc. But the strategy appears to be working, while BA short-haul lost £60m in 2003/04 and £26m in 2004/05, in 2005/06 BA's short-haul operations made a small profit.

Distribution

Overall, BA's distribution/selling costs have reduced (as a percentage of revenue) from 18% in 1994/95 to 14.5% in 99/00 and 5.2% in 05/06, with a 57% fall in distribution costs in absolute terms over the 2000-2005 period.

The key to distribution reform was to first sort out fares. Previously, BA's abundance of different short-haul affiliates and subsidiaries "engendered a plethora of fares types and rules". In the 1990s BA had at least 70 selling classes, and as late as 2003 BA still had 25 selling classes and 15 "types of passenger". Since then the fare structure has been simplified (e.g. by abolishing Saturday night stay rules), and altogether two-thirds of fares have been eliminated. Now there three basic types of flexibility - fares that can always be changed, fares that can never be changed, and fares that can be changed for a fee. The fare system is now structured on a "LCC economic basis" - i.e. the cheapest fares are available if booked well in advance, and fares always rise as the departure date gets closer (which was not the case previously).

As the fares structure has been overhauled, the importance of BA.com has increased. BA.com accounted for 3% of BA's bookings in 00/01, rising to 20% in 04/05 and 25% in 05/06. 80% of all direct bookings coming into BA are made on BA.com, with the call centres taking the rest (although the majority of their time is spent on servicing existing bookings, and BA is increasing the functionality of BA.com in order to take those servicing calls out of the call centres).

BA.com also allows customers to manage bookings (by select seats, choosing meals etc) and their FFP (an estimated 85-90% of all Executive Club transactions are online), and including this "servicing", a third of all BA's customers use BA.com. Additionally, BA.com helps BA with marketing and customer contact (e.g. for flight changes) - BA has 85% of web addresses of people who book online, compared with 50% of everyone who books with BA. And BA.com now allows passengers to fulfil API requirement for US government by providing immigration data online.

Within BA.com, the short-haul product is now aimed at three distinct segments: Business/Club - passengers willing to pay for full business short-haul product; Premier Economy - business travellers willing to pay for a separate cabin and extra leg room; and Economy - passengers wanting cheapest flight possible. Within each of these there are two segments - "lowest" and "flexible" fares - giving six core product/pricing categories

BA.com also enables upselling - telling customers what they can get (e.g. cabin or flexibility) if they pay a bit more. BA is finding that "a surprising number of people are trading up", and although upselling is at early stage, in 2005 upselling increased yield by 1.5% on tickets sold through the website. In 2005 BA also introduced online packaging, allowing customers to buy not just air tickets but assemble entire holiday package. This allows higher margin sales of other package components, and BA forecasts significant uplift in ancillary sales over next few years.

Altogether, BA.com has delivered more than £100m in improved bottom line to BA over the 2003 to 2005 financial years, at an investment cost of £42m (which is less than initial estimates of £50m). Most of this upside has come from reduced manpower and distribution costs, with significantly less people at call centres - centres have closed in London, Glasgow, Japan, Sweden and Italy, with 400 call centre jobs going in 2004/05 and 400 in 2005/06.

In 2006 BA is making further "significant investments" in BA.com, including in the area of e-tickets. Around 80% of BA tickets are now e-tickets, which the airline claims is the highest e-ticket use of any network carrier outside the US. e-tickets have reduced costs at BA - in 2003 BA had 80 people in Newcastle printing tickets and sticking in envelopes, but these jobs have now gone.

Crucially, BA.com was "key to reducing travel agency payments", with at least 60% of short haul business in economy and premium economy (i.e. excluding business/club) now made on BA.com. However, BA says there is much room for improvement, and it is aiming for zero percentage distribution/selling costs, thanks to BA.com and elimination of travel agent commission down to zero.

Cost cutting

BA has been cutting costs for many years, well ahead of other European majors. However, 1st half 05/06 results (April-September 2005) saw costs creep up again at BA - despite ongoing cost-cutting - and new CEO Willie Walsh said there was "need to re-energise efforts to deliver a competitive cost base".

Approximately 30% of BA's costs are in payroll, 20% in fuel and 50% the rest, of which distribution has been (and will be) the most significant area of cost reduction (see above). There is a BA-wide target of £300m of employee cost cutting by end of 06/07 FY, and most of this will come from the switch to Terminal 5 at London Heathrow, although £50m will come from cutting 597 senior and middle managers out of a total of 1,715 by end of the 2007/08 financial year.

There is further potential for further reductions in fleet costs. Although the average age of the short-haul aircraft is just under nine years, the fleet will not be added to until after March 2008. However, there could be short-haul reductions, with 11 767s currently on short-haul potentially redeployable to long-haul. Parallel to this, each of BA's short-haul hubs/units (London Heathrow, London Gatwick and the Regions), are undergoing cost stripping programmes in their own right:

At London Heathrow, the move to T5 in March 2008 (with a capacity of 30m passengers per year) gives BA "once in a lifetime opportunity" to address working practices. As T5 is in middle of existing runways, there are reduced taxi and turnaround times anyway,

BRITISH AIRWAYS' FLEET

		Fleet	Orders (Options)
British Airways	A319	33	(51)
	A320	27	7
	A321	7	3
	737	33	
	747	57	
	757	13	
	767	21	
	777	43	
	Total	**234**	**10 (51)**
BA Connect	146	13	
	145	28	
	DHC8	8	
	Total	**49**	

but BA hired specialist process engineering consultants to help design T5 from the outset, giving "opportunity to develop efficient working practices" and cost-efficient operations. This has included a redesigned customer flow through terminals - the layout has no bottlenecks and cul-de-sacs - and a maximum 15 minutes journey time from luggage entering the baggage system to arriving at the correct aircraft stand. Costs will also be saved by implementing a logistics system for guiding BA equipment and staff through T5, which includes much reduced equipment lines.

New working practices tentatively agreed with unions for T5 include a breakdown of demarcation between different work groups: as short- and long-haul operations are in same terminal - with different peaks and troughs - staff will work across these operations. And all employees, from crew to ground staff, will be based in T5 and not in separate buildings - over the last five years BA has sold half the property it occupied at Heathrow (although in the same period staff stationed there has risen from 2,500 to 4,500).

At London Gatwick BA has set "challenging cost and revenue targets" in a programme launched in September 2005, with £13m of savings at short-haul out of Gatwick by the end of the 2006/07 financial year. This is on top of existing cost cutting and capacity reductions at Gatwick - for example, BA has reduced short-haul capacity out of Gatwick by an estimated 40%-50% since the start of the decade. Tricky negotiations are ongoing with unions and job cuts are not ruled out, but initially management's focus is on more flexible working, reduced recruitment and natural staff turnover. Revenue growth is also targeted, mainly via increased marketing.

At the Regions, initially BA Connect will have lower fares but the same cost basis as CitiExpress, although over next two years BA is looking to take £35m out of the BA Connect cost base. This is to be achieved via reductions in overhead, simplifying fleet, cheaper supplier contracts, elimination of complimentary catering and productivity increases. The 2,000 BA Connect staff will not be reduced. However, BA insists that cost-reduction is not the prime focus here; rather, BA is relying on revenue growth to get BA Connect airline into profit by 2008 - or else it will face sale or closure.

With BA's short-haul operations breaking even in 2005/06 (for the first time in 10 years), BA's response to the LCCs has been - in relative terms - successful. Although BA's short-haul operations will never be as profitable as easyJet or Ryanair, their prime purpose is to provide feed into BA's profitable long-haul, so as long as they continue to do that and at least break-even in the face of LCC competition, BA will consider that strategy a success.

Qantas: The Jetstar brands

Qantas's reaction to Virgin Blue is based partly on improving its mainline product (through cost-cutting and the introduction of selected frills such as complimentary hot meals for domestic economy), but primarily on setting up a series of LCC airlines under the Jetstar branding: - Australian-based Jetstar, Singapore-based Jetstar Asia and the planned Jetstar International, which will operate out of Australia.

Jetstar

Jetstar was established in May 2004 as a low-cost domestic subsidiary of Qantas, and today operates a fleet of 22 A320-200s and six 717-200s domestically and internationally. Jetstar initially flew 717s, but the 717s being phased out and part of a move to all-A320 fleet (with one outstanding A320 on order).

Jetstar offers a JetFlex fare, which offers business travellers flexibility, priority boarding and Qantas FFP points. Domestically, the airline operates from five bases - Brisbane, Sydney, Melbourne, Adelaide and the Gold Coast - to 13 east Australian destinations. In early 2006 Jetstar opened a crew base at Adelaide airport's new terminal and stationed two A320s there, with help from "a support package from the South Australian government". Virgin Blue also moved into the terminal at the same time, and competition between them is expected to become fierce. The move allowed Jetstar to add routes out of Adelaide to Sydney and Brisbane from February and to Hamilton Island and the Sunshine Coast from March, adding to the existing routes to Melbourne and the Gold Coast. A similar deal was also done in 2005 at Cairns, where three aircraft are currently stationed.

In March 2006 Jetstar launched a daily Melbourne-Perth service out of Melbourne's second airport Avalon, from which Jetstar also operates to Adelaide, Brisbane and Sydney. Altogether Jetstar operates from the main Melbourne Airport to nine domestic destinations (Qantas operates on Melbourne-Perth), and in July 2005 Jetstar replaced Qantas Airways' regional arm QantasLink on the Sydney-Ballina route, in competition against Virgin Blue.

In December 2005 Jetstar launched its first international routes, to Christchurch from Brisbane (daily), Melbourne (nine flights per week), Sydney (10) and the Gold Coast (two a week), with two A320s stationed in Christchurch. These are direct competition for Virgin Blue's New Zealand subsidiary Pacific Blue, which launched in 2004 and connects Australia, New Zealand and Pacific island destinations. Pacific Blue operates from Christchurch (on a weekly basis) 11 flights to Brisbane, one to

Melbourne, five to Sydney and two to the Gold Coast. Christchurch-Gold Coast is a new service for the Qantas group but Jetstar's Christchurch-Melbourne and Christchurch-Brisbane flights replaced Qantas's services, while Qantas has reduced frequency on the Sydney route.

The New Zealand services are operated and piloted by Jetstar staff - except for the cabin crew, who come from Qantas' New Zealand subsidiary Jetconnect - and the flights offer the same product as domestic Jetstar.

Jetstar recorded a US$26.8m profit in the year to end June 2005, compared with a US$14.2m loss in the year to June 2004 (which were largely set up costs). In the year to June 2005, Jetstar flew 4.4m passengers and had an average load factor of 72.4%.

Jetstar International

Jetstar International will launch in late 2006, initially using four A330-200s borrowed from Qantas's domestic fleet. In December 2005 Qantas ordered 45 787-8/9s (with 70 more on option), of which Jetstar International will receive 10 787-8s from August 2008 onwards (five in 2008), and an unconfirmed number of 787-9s.

Jetstar International will initially operate with 10 aircraft on point-to-point routes to Asia-Pacific destinations, although there are also tentative plans to expand to North America destinations and even Europe at a later date.

The airline is targeting leisure destination such as Phuket, Bali and Honolulu, and will "complement Qantas's mainline international operations", concentrating on routes within 8-10 hours flying time of Australia: "routes that probably Qantas has either withdrawn from over the past 10 years or may have withdrawn off over the last year or so, and also new routes". Essentially Jetstar International will fly routes that "Qantas and Australian carriers do not fly to" - i.e. routes that are marginally profitable at best for Qantas (and are leisure dominated, whereas Qantas caters for business class as

QANTAS FLEETS

		Fleet	Orders (Options)
Qantas	A330	14	
	A380		12 (10)
	737	51	(42)
	747	35	
	767	24	
	787		45 (70)
	146	2	
	DHC8		1 (10)
	Total	**126**	**58 (132)**
Jetstar	A320	23	(40)
	717	6	
	787		12
	Total	**29**	**12 (40)**
Jetstar Asia	A320	4	
	Total	**4**	

well).

Jetstar International will operate initially from Melbourne, Sydney and Brisbane, and its ambition is to grow no bigger than "20%, at maximum, the size of Qantas". The airline also aims to have the lowest cost structure of any international carrier to-from Australia, with a product based on two-class configuration (economy and premium economy class - called "StarClass"); assigned seating (like domestic Jetstar and Jetstar Asia); baggage interlining for international connections; video-on-demand, and complimentary meals in StarClass (with paid-for meals in economy).

While Jetstar International will have a codeshare arrangement with Qantas for all international flights, it's not yet known how Jetstar International will affect Australian Airlines, Qantas's existing lower-cost international arm, in the long-term, although Qantas group says it is committed to Australian. Australian Airlines operates mainly to secondary leisure destinations in the Asia-Pacific region with five 767-300ERs. A clue to its future may come from the fact that its aircraft used to have a single class configuration, but from this summer they changed to a two-class configuration, with premium economy seating. Under agreements with unions, previously Australian Airlines was only allowed to operate 767s to destinations within four hours flying time zone from base in Cairns, although in 2005 new agreements were signed with unions that abolished these restrictions.

Jetstar Asia

Singapore-based Jetstar Asia is owned by a holding company called Orangestar, which is owned 49% by Qantas, 22% by Singapore businessmen Tony Chew, 19% by Singapore government investment arm Temasek Holdings, and 10% by Singapore businessmen FF Wong. The airline launched in December 2004 and currently operates from Singapore to 10 destinations (Hong Kong, Taipei, Bangkok, Manila, Phuket, Kolkata, Yangon, Siem Reap, Bangalore and Phnom Penh). It has a fleet of four A320s - two on lease from Aviation Capital Group and two from Singapore Aircraft Leasing Enterprise. Again, Jetstar Asia does not offer a standard LCC product, as it gives assigned seating and offers paid-for hot meals on its longer sectors.

However, the airline has had a rocky start, and in the year to the end of June 2005, Jetstar Asia made a US$28m net loss, of which Qantas's share was US$14m. In 2005 Jetstar Asia considered leasing out its A320s as it dropped Singapore-Pattaya services due to weak demand and suffered delays in securing landing rights to other countries. Although Singapore regulators granted Jetstar Asia traffic rights to China, India, Indonesia, the Philippines and Vietnam, the airline had to delay launching routes to these destinations because it is waiting on approval for operating permits from those respective countries.

Jetstar Asia has therefore had to "buy" its way into the Indonesian market, and Orangestar purchased Singapore-based Valuair in 2005 for undisclosed sum. Valuair launched in May 2004, but is believed to be loss-making ever since. The two airlines operate separately, but effectively they are merging their operations e.g. Valuair has dropped routes to Bangkok and Hong Kong as Jetstar Asia serves both destinations. Valuair now operates only to Jakarta, Surabaya and Denpasar (Bali), with fleet of four A320-200s. Valuair's brand has been retained only because the Indonesian government does not allow Jetstar Asia to operate to Indonesia as it is a LCC (whereas Valuair is allowed, as is not classified as a LCC).

The Qantas group is trying to leverage its links with Jetstar Asia - Jetstar CEO Alan Joyce is to join the board of Jetstar Asia, and in December 2005 Qantas applied to Australian regulatory authorities for the right to codeshare on some of Jetstar Asia's services (to Bangkok, Phuket and Kolkata in India), a move that rival LCC Tiger Airways says is "backdoor way" for Qantas to enter the Singapore market and which will ruin Jetstar Asia's cost base.

Ambitions

Qantas's ambition is that the Jetstar group will comprise more than 60 narrow-body and widebody aircraft by 2010, under three (or more) airlines. To encourage Jetstar's rapid growth, in February 2006 Qantas created two distinct management teams: one for mainline Qantas and one for Jetstar, and each has been given operational independence.

However, there are question marks as to how effective Jetstar will be for Qantas. Currently Jetstar competes only against approximately 20% of Virgin Blue capacity, and the majority of Virgin Blue flights compete against Qantas mainline. Virgin Blue is also apparently changing its strategy to become what it calls a "New World Carrier" - essentially a low-cost network carrier that offers frills (either paid for or as part of core product) and which is targeting higher yield business passengers that traditionally fly with Qantas.

Virgin Blue believes it can offer a better product than traditional LCCs (i.e. Jetstar) and so can afford to nudge up costs slightly - as it starts from a lower base than Qantas - in order to attract significant amounts of business travellers away from Qantas. If this strategy works, the effectiveness of Qantas's Jetstar efforts may be significantly less than management hopes.

US LCCs: Star performers and puzzling trends

The newly solvent US legacy carrier sector turned in a highly respectable performance in the second quarter in light of the record high fuel prices: operating margins were in the mid-to-high single-digits, up by a uniform three-to-four percentage points. However, the LCCs' results were more interesting, given the greater variation and some puzzling trends.

At one extreme, there were the star performers. The three most profitable US airlines in the second quarter were LCCs, and they all saw the greatest margin improvements. Southwest increased its industry lead with a spectacular 17.5% operating margin, up from 13.2% a year earlier. US Airways consolidated its position as the hottest newcomer - a new type of "hybrid LCC" since its September 2005 merger with America West - with a 10.7% operating margin. AirTran Airways, in third place with a 10.3% margin, returned to double-digit profits not seen since 2000.

Normally it would not come as a surprise that LCCs outperform the legacy carriers. But wasn't this supposed to be the year when the legacies take their revenge and capture the biggest RASM improvements with the help of their more sophisticated yield management systems?

In contrast to the three star performers, however, JetBlue - the former high-flyer - saw its operating margin decline to 7.7% from 9.3% a year earlier. And Denver-based Frontier, while staging a turnaround from a marginal loss in the same period in 2005, still only achieved a 3.5% operating margin.

The LCCs' second-quarter results reflect three things. First, with the notable exception of Southwest, which still has reasonable fuel hedges in place, the high fuel prices are having a significant impact on the bottom line of LCCs, just like the legacy carriers.

Second, while all US airlines have benefited from a robust domestic revenue environment - reflecting industry capacity cuts and strong demand - and most have been able to increase profits because revenue growth has more than offset the higher fuel prices, it was LCCs that saw the biggest RASM gains in the second quarter. However, Frontier was an exception due to unique circumstances.

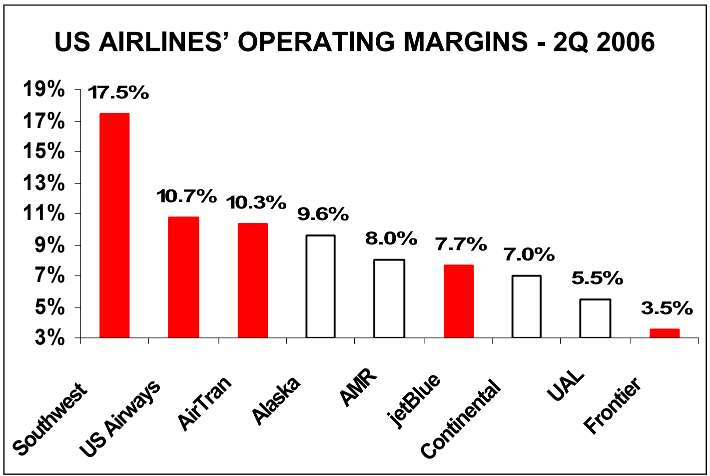
Third, while most US airlines had non-fuel costs well under control, JetBlue's non-fuel CASM surged by an alarming 9% in the second quarter. As a result, its profits declined despite extremely healthy RASM growth.

Why the LCC RASM success?

US Airways' mainline RASM surged by 21% in the second quarter; the increase was 23.8% if only the pre-merger East Coast network was included (the AWA routes saw 16.3% RASM growth). Southwest's unit revenues were up by 17.5%, AirTran's by 16.8% and JetBlue's by 15.6%. These rates were significantly higher than the 11-12% seen by American and Continental in their domestic mainline operations.

The LCCs outperformed, first of all, because many of them have heavy exposure to the East Coast, which has seen the biggest industry capacity cuts over the past year, including a major shrinkage by Delta. The main beneficiaries were AirTran and US Airways, which have significant network overlap with Delta. In particular, AirTran has been helped by Delta's heavy cuts at the Atlanta hub that the two share.

In contrast, Frontier saw only an 8.2% RASM improvement in the second quarter, because it operates in the West and because it faced Southwest as a new competitor in Denver. Since entering the market in January, Southwest has tripled its daily



fights from Denver to 32. United, which had previously removed capacity from Denver, has shifted it back to facilitate a strong competitive response to Southwest. Despite evidence of the famous "Southwest effect" (demand stimulation), the result has been excess capacity in the Denver market.

Another new development on the RASM front is that Southwest has played a leading role in fare increases. This year, for the first time in memory, Southwest has initiated numerous modest fare increases in an effort to offset fuel price hikes. Its average fare was up by a significant 15.5% to $107 in the second quarter - apparently without ill-effects because demand has been so strong. In addition to helping Southwest attain unusually strong 2Q RASM growth, the low-fare leader's price hikes have paid significant industry revenue dividends.

Third, according to JP Morgan analyst Jamie Baker, there is some evidence that short-haul LCCs like Southwest are seeing a shift from driving to air travel in short-haul markets, as the price of unleaded petrol has soared. Some recent revenue data from regional operations has supported that hypothesis, though in some cases the RASM increases are probably the result of continued restructuring, including aircraft down-gauging.

Fourth, the LCCs' RASM performance may also reflect improved revenue management. Calyon Securities analyst Ray Neidl suggested in a research note that the better yield management skills of the former AWA management, which took over running the combined company known as US Airways, may partly explain the RASM surge in the old US Airways network.

There is evidence that the new revenue strategies introduced by JetBlue in recent months are working, although the airline's impressive 2Q RASM performance also reflected industry capacity cuts and shorter stage lengths associated with the E190s.

Back in April, following its first-quarter loss, JetBlue identified revenue management as the key part of its business requiring overhaul. The premise of the previous model, which worked well when crude oil was at $20-30 a barrel, was to keep costs and prices low and make substantial profits on volume and growth, but JetBlue decided that it must now sacrifice some load factor to the yield. That has meant moving towards conventional yield management and more complexity in its pricing model - strategies that European LCCs like Ryanair have used successfully since their inception.

The initiatives introduced by JetBlue's revamped revenue management team have included fare bucket adjustments and selected fare increases, including raising the highest fare (used on peak and sold-out flights) from $349 to $399. As a result, JetBlue's average fare increased by 15% or $17 to $128 in the second quarter - more than the $5-10 the management talked about in April. The load factor fell by 5.5 points; this was against the industry trend, but JetBlue could afford the decline since the resulting 82.2% was similar to competitors' load factors.

With the exception of JetBlue, which has some non-fuel cost issues to work out, US LCCs have kept non-fuel cost increases in check and maintained a significant CASM advantage over legacy carriers by improving efficiency and productivity. However, the legacy carriers' sharp cost cuts in the past few years have slightly narrowed the CASM advantage.

According 2Q stage length-adjusted ex-fuel mainline CASM comparisons provided by JP Morgan (with the CASM figures apparently adjusted to US Airways' average stage length of a little less than 1,000 miles), the difference between the highest-cost carriers (United and Continental, both 8.9 cents) and the lowest-cost carriers (AirTran 5.0 cents and Southwest 5.2 cents) was a very meaningful 3.7-3.9 cents. On a stage-length adjusted basis, JetBlue's ex-fuel CASM (6.2 cents) was a full cent higher than Southwest's. Frontier's CASM (5.9 cents) was also lower than JetBlue's. US Airways was in the middle of the pack with ex-fuel CASM of 7.1 cents - lower than the legacy network carriers but higher than LCCs'.

When fuel costs are included, the CASM picture is not pretty. With US airlines paying typically 27-33% higher average fuel prices per gallon in the second quarter, total CASM surged by typically 8-12%. JetBlue's total CASM was up by as much as 17.8%, though Frontier escaped with a mere 3.2% hike because it managed to reduce non-fuel costs by 6%. For the record, US Airways' 2Q total CASM was 11.06 cents, AirTran's 9.99 cents, Frontier's 9.39 cents, Southwest's 8.83 cents and JetBlue's 7.83 cents.

With hybrids such as US Airways emerging, and now that many LCCs are moving towards legacy-style revenue strategies, it is becoming harder to categorise US airlines. As one industry figure noted recently, all airlines now have to be low cost - relative to the revenues that they produce.

US LCCs have continued to grow rapidly. In the second quarter, both JetBlue and AirTran recorded year-over-year ASM growth of over 23%, while Frontier's capacity increased by 19%. However, Southwest's 7.2% was below its customary 10% rate, and US Airways' capacity declined by 9% because of the merger.

Strong growth is set to continue for the time being at least at AirTran and JetBlue, which anticipate 25% and 20-22% ASM increases, respectively, for 2006. Frontier is poised to grow its capacity by 15% this year. Southwest's full-year growth is expected to be about 9%, while US Airways will see a 5.8% decline. With no aircraft deliveries other than E190s scheduled until 2009, US Airways will not be a growth airline for several years.

But much will obviously depend on fuel price and RASM trends. Fuel prices are expected to remain high. While a broadly favourable revenue environment is also expected to continue into and probably through 2007, there are some concerns related to future capacity addition and the LCCs' strategies.

The key questions related to LCC prospects include the following:

• What happens when legacy carriers such as Delta resume capacity addition? There are some concerns about the potential impact of Delta's 4Q plans on LCCs such as AirTran.
• Will Southwest continue to press for higher fares, benefiting everyone? Or will it find other ways to offset its waning fuel hedges?
• Will US Airways find its progress hampered by serious trouble with its labour groups who insist on getting their fair share of the profits?
• What will be the effect of increased competition between LCCs on individual carriers?
• Will Virgin America take to the air, and if so, will it have much negative impact on JetBlue and the transcontinental market generally?
• Will LCCs keep debt leverage in check?
• To what extent will LCCs participate in the future industry consolidation process?

Southwest

Southwest reported record quarterly net earnings of $273m (excluding accounting adjustments), up 87%, on revenues of $2.45bn, which rose by 26%. The results were attributed to a 5% reduction in competitors' capacity in Southwest markets and the longstanding fuel hedging programme, which saved the airline $225m in the quarter. In addition to strong yield and RASM improvements, the load factor rose by 5.5 points.

However, Southwest's average fuel price surged by 39% (though, at $1.42 per gallon, it was still much less than what other airlines paid) because the fuel hedging programme is gradually winding down. After modestly adding to the later years' fuel hedges in the second quarter, Southwest is currently 73% hedged for the rest of 2006 at $36, 65% hedged in 2007 at $41, 38% in 2008 at $40, 34% in 2009 at $44 and 12% in 2010 at $61. The airline said that it has "insured ourselves with years of price protection that will allow time" to make changes.

Southwest has many initiatives under way to conserve fuel, including plans to install Blended Winglets on 90 future 737 deliveries, and to improve productivity and efficiency and maintain cost competitiveness. Among other things, employees per aircraft has fallen steadily from 91 to 69 in the past four years.

CEO Gary Kelly sees "tremendous opportunities" to grow the route system. Washington/Dulles will be added as the 63rd city in early October - it will complement Southwest's nearby Baltimore operations. Initial plans call for 12 daily flights to four cities. However, Kelly said that, because of the need to add flights in existing markets, the company needs additional aircraft before it can "even think about adding new cities".

Consequently, Southwest is currently pursuing additional used aircraft on top of its Boeing order commitments, which include 34 737-700s this year, 35 next year and 78 in subsequent years, as well as 116 options and 54 purchase rights. The airline said that it could easily use another 20 aircraft in the near-term based on anticipated demand in Denver, Las Vegas, Chicago, New Orleans, St Louis, Kansas City and Reno.

Southwest foresees solid revenue trends for the next several quarters and expects to "easily exceed" its 15% earnings growth goal for 2006. It has also set a 15% earnings growth target for 2007. The intention is to delay fare increases as long as possible and "use them only to offset soaring jet fuel increases", because "we know from experience that you can only raise prices so far".

Southwest is currently testing assigned seating in the San Diego markets. It would be a major departure for the airline, which has benefited greatly in the past 35 years from the efficiency of its existing boarding process.

Southwest has an excellent liquidity position, with $3bn in cash at the end of June and an unused $600m revolving credit line. The company repaid $99m in debt in the second quarter and plans to repay $470m in the second half. Southwest has also completed a $300m share repurchase programme that was authorised in May.

US Airways

US Airways posted a net profit of $305m on 14.1% higher revenues of $3.2bn for the second quarter. The result compared with a combined $46m net loss reported by the old US Airways and America West for 2Q05 and was twice as high as the $150m profit projected by the pre-merger models. CEO Doug Parker attributed the strong results to the September 2005 merger, which "has improved the earnings power and viability of both companies". The profits were impressive in light of the $183m additional fuel costs incurred as a result of the price hikes.

While US Airways will not be able to maintain 20%-plus RASM growth, the company expects to report a profit for 2006 even at the current fuel prices. The cash position is strong ($3.2bn) and the only aircraft deliveries before 2009 will be 25 E190s. US Airways' efforts focus on completing the integration of the two entities and accomplishing that without labour or service problems. The airline still needs to obtain a single operating certificate, convert to a single reservations system and reach final agreements with labour groups. The aim is to complete most of those tasks by the second half of 2007.

The biggest challenge is on the labour front, namely combining the contracts of the two pilot and flight attendant groups without increasing labour costs. The pilots issued a strongly worded response to the 2Q profit announcement, saying that after contributing billions of dollars in cost savings (during two Chapter 11 visits that preceded the merger), they will no longer tolerate the company "posting substantial profits on the backs of the pilots". The pilots cautioned that "if US Airways management intends to capture all the planned synergies of this merger and have any chance of enjoying labour peace, bankruptcy-era bargaining tactics need to end". The knowledge that pilots wanting their fair share have brought down many airlines in the past is one of the factors that has kept a lid on US Airways' share price.

CEO Parker recently reportedly sounded out Delta's leadership about a merger, but Delta made it clear that it intends to emerge from Chapter 11 as a stand-alone airline. In the 2Q call Parker merely said that US Airways has an obligation to consider a merger with Delta or Northwest because "tremendous value can be created through consolidation". Parker pointed out that, by bringing together AWA, with a market value of $200m, and $800m in new equity, the merger created a company that now has a market capitalisation of $5bn.

AirTran

After disappointing 1Q results, in the latest period AirTran nearly tripled its net profit to $32m on revenues of $528.2m, which were up by 44%. The airline was greatly helped by Delta's capacity shrinkage, which analysts estimated at about 16% in AirTran markets in the second quarter.

AirTran continues to pursue aggressive growth, but the bulk of it is adding frequencies in existing markets (lower-risk growth) - only two new cities are introduced this year. The current aim is to serve fewer but larger cities in an effort to establish a greater market presence and spread costs. Calyon Securities analyst Ray Neidl, who recently raised his recommendation on the company to "buy" on value grounds, suggested that AirTran is "reaching competitive market mass" and therefore becoming more attractive to business travellers.

However, Raymond James analyst Jim Parker, who downgraded AirTran to "market perform", expressed concern about Delta's plans to reverse some of its earlier cuts in the fourth quarter by adding 12% capacity in AirTran markets. Parker also noted that double-digit RASM increases were unlikely to continue in the third and fourth quarters in light of AirTran's planned 20%-plus ASM growth.

After taking its final two 717s in the second quarter, AirTran's fleet at the end of June consisted of 87 717s and 32 737s. In the latest period, the airline exercised options for 24 additional 737-700s for delivery in 2008-2010, completing the 100-aircraft order placed in the summer of 2003.

AirTran's non-fuel CASM will continue to decline as the mix of the larger 737s in the fleet increases; eight more aircraft are scheduled for delivery in the second half of this year. The airline also aims to keep costs down by increasing productivity, such as gate utilisation, across its system. Cash balance at the end of June was an ample $439m.

JetBlue

Following losses in the fourth quarter of 2005 and the first quarter of 2006, JetBlue reported a marginal $14m net profit on revenues of $612m for the latest period. Revenues were up by 42% but the profit was flat. The airline delivered on its RASM promises but disappointed in terms of non-fuel CASM. The 9.3% increase in non-fuel CASM was driven by an 8.4% decrease in average stage length (to 1,253 miles), charges related to stock compensation, rental costs on a new JFK terminal and lower-than-anticipated initial E190 utilisation.

CEO David Neeleman said that the "Return to Profitability" plan, announced in April, was on track. After deferring some aircraft orders in the spring, JetBlue has signed LoIs on the sale of five of its older A320s, which will be withdrawn from service by September/October. Cost cutting efforts, which are part of a targeted $60-80m in profitability improvement by year-end (also including revenue initiatives), are running slightly ahead of schedule. Following Southwest's and AirTran's lead, JetBlue is in final stages of negotiations with several GDSs.

A key part of the financial recovery strategy is to add short haul flights with the growing E190 fleet and cut back on long haul. However, recent city additions have included a wide variety of markets. In the second quarter, the airline added Bermuda, Portland (Maine), Jacksonville and Pittsburgh, followed by Charlotte and Raleigh in July. Near-term expansion will include Nashville, Aruba, Houston, Sarasota, Tucson, Columbus and Cancun (Mexico).

On the positive side, and in contrast with AirTran's situation, Delta's capacity reductions in JetBlue markets are expected to accelerate in the second half of this year. According to Neeleman, in the fourth quarter industry capacity is set to decline by 19% out of New York and by 26% out of Boston.

Nevertheless, JetBlue provided extremely lacklustre earnings guidance. The company anticipates operating margins of only 4-6% and 2-4% in the third quarter and full-year 2006, respectively, while the pre-tax result is likely to be breakeven (between -1% and +1%). In light of its stunning fall from a high-flyer with industry-leading profits to the least profitable US airline without a clear reason, analyst views on JetBlue are understandably divided, though recommendations are mostly "hold" or "sell" on valuation grounds. Merrill Lynch's Linenberg suggested that the franchise is a solid one and that JetBlue is merely experiencing growing pains, which he views as temporary. But JP Morgan's Baker cautioned investors to recall that JetBlue's peak margins occurred "not only during the airline's relative infancy but against the backdrop of meaningful legacy carrier mismanagement". In other words, Baker was suggesting that JetBlue might not be able to return to strong margins now that the legacy carriers have got their act together.

Neeleman conceded in the 2Q call that next year will be a critical year for JetBlue. Analysts have suggested that 2007 will be a year in which the airline either returns to decent profitability or scales back growth plans.

One point of concern is that JetBlue has now officially backed away from its long-stated 75% lease-adjusted net debt-to-capitalisation ceiling, which it has persistently exceeded. CFO John Harvey stated in the 2Q call that the ratio will be close to 80% by year-end as at this point there are no plans to raise equity. The airline was previously believed to be considering an equity offering this autumn, but a decline in the share price has evidently made it hesitant to further dilute existing shareholders. JetBlue is still expected to have a healthy cash position at year-end, with a liquidity ratio of 23%.

But JetBlue may have to pay higher borrowing costs as S&P, once again, cut the company's credit ratings after the 2Q results. The agency cited a weakened financial profile, with only modest improvement expected this year.

Frontier

Frontier has the industry's weakest earnings in the second quarter (the airline's first fiscal quarter), but at least it returned to profitability with a net income of $4m, compared to a $2.7m loss a year earlier. This was despite the record fuel prices and significantly escalated competition at its Denver hub, where it earns 90% of its revenues. Denver saw a 6.8% hike in industry capacity - the highest ASM increase of any US hub - as new-entrant Southwest, United and Frontier all added capacity.

Frontier's revenues rose by 27.8% to $302.1m. Its load factor was up by 3.5 points, reflecting strong demand stimulation resulting from Southwest's entry, but the 8.5% RASM improvement was among the weakest in the industry.

The brightest spot was non-fuel cost containment, which was achieved despite a 2.5% reduction in the average stage length to 917 miles. Non-fuel CASM fell by 6.1%, which was attributed mainly to continued cost benefits of operating a single mainline aircraft type. The fleet currently includes 54 A319s/A318s, plus nine CRJ-700s operated by Horizon as Frontier JetExpress.

Frontier is poised to continue expanding and diversifying its route network. In recent months it has launched a five-per-day service on the competitive Los Angeles-San Francisco route and become the first US LCC to fly to Canada (RJ service to Calgary). It is planning further expansion to Mexico, after recently receiving approvals to operate Denver-Guadalajara and seasonal San Diego-Cancun and Kansas City-Cabo San Lucas service. The airline has also secured six additional gates at Denver, to bring the total to 22 next year, to facilitate growth.

Frontier expects similar profitability in the current quarter, helped by low double-digit RASM growth. So far the airline has fared reasonably well in direct competitive clashes with Southwest, achieving higher load factors than Southwest on most routes. However, analysts are concerned because competition at Denver is set to intensify, which is likely to mean marginal profitability at best. Southwest is currently present in 18% of Frontier's markets, and that percentage can be expected to grow steadily. Frontier's stock is mainly rated "sell" or "neutral" - views that analysts say are likely to be maintained until the capacity situation changes or Frontier comes up with a good strategy to deal with Southwest and a more aggressive United. Otherwise, Frontier has ample resources - $276.5m in cash or 26% of annual revenues - to fight competitive battles.

By Heini Nuutinen

Varig: Will Volo’s rescue succeed?

Brazil's old-established airline Varig, which has been in bankruptcy since June 2005, recently averted liquidation when it was sold at a public auction to a local group called Volo do Brasil, which plans to facilitate the airline's "return to its golden age". Is Volo likely to succeed? What impact, if any, will the possible scenarios have on Gol and TAM?

Volo do Brasil, which together with US investment fund Matlin Patterson already owned Varig's former cargo unit VarigLog, acquired Varig for $24m plus a pledge to invest $485m. When the sale was finalised on July 20, much of the $24m had already been paid to keep the airline flying, but Volo was reportedly required to transfer an additional $75m to the airline within 48 hours.

Under the deal, Varig will be split into two companies: an airline-operating unit and a separate company that will assume Varig's R$7bn ($3.1bn) debt and will remain under bankruptcy protection until June 2007. Volo will take over the airline operating unit, namely the brand, routes, airport slots, fleet and FFP, plus R$245m of tickets that have been issued.

The other company, to be run by Varig's long-time controlling shareholder Ruben Berta Foundation, will remain in control of the airline's pilot training centre and various buildings and will also keep one domestic route. Revenues from those assets, including fees paid by the airline, will be used to pay back the debt.

It sounded like a good solution. Volo was the sole bidder and the only remaining hope for the airline, which has seen its situation deteriorate rapidly in recent months. In June Varig had to ground most of its fleet as it ran short of cash and spare parts and as lessors and creditors began repossessing aircraft. It was suspended from IATA for non-payment of monies to travel agents, which meant that other airlines were no longer obligated to fly its stranded passengers. When Volo took over, Varig operated only 13 aircraft out of its former fleet of 65.

The plan is to initially operate as a smaller airline, while paying debts to airports and fuel suppliers and negotiating with lessors for more aircraft. But Varig could rapidly resume growth, rehiring workers, restoring service to all destinations and operating up to 80 aircraft within six months.

Volo is seeking additional investors as

equity or strategic partners; to start with, it has held talks with ACE's subsidiary Aeroplan. According to AvNews, TAP's CEO Fernando Pinto has expressed some interest. More companies may be interested in Varig now that it is (in theory at least) debt-free.

Also, Varig recently won a breathing space for restructuring when the US bankruptcy court dealing with its case extended until September 14 a preliminary injunction that blocks lessors from seizing their aircraft. The judge set a hearing for September 13 and said that he may consider making the injunction permanent.

However, there have been some early setbacks. On July 31, a union representing Varig's workers obtained an injunction in a Rio de Janeiro labour court which ordered the airline to use the $75m cash injection to pay late wages. This may jeopardise the recovery plan, because those monies had been earmarked for paying airports and suppliers.

As a separate issue, it is shocking that Varig apparently has not paid many of its workers for three or four months. It is surprising that the consultants and lawyers did not see this coming. And it is amazing that the Brazilian government or the courts did not interfere earlier to ensure that worker wages and salaries get priority.

Volo's initial attempt to temporarily suspend all of Varig's operations except the lucrative Rio-Sao Paulo shuttle, where flights would be more than tripled, did not inspire confidence in the new owners. The proposal was vetoed by Brazil's civil aviation authorities, which ordered the airline to fly certain key routes and resume service on all of its assigned routes within 30 days or lose route authority. At the end of July, Varig was serving seven domestic cities and operating limited international flights to Frankfurt, New York, Miami and Buenos Aires.

At the end of July, the new owners also got their first taste of the difficulty of negotiating with an unhappy workforce. After letters were sent informing workers that Varig would be cutting 5,500 or almost 60% of its staff in Brazil, the airline's employees at Sao Paulo airport went on strike (they were also demanding unpaid wages from the past three months).

It is obviously highly uncertain that Volo will be able to rebuild Varig's operations. In addition to dealing with labour, the company must still fend off creditors, ward off court action and complete difficult negotiations with lessors. It will also be necessary to rebuild image and win back the trust of customers. It will be tough to make a comeback after the sharp market share deterioration; after all, many customers have had a chance to try out competitors.

Are the funding plans adequate? In late June, Merrill Lynch analyst Mike Linenberg estimated that a new Varig owner would need to spend at least $150-200m just to get all the aircraft flying again - making lessors whole, required maintenance, etc. At that time the airline still had 19 aircraft in operation.

The biggest concern that many analysts have is that the rescue plan offers nothing that would solve Varig's problems. Among other things, the airline needs to reduce its costs. Consequently, some analysts take the view that the Volo deal has merely delayed the inevitable. Others feel that Varig will slowly improve but remain much smaller than in the past. That said, Brazil is a strong growth market. With air travel increasing at a double-digit rate, and given Varig's strong brand, the airline may be able to recover some lost ground.

Whether Varig recovers or disappears, does it make much difference to the two high-flyers Gol and TAM? Not really. As Calyon Securities analyst Ray Neidl recently pointed put, TAM's and Gol's models work on their own, regardless of what happens to Varig. Neidl suggested that any share price weakness is an opportunity to buy into these carriers.

Both TAM and Gol have already benefited significantly from Varig's shrinkage over the past year, and any additional benefits even in the event of a shutdown would be of a lesser degree. However, certain assets, such as Varig's domestic slots, would always be appreciated.

The past year's market share gains have been substantial, and the trends accelerated sharply from May to June. Between June 2005 and June 2006, Varig's domestic RPK share plummeted from 24.7% to 10.5%, while TAM's increased from 40.5% to 47.6% and Gol's from 27.4% to 35.1%. Internationally, in the same period, Varig's RPKs declined from 78% to 53.8%, while TAM's increased from 17.8% to 37.9% and Gol's from 2% to 5.6%.

One consequence of Varig's troubles has been more aggressive price cutting this summer. In addition to what one analyst described as "desperation pricing" by Varig, Gol and TAM have also priced aggressively to maximise their market share gains. Gol and TAM apparently also did not want to appear to be price gouging with Varig cutting back. However, now that Varig's market share is dipping below 10%, the price pressures are easing.

TAM and Gol have said that, in the event of a Varig shutdown, they believe that the domestic routes would be awarded to other Brazilian carriers on the basis of their existing market share. However, there was some speculation earlier that the government might favour the smaller carriers to prevent TAM and Gol totally dominating the market.

While both Gol and TAM would benefit internationally, TAM could gain disproportionately because it is the only local airline that already serves North America and Europe. However, both airlines have made it clear that they have their own growth plans and do not find many of Varig's international routes very attractive. American, which already dominates the Latin America region, would be among the major beneficiaries.

Both TAM and Gol have announced service expansion and added to their aircraft order books this summer, to take advantage of opportunities arising from Varig's shrinkage and to cater for strong market growth.

In late June TAM signed an MoU for 37 additional Airbus aircraft (15 A319s, 16 A320s and six A330s), for delivery through 2010. This was in addition to last year's order for 29 A320s and 20 options. The aim is to ensure growth in the domestic market, replace 100-seat Fokker 100s and facilitate "selective profitable growth in the international segment". TAM will operate 96 aircraft by year-end and 127 by the end of 2010.

TAM recently announced plans to add Asuncion (the capital of Paraguay) and Buenos Aires to its network. Daily A330 flights from Sao Paulo to London will begin on October 28. The airline has secured prime slots at Heathrow, allowing immediate connections at both ends, and will be targeting primarily business traffic with the three-class service. TAM's long-haul network already includes Paris, New York and Miami.

Gol also added to its order commitments in late June, announcing that it will take four additional 737NGs in the 2006-2008 period. The aim is to meet strong domestic demand. The fleet is scheduled to grow from 50 aircraft at the end of June to 96 by 2011, and there are 34 options on top of that. This year is seeing dizzying 45% ASK growth, somewhat reducing to 30% in 2007.

Gol is poised to continue expanding its network throughout South America, but the airline currently does not have plans to add widebody aircraft to its fleet. The planned Mexican joint-venture LCC start-up is still awaiting regulatory approval.

		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	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	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
	Apr-Jun 06	5,975	5,499	476	291	8.0%	4.9%	71,774	59,314	82.6%		86,500
America West	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
	Apr-Jun 06	981	920	61	68	6.2%	6.9%	14,144	11,589	81.9%	7,377	12,766
Continental	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	
	Apr-Jun 06	3,507	3,263	244	198	7.0%	5.6%	45,477	37,605	82.7%	17,596	
Delta	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	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	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
	Apr-Jun 06	2,449	2,047	402	333	16.4%	13.6%	36,827	28,716	78.0%	21,999	31,734
United	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
	Apr-Jun 06	5,113	4,853	260	119	5.1%	2.3%	64,499	54,541	84.6%	18,228	53,500
US Airways	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	
	Apr-Jun 06	3,191	2,849	342	305	10.7%	9.6%	37,666	30,683	81.5%		
JetBlue	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
	Apr-Jun 06	612	565	47	14	7.7%	2.3%	11,590	9,533	82.2%	4,525	9,377

** = 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/	Apr-Jun 04	5,394	5,205	189	115	3.5%	2.1%	48,944	38,025	77.7%		
KLM Group	Jul-Sep 04	6,328	5,964	364	248	5.8%	3.9%	57,668	46,767	81.1%		
YE 31/03	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	Jul-Sep 04	3,645	3,213	432	221	11.9%	6.1%	36,639	28,749	78.5%	9,822	46,179
YE 31/03	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	Apr-Jun 04	1,461	1,371	90	95	6.2%	6.5%	14,743	11,106	75.3%	6,913	
YE 31/12	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**
	Jan-Mar 06	1,457	1,536	-79	-54	-5.4%	-3.7%	15,689	11,876	75.7%	6,300	23,772
	Apr-Jun 06	1,816	1,753	63	44	3.5%	2.4%	16,809	13,420	79.8%	7,461	24,109
Lufthansa	Apr-Jun 04	5,269	5,045	224	-28	4.3%	-0.5%	36,440	26,959	74.0%	13,336	
YE 31/12	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	
	Apr-Jun 06	6,529	6,203	326	142	5.0%	2.2%	37,797	28,603	75.7%	14,106	
SAS	Jul-Sep 04	2,099	1,860	239	9	11.4%	0.4%	13,557	9,198	67.8%	8,591	
YE 31/12	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**
	Jan-Mar 06	1,078	1,064	-150	-137	-13.9%	-12.7%	12,275	8,179	66.6%	8,532	31,528
Ryanair	Apr-Jun 04	366	288	78	64	21.3%	17.5%			83.0%	6,600	2,444
YE 31/03	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
	Year 2005/06	**2,045**	**1,598**	**447**	**371**	**21.9%**	**18.1%**			**83.0%**	**34,768**	**3,063**
	Apr-Jun 06	711	539	172	146	24.2%	20.5%				10,700	
easyJet	**Year 2002/03**	**1,553**	**1,472**	**81**	**54**	**5.2%**	**3.5%**	**21,024**	**17,735**	**84.1%**	**20,300**	**3,372**
YE 31/03	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**
	Oct-Mar 06	1,095	1,177	-82	-50	-7.5%	-4.6%	16,672	13,642	81.8%	14,900	

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
May-06	27.2	19.1	70.1	20.6	17.1	83.1	15.3	11.6	75.8	49.7	39.1	78.6	73.7	55.8	75.7
Ann. change	4.5%	6.6%	1.4	1.2%	0.6%	-0.5	9.0%	12.3%	2.2	4.1%	5.4%	1.0	4.7%	6.0%	0.9
Jan-May 06	124.8	81.8	65.5	88.9	70.9	79.7	74.2	58.7	79.1	234.9	187.6	79.9	344.8	260.6	75.6
Ann. Change	2.9%	5.8%	1.8	0.9%	0.6%	-0.3	10.5%	12.8%	1.6	4.8%	5.8%	0.7	4.6%	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
Jun 06	82.7	70.3	85.0	17.8	15.8	88.8	9.8	8.8	89.7	8.9	6.8	77.0	36.5	31.5	86.2
Ann change	-4.6%	-2.2%	2.0	11.6%	11.3%	-0.3	-0.6%	0.3%	0.8	2.5%	7.5%	3.6	5.8%	7.2%	1.1
Jan-Jun 06	483.8	387.5	80.1	89.3	71.8	80.4	58.2	48.5	83.3	55.1	41.8	75.7	202.7	162.1	80.0
Ann change	-3.6%	-0.1%	2.8	6.7%	5.0%	-1.3	1.8%	3.0%	0.9	2.0%	6.4%	3.1	4.0%	4.7%	0.6

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	17 Jul	Lion Air	30 x 737-900ER	2010/12	exercised purchase rights
	17 Jul	Load Air Cargo	2 x 747-400ERF	2009	
	18 Jul	Pegasus Aviation	6 x 787-800	2009	
	18 Jul	Av. Capital Group	14 x 737-800		
	19 Jul	ILFC	6 x 737-800, 2 x 777-300ER, 2 x 787		
	21 Jul	Futura	3 x 737-800	2009/10	plus 3 options
Airbus		Go Air	10 x A320		plus 10 options
		Air caraibes	1 A330-300		
		ILFC	6 x A320		
		Air Asia	40 x A320		plus 30 options
	19 Jul	Aegean A/L	3 x A320	2007/09	IAE V2500
	20 Jul	CIT	5 x A330-200, 4 x A320		
	20 Jul	Wizz Air	20 x A320		
Embraer	24 Jul	Republic A/L	30 x E175		converted options
Bombardier					

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

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