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Amazing AZ

The Italian government probably feels more than a little relieved that it received 11 expressions of interest in buying at least 30% of Alitalia, including such illustrious private equity names as Texas Pacific Group and Cerberus Capital Management. There were also interesting bids among the 11 - from Porcellano Castello, a consortium of 70 families from the Bologna region whose idea is to turn Alitalia into a 5-star luxury airline, and from a Roman schoolteacher who is apparently a disgruntled Alitalia customer.

There was, as expected, no bid from SkyTeam partner Air France/KLM. The resignation of Jean-Cyril Spinetta, the Air France CEO, from the Alitalia Board has left it inquorate, and the Alitalia CEO Giancarlo Cimoli is reported to be leaving as well. The second Italian carrier, Air One, did however put in a bid, through a vehicle called AP Holding.

The valuation of Alitalia has been widely reported as being around the €2bn mark. But could the airline possibly be worth almost as much as, say, 25% of Ryanair? Its stockmarket share price, buoyed by bid speculation, indicates a value of €1.2bn. Moreover, the airline's recent financial performance has deteriorated again - losses for 2006 are likely to be around €400m, double those of 2005. This brings Alitalia's accumulated losses since 2000 to €3bn, about 9% of turnover. The airline's net debt is about €1.2bn, plus another €1.2bn in capitalised lease commitments.

The situation poses some tricky questions for private equity investors:

- Banks considering leveraging a deal will have to take into account the existing level of debt as well as the capex that will be required to replace the ageing MD80 fleet, some €3bn; presumably state guarantees for loans are out of the question
- Selling off assets or downsizing will likely be fiercely resisted by the unions, management and politicians; adding to Alitalia's regular strike-days will allow competitors, especially the LCCs, to further increase their growing share of the Italian market
- Designing a new turn-around strategy is perfectly feasible but implementing it is another matter; it appears that there are too many vested interests determined to preserve the status quo at the flag-carrier and procrastinate until the government or the relevant government minister changes
- Bringing in an airline partner would be the most politically acceptable way to provide a catalyst for turn-around; this idea dates back to Alitalia's wooing of SAS in the late 80s, was almost consummated with KLM in the late 90s but ended acrimoniously, and has now been rejected by Air France

Perhaps we are being too cynical and there actually is an effective refinancing and restructuring strategy for Alitalia - the binding bid stage of the process may unveil an unexpected solution.

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With demand for traditional package tours falling fast, German airlines that still have large amounts of charter business are frantically trying to convert themselves into fully-fledged scheduled operators, usually with a city-to-city LCC business model. But even this may not be sustainable, as Air Berlin's acquisition of dba in 2006 has put further pressure on the other players in Germany to either merge or to find a secure parent with very deep pockets. Talks - formal and informal - have been and are being held between virtually everyone in the German aviation industry.

Air Berlin and dba

Air Berlin is the third-largest LCC after easyJet and Ryanair, and the second largest airline in Germany, but after a troubled IPO in May 2006 (see *Aviation Strategy*, May 2006) the carrier cemented its position through buying rival dba in August for a price that was in the "mid-two figure millions" [€250m], according to Joachim Hunold, CEO of Air Berlin. dba was acquired from various shareholders including Intro Verwaltungsgesellschaft (59.9%) - a holding company for businessman Hans Rudolf Wohrl that bought Deutsche BA from British Airways back in 2003 - and from Aton (25.1%), a company controlled by businessman Lutz Helmig.

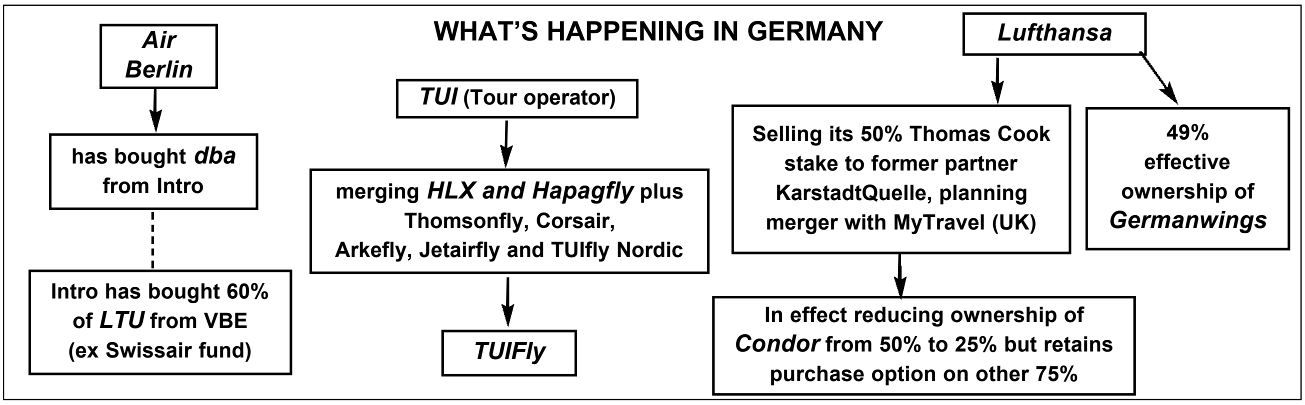
The acquisition was approved by Bundeskartellamt - the German competition regular - in September last year on the grounds that there was little overlap between the domestic network of dba (although it also operates some international routes and charter flights) and the scheduled European network of Air Berlin (it started low-fare city services back in 2002), and that the deal would provide better competition to the domination of Lufthansa

From Air Berlin's point of view, the deal is a good match, giving Air Berlin access to valuable dba slots at Dusseldorf and Munich. The first joint schedule will operate from this summer's timetable (starting in April), with dba aircraft being used on Air Berlin routes to leisure destinations during the summer dip in domestic business travel, with larger Air Berlin aircraft already being used on the busier domestic dba routes over the winter season.

Following the acquisition, Munich-based dba is continuing to operate as an independent company according to Air Berlin, although it is now being marketed as Air Berlin "powered by dba". dba has a fleet of 30 737 and F100 aircraft, the latter arriving after dba bought and incorporated LCC Germania Express into its operations in early 2005 (although the Germania Express brand still exists).

The deal also gives Air Berlin access to more than 70 corporate clients of dba, whom are valuable given Air Berlin's focus on the business travel market and its desire for passenger growth of 10%-15% per annum for the next few years. That planned growth will be fuelled by a huge increase in the Air Berlin fleet - it currently comprises 58 A320 family, 737 and F100 aircraft, but there are 50 aircraft on firm order and another 42 on option, while an order for another 60 aircraft is imminent.

After previously being a loyal Boeing customer, in 2004 Air Berlin decided to lessen its dependence on one manufacturer by placing an order for 70 aircraft in partnership with Niki (in which it owns 24%), of which 15 A319s and 35 A320s are outstanding. Air Berlin also has options for another 40 A320s, and a decision is expected to be made on these sometime this year. This order came about partly because Airbus was very aggressive with its pricing, but in late November 2006 Boeing appears to have struck back after Air Berlin announced an intended order for 60 737-800s for delivery over 2007-2014, which at list prices are worth $5.7bn - although, inevitably, the German LCC will receive a substantial



discount (40-50%?) on that when the firm order is agreed.

Although the Boeing aircraft will partly replace the current 42-strong 737 fleet (many of which are leased), some will be used for growth - yet the news of the impending order was received poorly by the German stock market, with the airline's shares dropping by 13% on the day the news was announced (from €16.24 to just above €14.00; the share price as at the end of January was around the €16.00 level), even though at the same time the airline released encouraging third quarter 2006 results. In the July-September 2006 period (in which dba results were included for September only) Air Berlin reported a 26.5% rise in net profit to €38.7m, based on a 28% rise in turnover, to €510m, with a 1Q-3Q net profit of €37.7m, compared with a €12.5m net loss in January-September 2005.

However, at the same time as these results were issued Air Berlin's earnings forecast for the full year was reduced slightly (to €40m), due to higher than expected costs for the IPO and to the effect of the terrorist attacks in London and Turkey during the year. As Air Berlin only turned ongoing operating losses into profits through the second and third quarters of 2006 (after the introduction of a series of efficiency measures in 2005 and 2006), analysts remain cautious about the future, particularly given the substantial planned increase in capacity. In addition, Air Berlin will also have the use of 25 737-700s that are on firm order for dba, which brings to 85 the total of 737s that Air Berlin will receive over the period to 2014, once the November 2006 "order" is formally placed.

Part of the reason for Air Berlin's aggressive ordering is the difficulty it has had in leasing aircraft at anything other than very high rates, and so it has made a strategic decision to own its fleet going forward, rather than being at the mercy of market lease rates. But though this may be logical, the size of the orders also means that Air Berlin will be placing a large amount of new capacity (around an extra 10% a year over the next eight years) into a market where competition is fierce.

The combined Air Berlin/dba already carried 19.7m passengers in 2006, 12.6% up on 2005, with Air Berlin carrying 15.2m and dba 4.5m (compared with Air Berlin's 13.5m and dba's 4.0m in 2005). Load factor for the year was 75.3%, up slightly on the 75.2% of the combined airlines' totals for 2005.

The acceleration in Air Berlin capacity increases is already starting to appear, and this summer there will be a rise in capacity to Majorca of around 20%. Flights to Palma already account for 5m passengers - almost one-third of the total passengers that Air Berlin carried in 2006 - with a hub in Palma connecting flights from Germany through to destinations in the rest of Spain and Portugal. In November Air Berlin also launched a hub operation at Zurich, with feeder flights from Germany and Austria connecting onto routes to leisure destinations in the Canary Islands.

Eastern Europe is another target for Air Berlin. The airline entered the Russian market for the first time in December last year with routes from Nuremberg to Moscow and St. Petersburg, both of which are up against competition out of Germany from germanwings. Yet the biggest challenge to Air Berlin continues to come from Ryanair and easyJet.

AIR BERLIN/DBA FLEETS

	Fleet	Orders (options)
Air Berlin		
A319	4	15
A320	10	35 (40)
737-400	1	
737-700	5	
737-800	35	(2)
F100	3	
Total	**58**	**50 (42)**
dba		
737-300	14	
737-500	1	
737-700		25
F100	15	
Total	**30**	**25**
Air Berlin/dba total	**88**	**75 (42)**

Last year Air Berlin and the Federation of German Airlines (BDF) took Ryanair to court over subsidies paid by Lubeck airport to Ryanair, which Air Berlin claimed allowed Ryanair to offer passengers "dumping fares", thereby forcing it to close a route to London out of nearby Hamburg airport. As a result, a court in Kiel ruled that the subsidies were "unreasonable", and that the airport had to disclose the terms of its deal with Ryanair. But this is more of a moral victory than anything else since Lubeck is now in private hands, and Air Berlin's real defence against the bigger LCCs is to develop scale in its own markets and routes.

As expansion continues Air Berlin may start running into union troubles. Air Berlin is increasing salaries by just 3% this year, although it expects operating profit to increase by at least 30% in 2007, ahead of a 15% forecast rise in turnover. That is believed to be causing unease among some of its staff, particularly as the carrier does not recognise unions - although Vereinigung Cockpit and others are attempting to change the situation.

These worries aside, Air Berlin is undoubtedly the strongest of any German airline after Lufthansa, and it looks certain to play an acquisitive role in the German aviation industry over the next few years - as long as the German regulator will allow it.

Following the co-ordination of flight schedules between Air Berlin and Hapagfly for the last two years, speculation persists about a possible Air Berlin/TUI alliance - although this has been denied by Hunold, who insists that no merger talks have been held recently. That may be so, but informal negotiations were held in late 2006 between Air Berlin and the TUI group about potential co-operation between dba and Hapag-Lloyd Express (TUI's budget airline, which is now being integrated into TUIfly - see below). While Air Berlin and Hapagfly already codeshare on selected holiday routes, an extension into partnering on low-fare city routes operated by dba and Hapag-Lloyd Express may make strategic sense, although it's unlikely to evolve into anything more permanent in the short- and medium-term.

With 61.5% of Air Berlin now on free float - with the remainder being held by individual investors including Hans Joachim Knieps (9.1%), Joachim Hunold (3.5%), Johannes Zurnieden (1.7%), Rudolf Schulte (4.5%), Severin Schulte (4.6%) and Werner Huehn (5.5%) - pressure from shareholders for Air Berlin to be constantly dynamic may encourage the airline to be aggressive in terms of acquisitions over the next few years. If that's the case, Air Berlin will have plenty of targets to choose from if it wants to buy German.

HLX and Hapagfly

Hapag-Lloyd Express (HLX) is based at Hannover-Langenhagen airport and operates 16 737s aircraft on scheduled routes to 30 European destinations, while Hapagfly, also based in Hannover, uses 34 (mostly Boeing) aircraft for primarily charter flights on a network of around 40 leisure destinations (with some scheduled routes).

Both airlines are subsidiaries of giant German tour operator TUI, but although HLX was launched in 2002 as a standalone low fare, low cost carrier that would help compensate for the trend away from package holidays, the airline has proved to be insufficient in stemming the continuing troubles at TUI's tourism operations.

Over the past decade TUI has refocused from being an industrial conglomerate into becoming a specialist tourism and air transport company, but in 2005 the group expanded its small shipping business into a second business division. However, TUI's core is still what it calls its tourism business (which includes everything from its multitude of tour operators to no less than seven airline operations), and it's this business that has faced increasing problems. The tourism division has undergone deep cost-cutting and more than 6,000 job losses in the last few years, with the group trying to reduce volumes and increase margins - a policy that most major tour operators are already following across Europe

However, it wasn't until after a strategic review carried in early 2006 that TUI group came to the conclusion that the traditional charter market is falling away in favour of self-assembled holidays, with LCCs picking up an ever increasing share of the flight part of these self-assembled trips.

In August last year, alongside several changes in senior management, TUI took the decision to dispense with its confusing portfolio of airlines and brands, merging them all into one airline that would gain most of its revenue from seat-only, scheduled flights. The first stage of this process is the merger of Hapagfly and Hapag-Lloyd Express this year into a new airline, to be called TUIfly, and to be run as a low cost operation with an emphasis on low fares in its marketing.

In 2008 the five other airlines that TUI owns - Thomsonfly in the UK (with a fleet of 47 737s, 757s and 767), Corsair in France (10 A330s and 747s), ArkeFly in the Netherlands (five 737s and 767s), Jetairfly in Belgium (eight 737s, 767s and F100s) and TUIfly Nordic (five 737s and 757s) - will be rolled into TUIfly, with the cost standards adopted at HLX being the model for all airline operations in the new TUIfly. In the summer of 2006 pilot union Vereinigung Cockpit agreed a unified pay scale for its members at Hapagfly and HLX, under a deal that lasts until 2008, and this agreement is to be pushed by management as the basis for all future TUIfly pilot contracts.

Once the seven airlines are merged and re-branded, TUI expects the move to boost net profits by at least €60m in 2008, with the combined fleet operating at least 120 aircraft and carrying around 25m passengers a year. But as the combined totals of the seven airlines that will make up TUIfly now amounts to 159 aircraft, this means that up to 39 aircraft will be disposed off, and these are most likely to be the larger aircraft currently used for short- and long-haul tour operator flights, which are not seen as being appropriate for the refocus on a city-to-city network. Between them, the seven constituent airlines of TUIfly own or lease 75 737s (of which 53 are -700 and -800 models), and these will be the core of the fleet going forwards.

In addition, in December 2006 the TUI group ordered 41 Boeing aircraft for delivery over 2010-2013 (with models yet to be specified, but likely to be 737s, with potentially a handful of 787s), which with 24 aircraft already on order bring total outstanding orders to 65. All of these aircraft will replace aircraft currently on leases, although TUI is considering establishing a joint venture with an established leasing company in order to manage and finance the aircraft.

TUIFLY'S FLEET

	Fleet	Orders (options)
Hapagfly		
A300	1	
A310	1	
737-700		1
737-800	32	3 (2)
Total	**34**	**4 (2)**
Hapag-Lloyd Express		
737-500	5	
737-700	8	
737-800	3	
Total	**16**	
TUIfly total	**50**	**4 (2)**

While a TUIfly.com internet site was launched this January, the first part of the process, the merger of charter carrier Hapagfly and low fare airline Hapag-Lloyd Express, will occur with the summer 2007 schedule, and this will create an airline with a fleet of 56 aircraft that will carry an estimated 13.5m passengers in 2007 (up from 11.5m in 2006). This summer TUIfly - which will be based at Hannover airport - will operate to 75 destinations in 17 countries, and TUI group says that the "marketing strength" of HLX will be the key to its success.

However, this initial merger will also include the cutting of 200 jobs (that will all be "administrative", according to TUI), which with other savings will reduce costs by €40m a year. The staff reduction will be part of an overall cut of another 3,500 to 4,000 positions at the tourism division of TUI, most of which are coming from TUI's tourism concerns outside of Germany.

The reaction to the airline merger from analysts is mixed - many welcome the move but some are critical, with Merrill Lynch telling clients that although the merger may bring some reduction in costs, there was no sign that the airlines were going to undertake "significant capacity cuts", which the bank said was necessary for improvement at TUI's airlines.

Indeed it's difficult to see how the new TUIfly will seriously affect the troubles at the tourism division as a whole, given the trend away from the traditional package holiday not just in Germany but in the whole of western Europe. While HLX is believed to have made a profit in 2005 and 2006, TUI's tourism division saw operating losses increase through the first half of 2006, which led to a profit warning being issued by the group in August 2006. (TUI's 2006 results will not be available until the end of March).

And while the new TUIfly will be run on a "low cost" business model, it will still have to serve both the leisure and scheduled markets, as most of Hapagfly's charter seats are sold to TUI's various tour operator brands and that need for charter capacity at TUI will still exist for some considerable time, even if the market is declining.

TUI Group says that the merged Hapagfly/Hapag-Lloyd Express operation expects to get 60% of its revenue from low fare, point-to-point traffic and 40% from the tour operator business, and to achieve this there will be a substantial rise in the amount of scheduled business; the summer 2007 schedule, for example, is 25% up on the combined capacity of the two airlines as of last summer.

But while the merged operation will allow aircraft to increased daily utilisation rates to above 12 hours per day, many aircraft will operate both city-pair flights and charter flights on the same day, and this may present problems in terms of continual changes to the product needed for different flights. TUI admits that its charter passengers will not accept a "no-frills" onboard service, and hence the onboard product will have to change flight by flight.

This mixed functionality makes the future for the TUIfly even more uncertain. At the same time as the merger announcement, TUI group appointed board member Peter Rothwell to head up all tourism operations, including the aviation units that are being merged into TUIfly, and TUI group now says that it is examining "strategic options" for its airlines.

Once TUI's airlines are merged, many analysts believe a sale of TUIfly is inevitable, and some believe it will come sooner rather than later in order to get rid of fixed costs that the group would rather not have (particularly given that the TUI group is keen to reduce its debts of around €3bn). And while the tourism division will still need access to cheap seats for its package holiday products, this could easily be achieved via a long-term contract with whomever TUIfly is sold to. Of course this would not be a problem if TUI ever decides that the pressure on the tour operating market will just get worse, and that "tourism" is a business it no longer wants to be part of. Although there is no firm evidence that TUI may go down this path at the moment, at the same time as TUI considered extending its existing codesharing with Air Berlin from charters to city-to-city flights late last year, unconfirmed reports suggested informal "side talks" held at the time also explored the possibility of TUI withdrawing from air transport altogether (reports that TUI firmly denies).

So if - or when - TUIfly is sold, who are its potential acquirer/partners? A TUI/Condor alliance is often talked about in the German press, and indeed a merger with Condor was one of the options recommended to TUI by Roland Berger, the consulting firm the group hired in 2006 to explore its options, according to reports in the German press. But there may also be potential buyers outside of Germany, although until TUIfly completes the integration of seven diverse airline operations and clears away the mish-mash of aircraft models, its unlikely that any serious moves will be made to sell TUIfly until 2008 at the earliest.

LTU International Airways

LTU International Airways is based at Dusseldorf airport and operates to more than 80 destinations around the world, both on short- and long-haul. Previously a charter specialist, LTU became part of the Swissair empire when a 49% stake was bought. It in effect went bankrupt when Swissair collapsed and was rescued through a ‘state aid’ loan provided by the state of NordRein-Westphalia. After a restructuring programme, in 2005 LTU began low fare services on selected city routes after its short-haul charter routes came under intense pressure from LCCs. LTU also began to build up long-haul routes, and in several markets (e.g. to Thailand) it started flying all year-round, rather than in just the peak holiday season.

Today the airline considers itself to be a low fare (but not low-frills) airline, with all but a handful of LTU's flights being operated as scheduled services - although much of its capacity is still sold to German tour operators that include TUI, ITS, Tjaereborg and Jahn Reisen.

Following a €200m recapitalisation structured by Deutsche Bank (which cleared the state aid loan), Intro Verwaltungsgesellschaft bought a 60% stake in LTU in early 2006 (buying the 49.9% stake previously held by Swissair (and since 2001 held in a special fund) and 10.1% owned by CKA, a German finance company that is owned by banking group Sal. Oppenheim). Later that year, Intro sold 24% of its shares to Marbach Beteiligung und Consulting, a holding company for Jurgen Marbach, the LTU CEO, and then bought the 40% stake held by Rewe. This increased Intro's share to 76%, before it sold another 21% to Marbach, thus bringing the shareholding as it currently stands to 55% for Intro and 45% to Marbach.

Intro's intention for LTU is to repeat the success it had with its investment in dba, which after a restructuring was subsequently sold. LTU therefore began a year-long restructuring programme in August 2006 aimed at returning the airline to profitability in 2007. Key to the restructuring is the belief of Hans Rudolf Wohrl, the owner of Intro (and chairman of LTU), that LTU was slow in spotting the trend to seat-only sales booked via the internet, and that the focus has to switch more quickly from tour operators to seat-only direct bookings (as practised by Air Berlin and Condor). Last summer LTU revamped its internet site in order to allow more flexibility in booking flights, and this May the airline is launching routes from Dusseldorf to Los Angeles and Las Vegas, to add to existing routes to New York, Miami and Fort Myers.

After losses in both 2004 and 2005, LTU is believed to have made a loss in the region of €15m-€20m in 2006, but following restructuring Wohrl expects the airline to get back into profitability during 2007, with LTU fully repositioning itself as a scheduled airline.

After that, the future of LTU will depend on who is interested in acquiring it. Former owner Rewe had been looking to offload its stake for some time, but found few interested buyers at the time - though post-restructuring, LTU should be more attractive. Prior to Air Berlin's acquisition of dba, LTU had particularly close links with dba, but Marbach has stated that Condor would be the best merger partner for LTU, as "our business model is almost identical", with many potential synergies. Intro too is thought to consider Condor as the best bet for LTU in the long-term, but an LTU/Condor merger would be problematical for the German regulatory authorities as this would mean there would be just one airline left that catered for the inclusive tour market.

LTU'S FLEET

	Fleet	Orders (options)
A320	10	
A321	4	
A330-200	8	1
A330-300	3	
BAe 146	1	
Total	**26**	**1**

Intriguingly, LTU briefly contemplated buying collapsed Spanish airline Air Madrid in January, although it quickly because apparent that this was not a viable option. However, LTU's interest attracted approaches form several parties (including San Jose, a Spanish construction group) over the possibility of launching a new long-haul airline out of Madrid that would operate of some of the routes that Air Madrid did. Potentially this could have reemployed up to half of the former Air Madrid' staff as well as taking over some of the aircraft lease contracts held by Air Madrid, but as at end of January nothing definite had developed, and the idea looks to have died.

germanwings

Essentially a business-oriented airline with a lower cost base rather than a genuine LCC, germanwings operates a fleet of 24 A319s and A320s to more than 50 destinations out of its home base of Cologne/Bonn airport, as well as from Stuttgart, Berlin and Hamburg. The airline is a subsidiary of Eurowings, which is owned 49% by Lufthansa and 50.02% by businessman Dr Albrecht Knauf, who is also chairman of Eurowings. Lufthansa has operational control of germanwings, which (in contrast to the importance of Condor) is a key part of Lufthansa group strategy to fight the challenge of Air Berlin, Ryanair and easyJet (see *Aviation Strategy*, July/August 2006).

germanwings plans to expand operations considerably over the next few years, as the first of 18 A319s on order arrived in 2006 and the fleet is scheduled to rise to 40 aircraft by the end of 2009, with five A319s arriving in 2007, seven in 2008 and four in 2009. Another 12 aircraft are on option.

That expansion has already begun, and last year germanwings added six destinations out of Cologne/Bonn - to Alicante, Jerez, Anatalya, Heraklion, Göteborg and Danzig - while Stuttgart-Anatalya and Berlin-Ibiza were also launched during the year. Further routes were added in the winter 2006/07 timetable, but another major expansion will come in the summer 2007 season, with two extra aircraft stationed at Cologne/Bonn providing capacity for eight new destinations out of the airport - Burgas (Bulgaria), Sarajevo, Sofia, Zadar (Croatia), Varna (Bulgaria), Alghero (Sardinia); Kavala (Greece), and Bucharest. There will also be an extra aircraft at Stuttgart, with a new route to Corsica, while a Hamburg-Mallorca service is starting and another A319 at Berlin-Schonefeld will be used to increase flights by 30% over the summer, with new routes to Mykonos, Burgas, Varna and Balaton (Hungary).

Berlin-Schonefeld is regarded by germanwings as having substantial potential for growth, with the airport being promoted as an alternative to Tegel for both business and leisure passengers. germanwings will station three aircraft at Schonefeld this year, serving 16 destinations, and the airline is targeting 1.8m passengers out of the airport in 2007 (compared with 0.3m in its first year of operation - 2002). Management expects its share of passengers there to keep rising from the current 20%, despite competition from Air Berlin, easyJet, Condor Berlin and Norwegian Air Shuttle.

More than half of the routes being added over the summer are to eastern European destinations, including Bulgaria, Macedonia, Romania and Croatia, and germanwings believes there is still much potential for growth into these countries, particularly on routes not currently served by flag carriers or LCCs. Apparently the majority of profits made by germanwings in 2006 was generated by the longer routes to Moscow (a Hamburg-Moscow service was launched in October, bringing routes to the Russian capital up to four) and to St Petersburg, and the airline wants to add more higher margin routes to eastern Europe rather than lower margin routes down to the Mediterranean, whether there is more direct competition,

GERMANWINGS' FLEET

	Fleet	Orders (options)
A319	21	16 (12)
A320	3	
Total	**24**	**16 (12)**

In 2006 germanwings reported a 39% rise in revenue to €560m, based on a 31% rise in passengers carried, to 7.1m. This is slightly less than originally targeted (€570m revenue and 7.5m passengers), although the airline believes this is good result given the increasing competition in the German aviation market. Although a net profit figure was not released, company sources indicate the profit levels were the highest ever since the airline was launched in 2002.

germanwings is looking to increase revenue by 15% in 2007, based on an increase in passengers flown to 8m, but with 16 more aircraft arriving over the next few years the airline is looking to expand not just its routes but also its number of bases. Currently 12 aircraft are stationed at Cologne/Bonn, with six at Stuttgart, two each at Berlin and Hamburg, and the other two being "spares". By 2009, 18 aircraft will be based at Cologne/Bonn, but expansion potential out of there and at the other bases (other than Schonefeld) is thought to be limited in the long-term. Therefore a fifth base is likely to be open sometime this year, and potentially this could be outside of Germany, with germanwing's analysts looking at a number of options in east Europe and the Mediterranean region.

germanwings' expansion over the next few years is being driven by Thomas Winkelman, managing director of the airline since his predecessor, Andreas Bierwirth, became marketing director at Lufthansa in September 2006. He will also increase germanwing's drive into the business market, Last year the airline launched an FFP called the "Boomerang Club", - claimed to be first FFP for an LCC in Europe - and it already has more than 50,000 members, with participants acquiring rewards not just for germanwings flights but also for bookings with car rental and hotel partners. germanwings looks set to be part of Lufthansa's empire for the foreseeable future, and that position will only change if Lufthansa group manages to impose an LCC-type cost basis onto its Economy Budget operations in the mainline Lufthansa - a scenario that appears highly unlikely.

Condor

Frankfurt-based Condor is undergoing another change of ownership as by the end of the first quarter of 2007 KarstadtQuelle, the German retail and mail order group, will complete a previously-announced deal to increase its stake in tour operator group Thomas Cook to 100%, by paying €800m for the 50% stake held by Lufthansa.

Condor operates to more than 60 leisure and city destinations across the globe with a fleet of 22 757s and 767s, while subsidiary Condor Berlin operates charter flights out of Schonefeld airport with 14 A320s.

In an attempt to diversify away from reliance on the traditional holiday markets to the Mediterranean and northern Africa, as well on long-haul holiday flights to Asia, Africa and the Americas, in 2004 Condor introduced seat-only sales (using Air Berlin as a "benchmark"). These grew rapidly to account for a third of all revenue within just 12 months, and in 2005 diversification continued with the launch of city-to-city services out of Munich to 10 foreign destinations, six of which were in Italy. In addition, Condor underwent restructuring in 2005 and 2006 that knocked €160m off the annual cost base, half of which came from fewer staff and better productivity. Condor expects 2006 net profits to fall compared with the €20m net profit of 2005, thanks mainly to higher fuel costs, although it is aiming to increase profits to at least €80m by 2008.

The aforementioned KarstadtQuelle deal has yet to be approved by the relevant regulatory authorities, but the flag carrier is desperate to sell its Thomas Cook stake (after a tentative plan to carry out an IPO proved impossible) as part of its refocus on core business - and because Thomas Cook has been dragging down Lufthansa group results.

CONDOR'S FLEET

	Fleet	Orders (options)
757-300	13	
767-300ER	9	
Total	**22**	
Condor Berlin		
A320	**14**	
Condor/Condor Berlin total	**37**	**0**

As part of the deal, Lufthansa will acquire the 50% held by Condor in SunExpress, a Turkish scheduled and charter airline that operates a fleet of 12 737-800s and 757-200s out of Anatalya (Turkish Airlines owns the other 50%). But crucially, while Thomas Cook Airlines UK (which has a fleet of 23 A320s, A330s and 757s) and Thomas Cook Airlines Belgium (six A320s) will remain part of Thomas Cook, and hence be transferred to KarstadtQuelle's ownership, the Condor situation is more complicated.

Again as part of the overall deal, Lufthansa is to increase its stake in Condor from 10% to 24.9% by acquiring 14.9% of KarstadtQuelle's current 90% stake for €20m - but the deal reportedly will include a call option for KarstadtQuelle to repurchase the shares after a two year period, as well as a put option in which Lufthansa can require KarstadtQuelle to buy its shares at the same date. If neither option is exercised, Lufthansa then has the option to acquire the 75.1% held by the German retailer.

For the staff at Condor, this uncertainty over who will own the airline in a couple of years is "bewildering", according to one pilot. In December last year industrial action was carried out briefly at Condor Berlin before a collective pay deal was agreed between management and 240 flight attendants represented by the Verdi union, and sources suggest that the workforce is uneasy over the airline's medium-term future.

Although both a Condor/TUI and Condor/LTU link has been rumoured, much will depend on how KarstadtQuelle evolves Thomas Cook, and whether it needs its own in-house airline or prefers to buy in seat capacity from others. The likelihood is that Lufthansa will not want to keep Condor in the long-term, given that it is not considered part of its core assets.

Airbus/Boeing - competitive positions reversed

In 2006 Boeing recorded 1,044 net orders, 42 more than 2005 and, crucially, 254 more net orders than Airbus, which recorded 790 net orders.

Boeing's record 2006 performance was heavily supported by 737 orders, which accounted for almost 70% of the manufacturer's net orders. Widebody sales included 157 orders for the yet-to-be-launched 787 series aircraft, 76 orders for the 777, and ten 767 orders. As Richard Aboulafia, Teal Group analyst, puts it " [Boeing] have gone from uncertain future and second place to unquestioned dominance".

Boeing and Airbus have sold more commercial jets in the past two years than at any time in aviation history. Orders placed in Asia, and in particular China, were very robust. Boeing recorded 284 orders in Asia, with a 2:1 narrowbody to widebody ratio. Airbus fared better, recording 344 orders, with CASGC ordering 150 A320 family air-

BOEING ORDERS 2006

	737	747	767	777	787	Total
Air Berlin	75					75
Air France				1		1
Air Europa	16					16
Cargolux Airlines		2				2
First Choice Airways					2	2
Futura	3					3
Icelandair					2	2
KLM Royal Dutch	9			1		10
Lufthansa		20				20
Monarch Airlines					6	6
Ryanair	42					42
Sky Airlines	3					3
SkyEurope	5					5
Travel Service	2					2
European Total	**155**	**22**	**0**	**2**	**10**	**189**
AirTran	25					**25**
Alaska Airlines	13					**13**
Atlas Air		12				**12**
Aviation Capital Group	14					**14**
Boeing Business Jet	14	4			5	**23**
CIT Leasing Corp.					5	**5**
Continental Airlines	26				13	**39**
Delta Air Lines	10					**10**
Fedex				15		**15**
GECAS	30					**30**
Guggenheim Av. Partners		4		3		**7**
ILFC	6			2	2	**10**
Nakash Group					2	**2**
Pegasus Airlines	6					**6**
Pegasus Av. Finance					2	**2**
Southwest	82					**82**
WestJet	3					**3**
N.American Total	**229**	**20**	**0**	**20**	**29**	**298**
Aeromexico	16				2	**18**
Copa Airlines	1					**1**
Gol Airlines	22					**22**
LAN Airlines			3			**3**
L. American Total	**39**	**0**	**3**	**0**	**2**	**44**
Air China	25					**25**
Air Pacific					5	**5**
Cathay Pacific		6		2		**8**
China Eastern Airlines	16					**16**
China Southern Airlines	10					**10**
Hainan Airlines	19					**19**
Jet Airways					10	**10**
Korean Air	4	5		15		**24**
Lion Air	30					**30**
Nippon Cargo Airlines		2				**2**
Qantas	5				45	**50**
SALE	10					**10**
Shandong Airlines	12					**12**
Shanghai Airlines	8					**8**
Shenzen Airlines	5					**5**
Singapore Airlines					20	**20**
SpiceJet	10					**10**
Virgin Blue Airlines	9					**9**
Xiamen Airlines	11					**11**
Asian Total	**174**	**13**	**0**	**17**	**80**	**284**
Air Sahara	10					**10**
Buraq Air	1					**1**
Egyptair	6					**6**
Emirates		10				**10**
Kenya Airways					9	**9**
LoadAir Cargo		2				**2**
Qatar Airways				22		**22**
Africa/M.East Total	**17**	**12**	**0**	**22**	**9**	**60**
Unidentified Total	**119**	**5**	**5**	**16**	**30**	**175**
Gross Total	**733**	**72**	**8**	**77**	**160**	**1050**
Changes	-4	-	2	-1	-3	-6
2006 Net Total						**1044**

***Source**: Boeing*

craft. Other significant orders in 2006 included an 82 737 order from Southwest, Air Berlin ordered 75 and Ryanair 42 of the same model. Apart from CASGC, main orderers of Airbus were the LCCs easyJet and AirAsia, with US low cost start-up Skybus ordering 65 A319s.

The sales performance at Airbus reflects its high-profile problems last year. Wiring problems plagued production of the A380, delaying delivery slots by two years and costing Airbus at least $3.6bn. Airbus has booked orders for 166 A380s, but only took under 20 orders in 2006, with a notable ten-plane cancellation from Fedex. Airbus indecision over the A350XWB, as well as potential customer concerns that it did not measure up to the 787, created a major advantage for the 787, which now has 448 orders booked to date. Notwithstanding its problems, Airbus has performed well in the final quarter of 2006 to finish with a 43% overall net order share, against a mid-2006 position of less than 20%.

In developments likely to figure in the orderbook battle, Airbus announced the industrial launch of the A330F, creating new competition in the midsized freighter market where Boeing has prevailed with virtually no competition in the past. The A330F will go up against the older 767 and newer 777 freighters and will be more capable than the 767 and cheaper than the 777, according to Airbus.

On the production side, both companies are predicting 440-450 deliveries for 2007. The industry's all-time peak of 900 aircraft shipped in 1999 looks set to be equalled. A repeated combined total of around 900 units indicates another all-round record year is in store for 2007.

AIRBUS ORDERS 2006

	A318	A319	A320	A321	A300	A330	A340	A350	A380	Total
Aegean			3							**3**
Aercap						20				**20**
Aer Lingus			2			2				**4**
Air One			5							**5**
Blue Wings			16	4						**20**
Boutsen Aviation		2								**2**
Czech Republic		2								**2**
easyJet		52								**52**
Finnair							3	9		**12**
Grupo Marsans						12				**12**
Jetalliance	1	1								**2**
Lufthansa		5	10	15		5	7			**42**
NIKI			1							**1**
RBS Aerospace		4	6							**10**
Stumpf Group		1								**1**
Wizz Air			20							**20**
European Total	**1**	**67**	**63**	**19**	**0**	**39**	**10**	**9**	**0**	**208**
CIT		5	4			10				**19**
Frontier Airlines			6							**6**
GECAS		1	2							**3**
ILFC		3	3			3		4		**13**
Pegasus Aviation						6		2		**8**
Skybus		65								**65**
US Airways				7						**7**
N.American Total	**0**	**74**	**15**	**7**	**0**	**19**	**0**	**6**	**0**	**121**
Air Caraibes						1				**1**
InterJet			10							**10**
TAM Linhas Aereas		12	16	3		6				**37**
Latin American Total	**0**	**12**	**26**	**3**	**0**	**7**	**0**	**0**	**0**	**48**
Air Asia			40							**40**
Air Blue			6							**6**
Air China		9								**9**
CASGC		40	60	50						**150**
Go Air			10							**10**
Indian Airlines		19	4	20						**43**
Kingfisher Airlines							5			**5**
SALE			20							**20**
Silk Air		4	7							**11**
Singapore Airlines						19			9	**28**
Tiger Airways			8							**8**
Qantas						6			8	**14**
Asian Total	**0**	**72**	**155**	**70**	**0**	**25**	**5**	**0**	**17**	**344**
Afriqiyah Airways		3	6			3				**12**
Air Mauritius						1				**1**
Alafco			6							**6**
Middle East Airlines		4				4				**8**
National Air Services	2									**2**
Tunis Air		1								**1**
Africa/M.East Total	**2**	**8**	**12**	**0**	**0**	**8**	**0**	**0**	**0**	**30**
Private Customer	1	8	2	0	0	1	0	0	0	**12**
Unidentified Total		12	39	5	0	5	0	0	0	**61**
Gross Total	**4**	**253**	**312**	**104**	**0**	**104**	**15**	**15**	**17**	**824**
Cancellations										-34
Net Total										**790**

***Source**: Airbus*

S&P explains credit ratings

Why exactly are airlines such as Qantas and BA considered less risky, as indicated by their superior corporate credit ratings, than the likes of American and JAL? A recent comparative analysis by Standard & Poor's* identifies the main differentiating credit factors for the world's top airlines.

The rating agency looked at both what it called "business risk" (industry characteristics, competitive position, etc) and "financial risk" (debt leverage, cash flow, liquidity, etc). The comparison, carried out in mid-December 2006 and based on statistics from 2005 or 2005/2006 financial years, plus qualitative analysis, included two airlines each from North America, Europe and Asia-Pacific: AMR, UAL, BA, Lufthansa, JAL and Qantas.

S&P concluded that the six airlines had broadly similar industry risk characteristics and that all had "quite good" market positions. The variation in business risk scores - BA, Lufthansa and Qantas were rated "satisfactory" while AMR, JAL and UAL were judged "weak" - was mainly due to differences in 2005 operating profitability (after adjustments for depreciation, operating leases and retiree expenses).

But the analysis found dramatic differences in cash flow generation and debt burdens between the six airlines. As a result, the financial risk scores ranged from Qantas' and Lufthansa's "intermediate" (or solid by airline standards), to BA's "aggressive" and AMR's, JAL's and UAL's "highly leveraged".

Industry risk/market position

The report contained some interesting observations about regional differences in the regulatory environment, degree of competition and other factors. S&P considers the "highly concentrated" Japanese and Australian domestic markets and the many rapidly growing Asian markets the least risky. JAL and Qantas are well-positioned in that respect, since they earn 53% and 73% of their revenues domestically (the latter figure includes New Zealand).

The US and Canadian domestic markets are clearly the riskiest, due to competition and relatively low barriers to entry. AMR and UAL are heavily exposed since they generate more than 60% of their revenues in the US domestic market.

European markets fall between the two extremes, though S&P noted that both BA and Lufthansa earn the bulk of their revenues (81% and 51%, respectively) from intercontinental operations, which are generally less risky than intra-European operations.

The report suggested that Lufthansa, JAL and United have the most regionally diversified route networks. BA and JAL have the best home hubs (London Heathrow and Tokyo Narita). But S&P felt that Lufthansa's and Qantas' home hubs (Frankfurt and Sydney), which serve smaller metropolitan areas, may lose some connecting business traffic with the increasing use of medium-sized, long-range aircraft such as the 787.

S&P rated Qantas' home market position the strongest among the six global carriers, despite the fact that its main competitor is an LCC. While JAL, BA and Qantas are the largest single operators from their home countries, those airlines (and Lufthansa) account for less than 50% of total traffic at their main hubs because those airports are served by a large number of international carriers.

By contrast, American and United dominate most of their major hubs, which handle large numbers of domestic passengers. They have large shares of each local market, which tends to generate higher-yield traffic, but they also face intense competition from LCCs either at the hubs or nearby airports.

The US-Europe unit passenger revenue differentials seem as wide as ever. AMR and UAL achieved less than 6 US cents per ASK in 2005, reflecting both low fares in the competitive US domestic market and a lesser reliance on international premium-fare passengers. BA and Lufthansa, which have mostly international operations and devote more space to premium classes, had unit revenues of 9.4 and 9.7 cents, respectively. Qantas and JAL were in the middle, with RASK of 8.4 cents and 7.7 cents, respectively - JAL's has declined because, following its 2002 acquisition of Japan Air System, it has a more equal blend of domestic and international flying. (The analysis did not include cargo and ancillary revenues, which can be significant contributors.)

The US airlines also had the lowest unit costs - around 6.5 cents per ASK (excluding restructuring costs) in 2005, compared to Lufthansa's 9.6, BA's

HOW THE AIRLINES COMPARE

Airline	Qantas	Lufthansa	BA	JAL	AMR	UAL
Rating	BBB+/Watch Neg	BBB/Stable	BB+/Positive	B=/Negative	B/Stable	B/Stable
Business Risk Score	Satisfactory	Satisfactory	Satisfactory	Weak	Weak	Weak
Financial Risk Score	Intermediate	Intermediate	Aggressive	Highly leveraged	Highly leveraged	Highly leveraged
Revenues*	$9.9bn	$22.4bn	$14.8bn	$18.7bn	$20.7bn	$17.4bn
Fully adjusted debt/capital ratio**	48.7%	73.5%	78.8%	91.1%	109.8%	90%***
Fully adjusted net debt/revenues**	21%	37%	51%	90%	110%	100%

Notes: * In 2005 or 2005/06 fiscal year, ** At the end of 2005 or 2005/06 fiscal year, ***=Upon emergence from Chapter 11 in early 2006
Source*: Standard & Poor's*

8.9, Qantas' 8.2 and JAL's 7.9. The differences reflect a combination of actual cost competitiveness and traffic mix. The multibillion dollar cost cuts implemented by AMR and UAL in recent years have helped maintain their CASK lead.

Financial risk: vivid differences

The report noted that AMR, JAL and UAL carry significantly higher debt loads and have weaker financial ratios than the other three airlines, reflecting post-September 11 borrowings to maintain adequate liquidity and finance capital expenditures, as well as overall weaker profitability and cash flow generation.

Qantas has the healthiest financial profile - so far. The report noted that its relatively light debt burden was one reason it caught the attention of private equity firms, which are looking to add considerable leverage. S&P cautioned that Qantas' debt burden was set to rise anyway due to substantial planned capital spending to modernise and expand its fleet, and that airlines generally are subject to a wide variety of potential stresses - reasons why a strong financial profile and ample liquidity are important.

The fully-adjusted debt-to-capital ratios (the standard leverage measure) at the end of 2005 or 2005/06 financial years, ranged from Qantas' 49% to AMR's 110% (or UAL's negative 305%, though this improved to positive 90% when the company exited bankruptcy in early 2006). Lufthansa was the second-best with a ratio of 74%, followed by BA with 79% and JAL with 91%. In terms of fully-adjusted net debt as percentage of revenues, which measures solely an airline's debt burden relative to its size, the range was from Qantas' conservative 21% to AMR's elevated 110%. The figures for Lufthansa, BA, JAL and UAL were 37%, 51%, 90% and 100%.

But why did UAL not get its debt-to-capital ratio below 90% despite all the Chapter 11 restructuring? Because, in S&P's words, "airlines, whose financial obligations mostly take the form of secured debt and leases, have less scope to deliever in bankruptcy than does a typical industrial company".

The report noted that each of the six airlines except JAL maintains a substantial unrestricted cash cushion. At the end of 2005 or 2005/06 financial years, BA's was the best at 29% of annual revenues, followed by Qantas' 21% and Lufthansa's 20%. AMR and UAL are now also in the 21% range, after significantly improving their cash reserves in 2006. Although JAL's equity offering in July 2006 more than tripled its cash reserves to US$1.6bn, this higher figure still amounted to only 9% of 2005 revenues.

Regarding what S&P called the "final liquidity line of defence", Lufthansa and Qantas have mostly unencumbered fleets. BA has some unencumbered aircraft. UAL's, AMR's and JAL's fleets are almost entirely encumbered, but the latter two have some other assets, such as AMR's FFP, that could be monetised.

Of the six airlines, Qantas has the highest credit rating with S&P - an investment-grade BBB+. However, the airline is on "creditwatch negative", meaning a downgrade is possible if the A$11.1bn takeover bid by a private equity consortium led by Macquarie Bank and Texas Pacific goes through, depending on how the transaction is financed. (According to the latest reports, the consortium has pledged to keep A$2bn of cash on Qantas' balance sheet to address airline industry risks, but that would be less than the A$2.9bn cash held at the end of June 2006.)

Lufthansa has the next-best credit rating (BBB), followed by BA (BB+), JAL (B+) and AMR and UAL (B). BA is the only one in the group that could secure an upgrade from S&P in the near term, thanks to steadily improving earnings and a gradual reduction in debt. Although AMR's and UAL's earnings improved dramatically in 2006, their high debt burdens mean that near-term credit rating upgrades are unlikely.

* "For Global Airlines, Similar Market Positions But Widely Different Financial Profiles" by Philip Baggaley, Standard & Poor's (18 December 2006)

Allegiant Air: The bets are on this LCC

The diverse US LCC sector has gained yet another variant of the low-cost model: operating cheap, fuel-guzzling MD-80s in low-frequency service between small cities and popular leisure destinations and deploying Ryanair-style revenue strategies. Allegiant Air, a Las Vegas-based niche carrier, has staged an amazing comeback with the help of this model since emerging from Chapter 11 bankruptcy in 2002. The airline has grown at a dizzying pace, is achieving industry-leading profit margins and recently completed an IPO. But will Allegiant be able to replicate the successful Las Vegas formula in the Florida markets?

The hitherto very low-profile "hometown America" airline became better known in the context of its parent Allegiant Travel Company's hugely successful IPO on December 7. The offering priced above expectations, raised $94.5m in net proceeds for growth and gave the company a listing on Nasdaq. Post-IPO, the share price has almost doubled, from $18 to $35 as of February 2.

The key selling points were Allegiant's four-year record of profitable growth, extremely low operating costs, strong balance sheet and experienced management and financial sponsors. Investors liked the many innovative strategies, including a focus on ancillary revenues and avoiding competitive markets. With 50-plus potential new cities identified by the management, Allegiant was viewed as a promising growth story.

But the IPO was also perfectly timed, launched in the wake of a sharp decline in fuel prices in the autumn months. Allegiant's MD-80 fleet would have made the company a tough sell at $70 oil.

Allegiant has been well received by Wall Street. By mid-January at least four analysts had initiated coverage of the company, though three of them were from financial institutions that were underwriters on the IPO. There are two "buy" and two "neutral" recommendations - the latter are mainly due to valuation.

But Allegiant's longer-term prospects are uncertain because some of its strategies may not be sustainable. How long can it rely on an aircraft type that is no longer in production? How long can it avoid competition in the US domestic market?

Many in the industry remain undecided about Allegiant because its model goes against the accepted wisdom that modern fuel-efficient aircraft, high aircraft utilisation and reasonably large markets are critical for an LCC's success in the post-2001 environment. To add to the unease, Allegiant's strategy invokes memories of what US LCCs used to be like in the pre-JetBlue days, when they typically operated old aircraft and many struggled, and eventually disappeared, because they could not find large enough markets.

The key thing to bear in mind is that Allegiant is a niche carrier, not a mainstream LCC. This type of model is not going to be significant in the US.

But, with around 50 cities already served across the nation and 50-plus more planned, Allegiant is going to be rather large for a niche carrier. The interesting question is: will the innovative revenue and other strategies enable Allegiant to stick to its current formula, or will it have to become like the other LCCs (new aircraft, larger markets)?

Allegiant's background

Allegiant has a little more controversy or colour in its history than the typical US LCC. It has been through Chapter 11. Its two largest investors - CEO Maurice Gallagher and Robert Priddy - were the founders and the leadership at ValuJet, the hugely successful early 1990s LCC start-up that was grounded on safety grounds following its

DC-9 crash in 1996. (That said, the executives were not directly blamed, and Priddy oversaw ValuJet's successful transformation into AirTran and remained its CEO for many years).

Gallagher was one of Allegiant Air's original backers when it was founded in 1997, but he did not become involved in management until 2002. The airline operated ad hoc charters and a small network of high-frequency scheduled service focusing on the business traveller in the West, utilising DC-9s in a two-class configuration. The strategy was unsuccessful and the company filed for Chapter 11 bankruptcy in December 2000. As part of the reorganisation, Gallagher's debt was restructured and he injected additional capital, becoming the majority owner and a board director (he took over as CEO in August 2003). A new management team was installed in June 2001, and Allegiant emerged from Chapter 11 with a new strategy in March 2002.

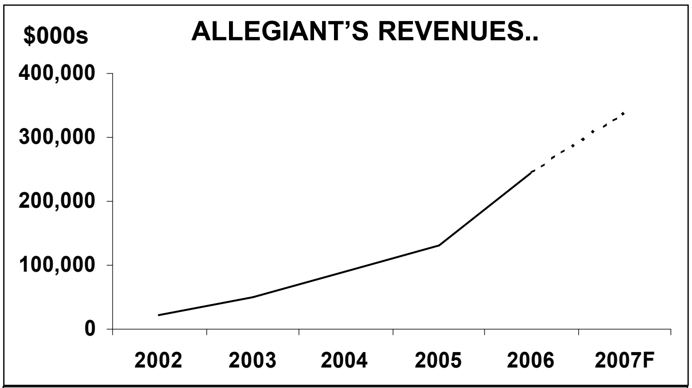
In the subsequent years, Allegiant sold equity to four of its senior officers and brought in additional investors through private placements. The present holding company structure was created in May 2004. All of that plus the IPO led to the company looking very strong in terms of its management, financial sponsor line-up and balance sheet.

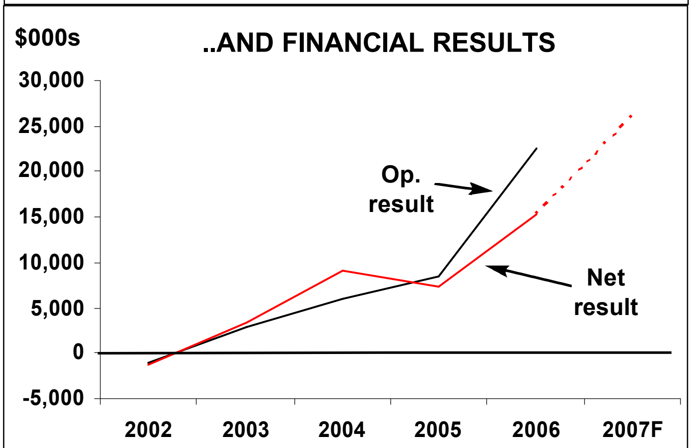
The management team, led by Gallagher, have been together for years, going back to the 1980s in certain instances. Many previously worked together at ValuJet or WestAir, a commuter carrier that Gallagher founded and led in 1983-1992.

In addition to Priddy, Allegiant's investors include ex-Ryanair/Tiger Airways executive Declan Ryan and PAR Investment Partners (a US institutional investor with holdings in AMR, US Airways, Alaska, Southwest and Republic). PAR acquired its 4-5% stake through a private sale in conjunction with the IPO.

While Gallagher's stake in Allegiant has declined from 80% in August 2003 to about 23% after the IPO, the board and management (including Gallagher) still hold about 56% of the stock. Gallagher has never taken a salary and does not have stock options.

As a result of the IPO, Allegiant has one





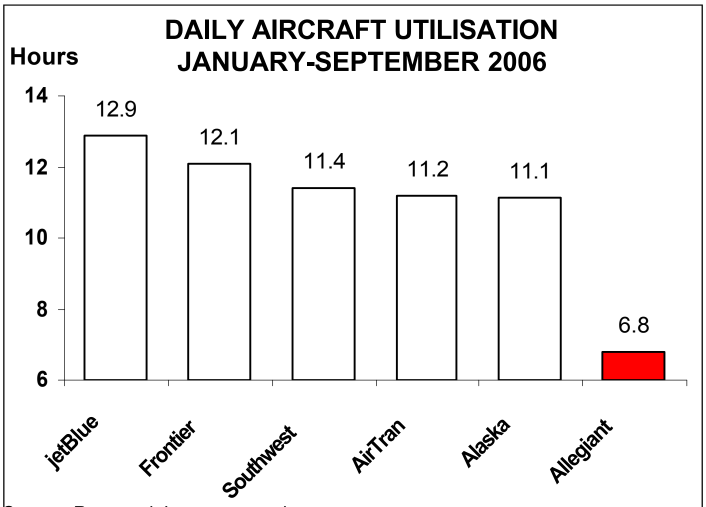
Notes: 2006 net profit of $15.2m is before a one-time tax accrual (including that, the profit was $8.7m). 2007 net profit forecast is the midpoint of the consensus range of $25-27m.

of the industry's strongest balance sheets. Year-end cash reserves were $136.1m - an exceptional 56% of last year's revenues. The company had total assets of $305.7m, total debt of $72.8m and shareholders' equity of $153.5m. It had a net cash position, which is rare for airlines. The lease-adjusted debt-to-capital ratio was only 41% - similar to Southwest's. All of this puts Allegiant in a strong position to grow the business and weather any setbacks.

Strong profitable growth

Allegiant has grown its capacity at a compound annual growth rate of 89.6% since 2002. In August 2003 it operated just six MD-80s, serving six cities; now the fleet totals 26 MD-80s (as of January 31), serving about 50 cities.

Revenue growth has been just as strong, from $22.2m in 2002 to $132.5m in 2006, a



Source: Raymond James research

CAGR of 82%. After small operating and net losses in 2002, Allegiant has earned profits in each of the past four years despite the increase in fuel prices. Last year, its operating profit almost tripled to $22.6m, representing 9.3% of revenues, while net profit more than doubled to $15.2m (before a one-time tax accrual of $7.3m). Revenue surged by 84% to $243.3m in 2006.

Allegiant's 11.7% operating margin in the fourth quarter was the best among the US legacies and LCCs. According to Merrill Lynch, in terms of pretax margin, Allegiant shared the lead position with Southwest (both 7%). This compared with JetBlue's and US Airways' 4% and breakeven or worse for other airlines.

Unusual niche and MD-80 strategy

Allegiant targets leisure travellers in small under-served cities that otherwise have few options to travel to what the company calls "world class leisure destinations", such as Las Vegas, Orlando and Tampa/St Petersburg (the three currently on the airline's route map).

Las Vegas and Orlando are two of the largest and most popular leisure destinations in the US. Las Vegas, where Allegiant is headquartered, offers gaming, shows and other attractions, as well as conventions, and has seen strong and consistent visitor growth in the past 25 years. Orlando is one of America's top family destinations, offering various theme parks and attractions, while Tampa/St.Petersburg is a popular beach vacation destination.

The markets targeted by Allegiant are typically too small for non-stop service by legacies or traditional LCCs, which require at least 2-3 daily frequencies, or they are so low-yield that they are not a priority for other carriers. While some of the markets might be suitable for RJs, Allegiant's CASM is significantly lower and its 150-seat aircraft offer a comfortable alternative to the RJs that secondary market travellers are accustomed to flying.

Consequently, in roughly 90% of its markets, Allegiant is the only carrier providing nonstop service; of the 70 routes it plans to serve at the end of the current quarter, only six routes have existing or announced service by other airlines. By being the only carrier to offer non-stop service and by making low fares available, Allegiant typically stimulates new traffic and quickly becomes the market share leader for O&D passengers. In other words, the airline has found a profitable niche - something that has historically been a challenge for LCCs.

But the "small cities, big destinations" niche is only possible because of a unique fleet and operating strategy. Profitable operation of 150-seat aircraft in the small leisure markets calls for very limited frequencies. Allegiant typically operates only 2-4 flights per week on a route; currently there are no daily flights.

This gives Allegiant very low average daily aircraft utilisation - just 6.7 hours in 2006, compared to 11-13 hours typical for LCCs. But the airline compensates for that by buying or leasing used MD-80s at prices that can be 80% below what other LCCs pay for new 150-seaters. The cost of acquiring and introducing to service an MD-80 averages less than $6m for the airline. In other words, Allegiant benefits from extremely low aircraft ownership costs. Fixed costs account for only about half of its total CASM, compared to an industry average of around 70%.

The low fixed costs give the airline

exceptional flexibility - a particularly valuable attribute in an era of volatile fuel prices. First, Allegiant can better tailor flight frequencies to the needs of the market on a daily and seasonal basis. Second, it can more easily enter or exit markets to limit unprofitable flying and maximise profitability.

The downside of operating older MD-80s, of course, is that they are very fuel-inefficient and more expensive to maintain. Raymond James' analysts suggested in a mid-January report that, at current fuel prices, the MD-80 ownership, fuel and maintenance costs largely offset one another. However, they pointed out that Allegiant also successfully employs other aspects of the LCC model, which makes it one of the lowest-cost US airlines.

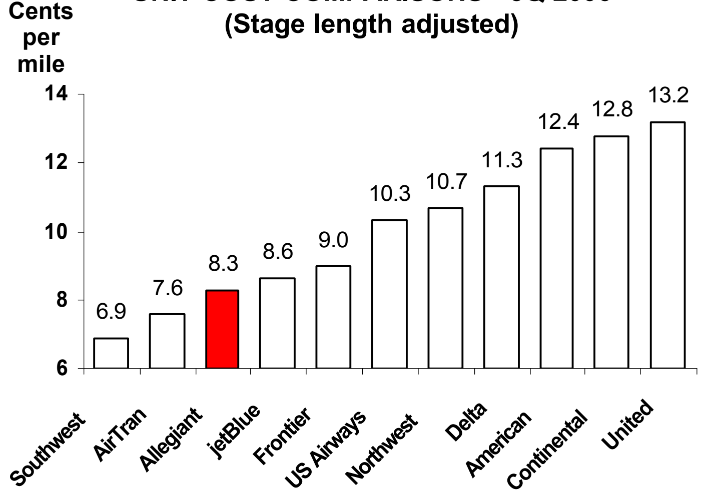
The MD-80 maintenance economics are expected to remain fairly constant. Although the fleet averages 16 years in age (the oldest in the US), it is relatively young in terms of cycles (takeoffs and landings). The fleet averages 25,000 cycles, and no aircraft has flown in excess of 43,000 cycles. With each aircraft adding roughly 1,000 cycles annually, it will be many years before the aircraft reach the 60,000-cycle mark, where maintenance requirements increase sharply due to ageing aircraft airworthiness directives.

Low operating costs

With scheduled service CASM of 7.69 cents in 2006, or 4.15 cents excluding fuel, and an average stage length of 966 miles, Allegiant is clearly one of the industry's lowest-cost producers. In Merrill Lynch's estimates for the first nine months of 2006, Allegiant's CASM (7.73 cents) was 29% below the average legacy CASM (10.91 cents) and 14% below the average for AirTran, Frontier, JetBlue and Southwest (8.96 cents). Excluding fuel, Allegiant's CASM was 46% below the legacies' and 32% below the four LCCs'.

Raymond James analysts calculated that, on a stage-length adjusted basis, Allegiant was the third lowest-cost airline in the US in the third quarter of 2006. At 1,000-mile stage length, it had CASM of

UNIT COST COMPARISONS - 3Q 2006
(Stage length adjusted)



Source: *Raymond James research*

8.3 cents, which was higher than Southwest's 6.9 cents and AirTran's 7.6 cents but lower than JetBlue's 8.6 cents and Frontier's 9.0 cents.

Allegiant's low cost structure stems from a highly productive workforce, extremely low aircraft ownership costs, a simple product, a cost-driven schedule and low distribution costs.

The non-union workforce is among the most productive in the industry, averaging just 37 full-time equivalent employees (FTEs) per aircraft, compared to 60-90 at other airlines. The high productivity stems from fleet commonality, fewer unproductive work rules, cost-driven scheduling, automation and the effective use of part-time employees.

The cost-driven schedule is an interesting concept. The airline designs its flight schedule so that most aircraft return to the three leisure destinations (effectively bases) at night, thereby reducing maintenance and flight crew overnight costs and providing a "quality of life" benefit to employees. The strategy is possible because leisure travellers tend to be less concerned about departure and arrival times.

The "return to base" strategy is even part of the route evaluation process. The two key initial criteria that a prospective new city must meet are that the catchment area population must support at least two weekly flights and that the city is not more than eight hours' roundtrip flight time from the destination. The eight-hour limit permits one flight crew to perform the mission.

Having a simple product is critical to keeping costs low. Allegiant does not offer connections, codeshares, FFPs, airport lounges or free catered items. Distribution costs are kept low by not selling through outside channels such as travel web sites or GDSs. All sales are direct through the company, via the website, call centres or airport ticket counters. Internet bookings represent almost 90% of scheduled service sales - the highest among US airlines.

Allegiant also benefits from low airport costs. This results from the use of secondary airports at Orlando and Tampa/St. Petersburg, as well as special incentives, such as reduced landing fees and marketing support, provided by small cities eager to attract new air service.

Diversified revenue strategy

Allegiant's revenue strategy differs from those adopted by other US LCCs. First, its revenue structure is more diversified, with fixed-fee contracts with tour operators and ancillary revenues accounting for as much as 26.7% of total revenues in 2006 (the remaining 73.3% came from scheduled services). Second, Allegiant has taken the so-called "unbundling" strategy, which was pioneered by Ryanair in Europe, the furthest among US airlines. In Gallagher's words, Allegiant is "more than an airline"; it is a "leisure travel company that happens to use aircraft".

The fixed-fee contract revenues, though helpful, are basically a relic from the pre-2002 business and are not expected to grow. While scheduled service revenues are the fastest-growing component, ancillary revenues (12.8% of total revenues in 2006) also offer much potential. Ancillary revenues are the highest-margin business; Merrill Lynch estimates that the pretax margin is in excess of 75%.

There are basically three types of ancillary revenues. First, there are the extra travel-related products that passengers may want to buy: hotels, car rentals, show tickets, night club packages and other attractions. The bulk of Allegiant's ancillary revenues come from the sale of hotel rooms packaged with air travel. The airline has agreements with some 90 hotels in the destination cities and around 28% of its passengers book a hotel room.

Second, there are the flight-related items, some of which airlines have always charged for (excess baggage fees, on-board sales of products, etc) and some of which were traditionally included in the air ticket price but are now offered for an additional fee by some airlines. In Allegiant's case, the latter include on-board food and drinks and advance seat assignments ($11 per flight, includes priority boarding).

Third, there are the items that one analyst called "nothing more than stealth fare increases", such as checked bag fees ($2) and fees for using Allegiant's website or call centres to buy tickets.

The basic idea is to be able to market an attractive low fare and then sell those additional services that each passenger values. In the fourth quarter of 2006, ancillary revenues boosted Allegiant's average scheduled fare of $88 by $19 to $107. The airline plans to grow its ancillary revenues by further unbundling its product and developing new and expanding existing partnerships with hotels, entertainment companies and attraction providers.

Allegiant offers a "simple, affordable" scheduled service product, with no requirement for Saturday night stay or round trip purchase. The fare structure consists of six buckets, with prices generally increasing as travel dates get nearer. Prices in the highest bucket are typically less than three times those in the lowest bucket. The highest one-way fare was $239 in December. All fares are non-refundable but may be changed for a $50 fee.

The airline uses yield management to maximise revenues. It continues to pay commission to travel agents for vacation packages (but not for flights), because travel agencies tend to have more influence in small cities.

Growth plans and prospects

Allegiant anticipates growing its fleet by 5-7 aircraft per year in the next few years. After the exceptional initial four-year growth spurt, ASM growth is expected to slow to the 30%-range in 2007 and average 20% annually over the next five years.

The airline has identified "at least 52" more small cities in the US and Canada and "several" popular vacation destinations in the US, Mexico and the Caribbean that it could potentially serve. Analysts have suggested Miami, Cancun and Palm Springs (California) as possible destinations. In addition, the airline expects to increase frequencies in existing markets.

The current year's focus will be on developing the markets to Orlando and Tampa/St Petersburg, which were only added in May 2005 and November 2006, respectively, and currently represent 30% of total revenues (Las Vegas accounts for 70%). Orlando was slow to take off, though that was partly because of the difficult 2005 hurricane season. The key challenge - and in many ways a test of the expandability of the business model - is making Florida as successful as Las Vegas.

Even though small cities generally may represent a large untapped market for leisure travel, a small city also poses a greater risk that the demand is not there. But Allegiant claims to have a 90% "hit rate" and it quickly pulls out of the 10% of cities that fail to generate "consistent after-tax returns".

The flexible business model allows Allegiant to enter and exit new markets quickly and inexpensively - something that will come in handy as the airline will almost certainly face more competition as it grows. This dynamic was seen in January when Allegiant pulled out of Newburgh (New York), which it had served for two years, after both AirTran and JetBlue announced daily non-stop service from Newburgh to Allegiant's Florida destinations.

One drawback of the Allegiant model is that it may not be possible to generate much repeat business, which would help facilitate frequency increases. After a weekend in Las Vegas and a vacation in Orlando, the leisure customer will probably want to go somewhere different. However, Allegiant's management feels that Las Vegas demand has not yet peaked, while the Florida market has a different dynamic (many second-home owners and Midwesterners looking for their fun in the sun).

Allegiant does not expect to face any near-term gate or facility constraints, though the gate situation at Las Vegas could become a problem in 5-7 years.

The consensus opinion is that MD-80 availability is not likely to constrain Allegiant's growth for the foreseeable future. Current availability is good, and the future replacement programmes of airlines such as American, which has over 300 MD-80s, should ensure an adequate supply of high-quality MD-80s at favourable prices. However, potential future FAA regulations limiting the age of aircraft in the US could result in Allegiant needing a newer aircraft type sooner than anticipated.

Allegiant is expected to continue posting strong earnings growth for the next couple of years. The current consensus forecast for 2007, which the company is comfortable with, is a net profit of \$1.20-\$1.30 per share, or \$25-27m, which would represent a 35-46% increase over last year's 89 cents per share (before the one-time charge). Operating margins are expected to rise to the 12-15% range in 2007-2009 (Gallagher said at Raymond James' growth airlines conference in January that Allegiant aims to be the highest-margin carrier in the US).

But all of that assumes that Allegiant will be able to replicate the successful Las Vegas formula in the Florida markets. In addition to the market and growth-related risks, the MD-80 strategy and the focus on leisure travellers make Allegiant more vulnerable than other airlines to any future increases in fuel prices or economic slowdown.

By Heini Nuutinen
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		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 emp.
Alaska	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
	Apr-Jun 06	710	639	71	49	10.0%	6.9%	9,389	7,440	79.2%	4,443	9,347
	Jul-Sep 06	760	789	-29	-20	-3.8%	-2.6%	9,895	7,842	79.3%	4,710	9,467
American	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%	23,642	86,600
	Apr-Jun 06	5,975	5,499	476	291	8.0%	4.9%	71,774	59,314	82.6%	25,879	86,500
	Jul-Sep 06	5,830	5,610	220	1	3.8%	0.0%	71,641	58,526	81.7%	24,977	86,400
	Oct-Dec 06	5,397	5,212	185	17	3.4%	0.3%	67,813	53,430	78.8%		85,200
America West	**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
	Jul-Sep 06	922	1,028	-106	-100	-11.5%	-10.8%	12,177	9,722	79.8%	5,463	12,365
Continental	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**	**42,200**
	Jan-Mar 06	2,947	2,936	11	-66	0.4%	-2.2%	37,070	28,996	78.2%	11,486	42,600
	Apr-Jun 06	3,507	3,263	244	198	7.0%	5.6%	45,477	37,605	82.7%	17,596	43,450
	Jul-Sep 06	3,518	3,326	192	237	5.5%	6.7%	47,091	38,691	82.2%	17,328	41,500
	Oct-Dec 06	3,157	3,137	20	-26	0.6%	-0.8%	43,903	35,036	79.8%	16,603	
Delta	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
	Apr-Jun 06	4,655	4,286	369	-2,205	7.9%	-47.4%	60,699	48,364	79.7%	27,221	51,700
	Jul-Sep 06	4,659	4,491	168	52	3.6%	1.1%	63,797	51,150	80.2%	27,556	51,000
Northwest	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
	Apr-Jun 06	3,291	2,996	295	-285	9.0%	-8.7%	37,743	32,593	86.4%	14,300	31,267
	Jul-Sep 06	3,407	3,041	366	-1,179	10.7%	-34.6%	38,741	33,024	85.2%	17,600	32,760
Southwest	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
	Jul-Sep 06	2,342	2,081	261	48	11.1%	2.0%	38,276	28,592	74.7%	21,559	32,144
	Oct-Dec 06	2,276	2,102	174	57	7.6%	2.5%	38,486	27,036	70.2%	21,057	32,664
United	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
	Jul-Sep 06	5,176	4,841	335	190	6.5%	3.7%	66,377	55,165	83.1%	18,099	
	Oct-Dec 06	4,586	4,563	23	-61	0.5%	-1.3%	63,226	50,324	79.6%	16,704	51,700
US Airways	**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%	17,748	13,350	75.2%	13,591	19,255
	Apr-Jun 06	3,191	2,849	342	305	10.7%	9.6%	19,396	15,944	82.2%	9,626	19,222
	Jul-Sep 06	2,968	2,952	16	-78	0.5%	-2.6%	20,255	15,943	78.7%	8,962	19,180
US Airways Group												
	Year 2006	**11,557**	**10,999**	**558**	**304**	**4.8%**	**2.6%**	**123,889**	**97,667**	**78.8%**	**57,345**	**32,459**
JetBlue	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
	Jul-Sep 06	628	587	41	-0.5	6.5%	-0.1%	12,129	9,756	80.4%	4,773	9,223
	Oct-Dec 06	633	569	64	17	10.1%	2.7%	11,712	9,331	79.7%	4,932	9,265

** = 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/	Oct-Dec 04	6,628	5,745	883	83	13.3%	1.3%	54,144	42,042	77.6%	15,934	
KLM Group	**Year 2004/05**	**24,641**	**21,744**	**641**	**453**	**2.6%**	**1.8%**	**214,606**	**168,998**	**78.7%**	**64,075**	**102,077**
YE 31/03	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**
	Apr-Jun 06	7,282	6,766	516	306	7.1%	4.2%	60,839	49,596	81.5%	19,049	
	Jul-Sep 06	7,779	7,058	721	475	9.3%	6.1%	63,616	53,611	84.2%	19,600	
BA	**Year 2004/05**	**14,681**	**13,666**	**1,015**	**472**	**6.9%**	**3.2%**	**144,189**	**107,892**	**74.8%**	**35,717**	**46,065**
YE 31/03	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**
	Apr-Jun 06	4,208	3,825	383	280	9.1%	6.7%	38,222	29,909	78.3%	9,569	45,100
	Jul-Sep 06	4,331	4,080	251	315	5.8%	7.3%	38,727	30,872	79.7%	9,935	45,058
	Oct-Dec 06	4,051	3,798	253	210	6.2%	5.2%	36,563	27,073	74.0%	7,878	42,197
Iberia	**Year 2004**	**5,895**	**5,663**	**232**	**230**	**3.9%**	**3.9%**	**61,058**	**45,924**	**75.2%**	**26,692**	**24,993**
YE 31/12	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
	Jul-Sep 06	1,825	1,700	125	96	6.8%	5.3%	16,846	14,065	83.5%	7,354	22,721
Lufthansa	Jul-Sep 04	5,511	5,164	347	154	6.3%	2.8%	38,115	28,883	75.8%	14,053	
YE 31/12	**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	
	Jul-Sep 06	6,765	6,188	577	461	8.5%	6.8%	39,225	30,627	78.1%	14,781	
SAS	**Year 2004**	**8,830**	**8,967**	**-137**	**-283**	**-1.6%**	**-3.2%**	**43,077**	**28,576**	**64.0%**	**32,354**	**32,481**
YE 31/12	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
	Apr-Jun 06	2,439	2,319	120	75	4.9%	3.1%	14,005	10,325	74.0%	10,325	32,622
	Jul-Sep 06	2,476	2,318	158	83	6.4%	3.4%	14,086	10,745	76.3%	10,141	32,772
Ryanair	**Year 2004/05**	**1,727**	**1,301**	**426**	**345**	**24.7%**	**20.0%**	**36,611**	**31,205**	**84.0%**	**27,593**	
YE 31/03	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	
	Jul-Sep 06	864	553	313	268	36.2%	31.0%				11,481	3,881
	Oct-Dec 06	651	575	76	63	11.7%	9.7%			82.0%	10,300	4,209
easyJet	**Year 2003/04**	**1,963**	**1,871**	**92**	**74**	**4.7%**	**3.8%**	**25,448**	**21,566**	**84.5%**	**24,300**	**3,727**
YE 31/03	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	
	Year 2005/06	**3,034**	**2,813**	**221**	**176**	**7.3%**	**5.8%**	**37,088**	**31,621**	**84.8%**	**33,000**	**4,859**

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 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%**	**48,860**	**29,098**
	Year 2005/06	**12,040**	**11,259**	**781**	**235**	**6.5%**	**2.0%**	**86,933**	**58,949**	**67.8%**	**49,920**	**22,170**
Cathay Pacific												
YE 31/12	**Year 2003**	**3,810**	**3,523**	**287**	**168**	**7.5%**	**4.4%**	**59,280**	**42,774**	**72.2%**	**12,322**	**14,673**
	Jan-Jun 04	2,331	2,046	285	233	12.2%	10.0%	35,250	26,825	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	30,877	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**
	Jan-Jun 06	3,473	3,201	272	225	7.8%	6.5%	43,814	34,657	79.1%	8,144	
JAL												
YE 31/03	**Year 2003/04**	**18,398**	**19,042**	**-644**	**-844**	**-3.5%**	**-4.6%**	**145,900**	**93,847**	**64.3%**	**58,241**	**21,197**
	Year 2004/05	**19,905**	**19,381**	**524**	**281**	**2.6%**	**1.4%**	**151,902**	**102,354**	**67.4%**	**59,448**	**53,962**
	Year 2005/06	**19,346**	**19,582**	**-236**	**-416**	**-1.2%**	**-2.2%**	**148,591**	**100,345**	**67.5%**	**58,040**	**53,010**
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**	**17,573**
Malaysian												
YE 31/03	**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**
	Year 2005/06	**3,141**	**3,555**	**-414**	**-421**	**-13.2%**	**-13.4%**	**65,099**	**46,122**	**70.8%**	**17,910**	**20,324**
Qantas												
YE 30/06	**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**	**35,520**
	Jul-Dec 05	4,999	4,626	373	258	7.5%	5.2%	59,074	45,794	77.5%	17,260	35,158
	Year 2005/06	**10,186**	**8,711**	**1,475**	**542**	**14.5%**	**5.3%**	**118,070**	**90,899**	**77.0%**	**34,080**	**34,832**
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**	**13,729**
Air China												
YE 31/03	**Year 2004**	**4,050**	**3,508**	**542**	**288**	**13.4%**	**7.1%**	**64,894**	**46,644**	**71.9%**	**24,500**	**29,133**
	Year 2005	**4,681**	**4,232**	**449**	**294**	**9.6%**	**6.3%**	**70,670**	**52,453**	**74.2%**	**27,690**	**18,447**
China Southern												
YE 31/03	**Year 2004**	**2,897**	**2,787**	**110**	**19**	**3.8%**	**0.7%**	**53,769**	**37,196**	**69.2%**	**28,210**	**18,221**
	Year 2005	**4,682**	**4,842**	**-160**	**-226**	**-3.4%**	**-4.8%**	**88,361**	**61,923**	**70.1%**	**44,120**	**34,417**
China Eastern												
YE 31/03	**Year 2004**	**2,584**	**2,524**	**60**	**39**	**2.3%**	**1.5%**	**41,599**	**27,581**	**66.3%**	**17,710**	**20,817**
	Year 2005	**3,356**	**3,372**	**-16**	**-57**	**-0.5%**	**-1.7%**	**52,428**	**36,381**	**69.4%**	**24,290**	**29,746**

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

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
Nov-06	26.5	16.8	63.4	17.0	13.3	78.2	15.2	12.2	80.0	47.2	37.6	79.6	70.2	52.3	74.5
Ann. change	5.0%	6.0%	0.6	3.6%	0.3%	-2.6	4.4%	6.7%	1.7	4.8%	4.9%	0.0	5.5%	5.6%	0.1
Jan-Nov 06	303.8	210.0	69.1	212.7	174.0	81.8	167.4	135.5	80.9	539.0	439.2	81.5	802.4	623.2	77.7
Ann. Change	3.3%	5.7%	1.6	1.9%	0.6%	-1.1	8.9%	10.3%	1.0	4.6%	4.8%	0.2	4.8%	5.4%	0.5

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
Nov 06	78.9	62.2	78.9	14.0	11.0	78.3	9.5	7.7	81.6	8.4	6.3	75.4	31.9	25.1	78.5
Ann change	-0.8%	1.4%	1.7	8.4%	6.4%	-1.4	1.0%	3.3%	1.8	3.5%	12.7%	6.2	4.8%	7.0%	1.6
Jan-Nov 06	897.1	718.2	80.1	174.8	141.6	81.0	108.3	90.1	83.2	97.6	74.1	75.9	380.7	305.8	80.3
Ann change	-2.7%	-0.3%	1.9	8.5%	6.8%	-1.3	1.2%	2.4%	0.9	2.3%	6.6%	3.1	4.7%	5.4%	0.5

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	22 Jan	GECAS	15 x 777, 24 x 737	2008-10	"unidentified" order in 2006
	08 Jan	SALE	20 x 737-800	2009-11	exercised options
	02 Jan	Jet Airways	10 x 787-800	2011	
	29 Dec	Korean Air	10 x 777-300ER, 5 x 747-800F 5 x 777F, 5 x 737NG		plus 8 mixed options
	21 Dec	KLM	3 x 737-800 1 x 777-300ER	2008	exercised options
	17 Dec	Kenya A/W	3 x 787-800		
	17 Dec	Qatar A/W	2 x 777F		
	12 Dec	Guggenheim	3 x 777F	2009	plus 1 option
Airbus	09 Feb	Air One	10 x A320		
	18 Jan	Guggenheim Av.	6 x A330-200F	2010	
	08 Jan	Air Asia	50 x A320		plus 50 options
	08 Jan	SALE	20 x A320		plus 10 options
	04 Jan	Pegasus Av. Co.	2 x A350XWB, 6 x A330-200		
	28 Dec	Grupo Marsans	12 x A330-200		plus 10 options
	21 Dec	Qantas	8 x A380		
	20 Dec	SIA	9 x A380		plus 6 options
	20 Dec	SilkAir	11 x A320		plus 9 options
	15 Dec	AerCap	20 x A330-200		
	07 Dec	Lufthansa	7 x A340-600	2008 onwards	
Embraer	18 Dec	Air Caraibes	1 x E190	4Q 2007	plus 1 option
	05 Dec	Sirte Oil Co.	1 x E170	03/2007	
Bombardier	27 Nov	Brit Air	3 x CRJ700		

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

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