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Fragmenting the Atlantic business market

Changes in the transatlantic travel market have accelerated with the announcement by both British Airways and Virgin Atlantic that they intend to set up all-premium services based in continental European cities, using 757s or 767s. With transatlantic premium business accounting for most of the profits of the European network carriers, the new all-premium strategies provide major opportunities and major threats.

For BA, positioning its operation at continental points minimises the risk of cannibalisation of its Heathrow traffic, though there will be some impact from losing connecting premium traffic. It can sell its relatively strong product directly into new markets, exploiting its corporate contracts, while still being largely protected at its base market, simply because of the lack of Heathrow slots at transatlantic business times. Virgin Atlantic, as an almost pure point to point carrier doesn't have to worry about cannibalisation, and now has the opportunity of pushing its brand into new European markets, though it is at a disadvantage to BA, Lufthansa and Air France in winning corporate accounts.

The BA project is a variation on Lufthansa's established PrivatAir operation, which is designed as a hub-bypass from, for example, Geneva and Düsseldorf to the US and Middle East and also as a hub supplement from Munich. PrivatAir's main focus is the corporate market in Germany, Switzerland and the Netherlands.

In the UK market there are three independent premium-class airlines, attacking this market from different angles.

Eos, with its London Stansted-JFK operation, poses the most direct threat to BA, aiming for frequency on one route (currently 17 weekly frequencies) with a comparable inflight product to BA on its 48-seat 757s. Its weakness may be in its pricing point, up to £4,000 return, which BA can easily undercut for its corporate customers.

Silverjet and MaxJet, operating from Stansted and Luton respectively, both with 100-seat 767s, are attempting to generate new markets - inducing business travellers from SMEs to fly relatively low-cost business-class and targeting averagely well-off leisure passengers. Their pricing point is around BA's full Premium Economy rate. MaxJet's strategy is based on expanding its US points (it is a US-owned airline) while Silverjet's is more focused on increasing its frequencies to a limited number of US cities, concentrating on New York (Newark). L'Avion, which started flying from Paris Orly to Newark this year, appears to be pursuing a similar strategy to Silverjet.

So, far from consolidating, the transatlantic market is fragmenting with new entrants and Euro-majors identifying what they hope to be profitable business travel niches. There will be casualties but there will also be more new entrants.

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US airlines: How are the industry fundamentals?

Having returned to the black in 2006 after five years of heavy losses, US legacy carriers have been counting on being able to consolidate profitability in 2007. Now that Northwest has exited Chapter 11 (May 31), for the first time since 2002 there are no major carriers in bankruptcy. But, just as the picture was looking rosy, industry fundamentals began deteriorating.

Recent months have seen two particularly worrying developments. First, crude oil is back in the mid-60s (dollars per barrel), even topping $68 in mid-June. Second, airlines have been reporting weakening domestic demand, reflecting a slowing economy. This has made it hard to raise fares to cover the increased fuel costs.

On the positive side, however, the earlier fears of a significant demand slowdown have proved unfounded. Barring exceptional developments, a downturn in 2007 is unlikely, thanks to improved economic indicators, more optimistic GDP forecasts, some timely capacity reductions by airlines and continued strength of international revenues.

At this point, 2007 profits are still expected to be substantially higher than last year's. However, because of the negative fuel and domestic RASM trends, profits will be less than what was expected a couple of months ago.

Calyon Securities analyst Ray Neidl, who revised down his estimates for several airlines on June 11 (citing oil prices rather than RASM concerns), still expects the six legacy carriers (AMR, UAL, Delta, Continental, Northwest and US Airways) to earn an aggregate net profit of $3.4bn in 2007, up from $889m last year. Aggregate EBIT (earnings before interest and taxes) is forecast at $6.8bn, roughly double last year's $3.5bn. The 2007 EBIT margin would be 6.8%, compared to 2006's 3.6%.

However, negative sentiment about the sector is likely to persist as more airlines issue profit warnings and more analysts revise down earnings forecasts for the second half of 2007 - and, of course, if fuel prices keep rising or spiking up. Everyone is keeping a very close eye on fuel, GDP, traffic and RASM trends - and whether LCCs will adjust their capacity and growth plans.

Oil prices: Crude oil prices, which hovered at around $65 per barrel in mid-June, have risen by 25% from the two-year low of around $52 in mid-January. The price is high by historical standards but below the summer 2006 all-time peak of about $77. The prices have been volatile and are notoriously difficult to forecast, though the consensus is that they will remain high - perhaps in the $60-70 range - for the foreseeable future.

According to S&P, crack spread (the cost of refining oil into jet fuel), at about $17, is quite high by historical standards. In the past seven decades it has averaged about $7.

GDP growth: Economic data released on June 1 indicated that US GDP growth amounted to a pitiful 0.6% in the first quarter - the lowest in over four years and in sharp contrast with the year-earlier 5.6%. In that light, the modest profits earned by most of the major carriers in the first quarter - the seasonally weakest period - were an amazing achievement.

Reports have suggested that consumer spending increased and other economic indicators turned positive in May, and many economists foresee faster GDP growth for the remainder of the year. This would bode well for domestic demand trends.

Demand and RASM: Numerous US airlines have been reporting softening domestic demand since March or April. In contrast with 2006, all of the recent attempts to raise domestic fares on a broad basis have failed, typically when LCCs refused to join in.

After two years of strong improvement, mainline domestic passenger unit revenue (PRASM) has stagnated this year. However, the absolute level of domestic PRASM is near its all-time peak of early 2001. Significantly, international PRASM growth has continued to be in the high-single digits.

Therefore overall PRASM remains at an all-time high. According to S&P, industry PRASM

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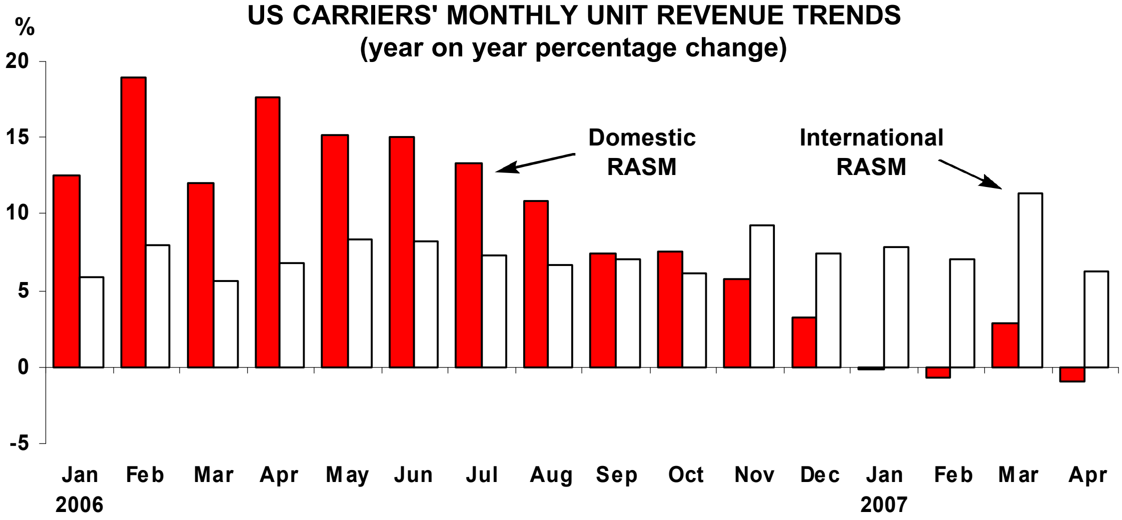
US CARRIERS' MONTHLY UNIT REVENUE TRENDS
(year on year percentage change)



Source: JPMorgan Research (ATA Monthly Data)

was 10.98 cents in the 12 months to the end of March, compared to 10.11 cents in early 2001 and a low of 8.55 cents in August 2002.

Capacity: One highly positive development is that airlines have begun to pull back domestic capacity, which should give them more pricing power. In recent weeks, US Airways, United and Northwest have all reduced their planned domestic capacity growth rates for 2007.

Continental has decided to defer the delivery of six 737NGs by a year from 2009 to 2010 and is also considering leasing out or selling up to 15 737-500s.

Merrill Lynch analyst Michael Linenberg estimates that industry domestic capacity will now grow by only 2% this year, compared to his earlier prediction of 3.4% (these figures exclude Virgin America, but VA's impact to 2007 industry supply should be small).

Significantly, LCCs may soon also cut capacity. Southwest's CEO Gary Kelly said in early June that the airline is considering slowing growth from its current 8% annual rate in response to softer than anticipated air travel demand almost across the board. Southwest needs 5% RASM growth to meet its target of 15% return on invested capital, which is now not likely to be achieved. However, a decision to slow growth may not be taken for a couple of quarters, as the airline tries to determine how long the sluggish revenue environment will last. It would mainly affect 2008 deliveries (32 firm 737s), where Kelly said he saw flexibility.

JetBlue's new CEO Dave Barger said at Merrill Lynch's annual conference that the airline is conducting a 60-day review of its growth plan, which may result in a further ASM growth rate reduction. The decision to slow growth in 2006, by deferring aircraft deliveries and selling five A320s, has paid great dividends. Currently, JetBlue's ASM growth is running at 10-13%, compared to 20% in 2006.

The legacy carriers have continued to shift capacity to international routes, where the revenue picture remains generally stronger in the near term. The industry's biggest fear must be that weakening demand could spill over into the international markets, though with the global economy going strong there seems little risk of that. All of the airlines at the ML conference said that international revenues continued to be strong.

US airlines: looming labour angst

Despite the alarming rise in oil prices and weakening domestic demand in recent months, 2007 is still expected to be a strong year for the US legacy airline sector (see previous article). But there is another major threat on the longer-term horizon: rising labour costs.

Virtually every one of the concessionary labour contracts secured by the US legacy carriers in the past five years comes up for renegotiation in 2008-2011. That and the many ominous new developments in the past two months indicate that labour costs will again be a major issue for the sector from mid-2008 onwards.

JP Morgan analyst Jamie Baker predicted in a mid-April research note that industry labour costs would rise by $5bn annually in 2008-2010, warning that "airlines are living on borrowed time".

A $5bn hike in annual labour costs would have devastating profit implications. Baker pointed out that the industry has never produced an annual operating profit in excess of $8bn, though that was roughly what he was forecasting for 2007.

This raises the disturbing prospect that the boom could be short lived. Labour cost hikes would sharply reduce or eliminate industry profitability in the final years of the decade. In other words, 2006 and 2007 could end up being the peak profit years in the cycle.

Such a scenario would be disastrous given the US legacy carriers' enormous re-fleeting needs. The sector has only just returned to profitability. Pre-tax profit margins are still only in the low-single digits. Debt and pension burdens are substantial, as the balance sheet repair process has only just gotten under way.

At this point, 2008 industry earnings are still expected to show a modest improvement over this year's earnings, which would make it three strong years in a row. However, Baker argued that the only legacy carriers likely to see profit improvement in 2008 are "those recently christened from bankruptcy who are still able to ring out a few more costs, offset by cost escalation at those carriers that navigated around the Chapter 11 process". Baker also suggested that, as 2007 wears on, "looming labour angst" would begin weighing on airline shares, starting with AMR.

Honeymoon over

It has become very clear in recent months that the US airline industry's post-September 11 honeymoon with labour is over. First, there has been a massive outcry about what the unions have called "executive greed" - unusually large top management stock awards or compensation packages at several major carriers, including AMR, UAL and Northwest. Angry airline employees all around the country have held protests and picketed or voiced objections at annual shareholder meetings.

Second, the Air Line Pilots Association (ALPA) has now officially adopted the position that the concessions negotiated by several carriers in bankruptcy since 2002 must be rolled back. ALPA said in April that it would seek to reopen contracts before amendable dates. This would mainly affect United, Delta and Northwest, which secured pilot contracts in Chapter 11 that become amendable between 2009 and 2011. US Airways has not yet succeeded in negotiating its initial post-merger pilot contract (and is now likely to find the process even tougher going).

Third, American's pilots, represented by the independent Allied Pilots Association (APA), disclosed on May 3 that they are seeking a whopping 30.5% pay rate increase and a 15% signing bonus effective from May 2008, when their current contract becomes amendable, plus 5% annual rate increases thereafter. The initial 30.5% pay hike alone would restore the pilots' purchasing power to the pre-2003 levels. In other words, it would eliminate the bulk of the labour concessions that American secured on the courthouse steps in May 2003, which enabled it to avoid Chapter 11.

It is highly unusual for labour unions to go public with their opening proposals. APA's decision to do so indicates that the stakes are high and that the union did not believe it would get what it wants through the normal negotiating process.

What happens at American will have critical industry implications, because APA is the first legacy pilot group to have a contract come up for renegotiation since the sector returned to profitability and because American's pilots are already the highest paid among in the industry. The APA rates will establish a new benchmark on pilot pay.

All of American's labour contracts become amendable in May 2008. The next in line will be Continental's pilots and mechanics in late 2008, followed by all the other legacy labour groups from mid-2009.

United's ALPA has already made its first move to reopen contract talks early. In a letter to CEO Glenn Tilton in late May, the pilots asked that negotiations with all of the UAL unions begin this August, with the goal of putting new contracts in place by February 2008 - nearly two years before the amendable dates.

The only legacy carriers that may enjoy slightly longer labour honeymoons are Delta and Northwest, simply because they are freshly out of bankruptcy. Delta has the advantage of currently excellent labour relations, reflecting the morale-boosting effect of fending off US Airways, a generous post-bankruptcy compensation programme, modest management pay and stock awards, etc. (see *Aviation Strategy*, April 2007).

Northwest has the advantage of not having any contracts become amendable until 2011, but it has an unhappy workforce. Its flight attendants ratified their concessionary contract narrowly and only two days before the company's Chapter 11 exit. Calling the contract totally unacceptable, the flight attendants approved it just so that they could get their $182m equity claim - which, like the other Northwest unions, they planned to sell for cash.

Pilot groups across the industry now appear committed to a common cause - a post-2001 development. There is more cooperation, such as twice-yearly conferences for North American pilot union officials. The latest of those, held in Dallas in early June, was co-hosted by American's APA and Southwest's independent pilot union SWAPA and it attracted 70 union officials from 16 airlines. According to APA, it is all "part of a concerted effort to reverse the damage inflicted on the pilot profession during the past several years".

Why the labour demands?

In recent years it has often been suggested that the post-September 11 era has dramatically changed the status of airline labour, reducing the power wielded by unions and permanently altering the negotiating balance in favour of management.

That is probably a fallacy. First, there has been no change to the labour law that would alter the negotiating balance. Second, labour costs have always been tied to the industry economic environment. In recent decades, airlines have managed to contain labour costs only in periods when they are losing money.

Third, this time around, there are two new issues that are making labour especially determined to get what they want: the massive concessions granted since 2002 and the growing differential between executive and worker pay.

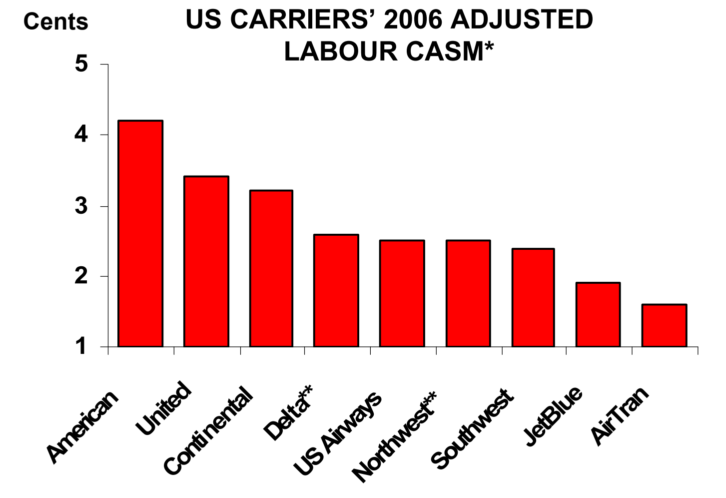
Therefore labour is back with lofty demands, in the first place, because the US legacies' financial recovery is well established. The sector will post a healthy profit for the second year running in 2007, after heavy losses in 2001-2005. Thanks to minimal capital spending, the airlines are generating significant free cash flow - the highest in more than 20 years. Cash reserves are excellent, amounting to 20-30% of annual revenues. Airlines are not only meeting significant debt maturities but have started repaying debt ahead of schedule.

Ironically (since it is first in line for pilot contract amendment), American has been one of the industry's strongest performers. Having turned around from a $677m net loss before special items in 2005 to a $330m profit in 2006, AMR is set to more than triple its earnings to $1.2bn in 2007. AMR also recently prepaid $364m of debt, which was in addition to this year's $1.3bn scheduled debt payments. And the company was able to tap the public equity market in January, raising $500m through a common stock offering.

As final proof that industry recovery is firmly established, credit ratings have started inching up. Over the past winter, the three main rating agencies have all upgraded Continental's and AMR's ratings (Fitch in October 2006 and Moody's in March). This spring, Moody's also revised US Airways' outlook to "positive", while S&P made that move with AMR, indicating that upgrades were possible within a year.

APA and the other pilot unions have argued that the industry recovery has been much faster and stronger than the scenarios painted by the managements in bankruptcy courts and at the bargaining table. Certainly, it would seem that the balance sheet and credit rating improvements have materialised a little sooner than had been expected.

But the unions feel a great sense of urgency because it has been payback-time for airline execu-



US CARRIERS' 2006 ADJUSTED LABOUR CASM*

Notes: * Seat-weight and stage-length adjusted to Northwest. Excluding profit sharing and unusual items. ** Projected post-restructuring results for Northwest and Delta.
Source: *Northwest Equity Roadshow (May 2007)*

tives and shareholders but not for the workers who have made enormous sacrifices since 2001.

According to Baker, US airlines have reduced their aggregate annual labour costs by $7bn since 2001, from $32bn to $25bn. The figures given by the unions are typically much larger because they often include pensions and are for multi-year periods.

In ALPA's estimate, its 60,000 members have given $5bn in concessions in the past five years. Some pilots lost as much as 50% of their income and retirement benefits.

American's APA provided $660m in givebacks in each of the past four years, for a total of $2.6bn worth of concessions. The pilots accepted immediate 20-50% pay cuts as part of the 2003 restructuring, and nearly 3,000 lost their jobs. Since then the pilots have received meagre 1.5% annual pay increases on top of a one-time 6% increase.

The APA givebacks were part of $1.8bn of annual wage, benefit and work rule concessions, amounting to $7.2bn over four years, granted by American's workforce in 2003. The management also made sacrifices; at the top, newly appointed CEO Gerard Arpey kept his previous president/COO's salary and declined to accept stock options that year. "Shared sacrifice" was the mantra heard from the leadership.

American's unions were therefore dismayed when in April the company paid special bonuses worth $160m-plus to nearly 900 executives and managers. The awards, which were in stock that could be sold immediately, were part of the company's long-term incentive plan. The payments were based on stock performance in 2004-2006 (AMR's share price soared from $5 in May 2003 to $41 in January 2007, though it has since fallen steadily to the mid-20s).

CEO Arpey has accepted large bonuses for the past two years. It was disclosed in April that his 2007 compensation would amount to $6.6m. In 2006 Arpey earned $5.4m, of which $4.8m was stock and option awards.

The unions are angry about what they call "extremely disparate rate of financial recovery" between executives and front-line employees. They say that executive pay has risen at a compounded annual rate of more than 80% since the 2003 restructuring. The workers are also upset that bonuses were paid not just to the top officers but to a broad spectrum of management, while rank and file continues to work under concessionary contracts.

APA's pay demands came within weeks of the bonuses being announced. The union observed that "other stakeholders have already recovered their investment in American's turnaround".

Executive pay is also an issue at United and Northwest. United's unions were enraged at the news in March that CEO Glenn Tilton earned $39.7m in 2006, mostly from stock and stock options. Tilton's and other top executive compensation packages were approved and well-publicised when UAL emerged from Chapter 11 in February 2006, but ALPA argues that they "violate the concept of shared sacrifice/shared reward that all employees expected after the turmoil of bankruptcy".

The awards seem excessive also when considering that UAL has underperformed the industry, posting losses for the past two quarters. The share price, at around $35 in early June, is only slightly above the level it started trading in early 2006.

At Northwest, employees are extremely unhappy about the executive compensation packages approved by the bankruptcy court. The company's top 400 executives and managers were granted 4.9% of the new equity over four years, worth $300m at the initial share price. The awards are in the form of restricted stock and stock options and will only have value if the business plan targets are achieved and the stock price appreciates.

CEO Doug Steenland's share of the stock awards was estimated at $26.6m (over four years). In contrast, flight attendant pay at Northwest tops at $35,400 a year, down from $44,200 before Chapter 11. Northwest employees granted $1.4bn worth of annual concessions, with pilots taking 40% pay cuts.

In contrast with United, Northwest is actually now among the most profitable US airlines, earning the highest pre-tax margin among the legacies in the first quarter (around 2%). The bankruptcy court rejected the flight attendants' request to have their pay cuts reconsidered in light of the company's speedy financial recovery; however, if Northwest continues to outperform the industry, the workers will not wait until 2011 to seek to have their pay restored.

Northwest has said that it hopes to share with employees more than $1bn in unsecured claims and profit sharing payments through 2010 (also, 4,800 employees below the top 400 received 0.6% of the new equity in the form of restricted stock vesting in a year, valued at $46.4m). The problem is that those payments will nowhere near make up for the concessions. The unsecured claim obtained by the flight attendants, for example, amounts to only around $15,000 per worker. The 2006 company-wide profit sharing payment in March was $32.6m, averaging about $1,000 per employee.

The other legacy carriers' profit sharing payouts have been equally modest, though Continental forked out a slightly more impressive $111m in March. Of course, AMR employees have not yet received any profit sharing, though payouts are likely based on the 2007 profits.

The math doesn't work

APA estimates that the pay rate increases it is seeking, which would average 17% annually over the proposed three-year contract, would cost AMR $450m annually, plus $400m for the initial signing bonus. The impact would be to effectively wipe out profits, given that American's other labour groups would demand similar increases. "We don't see how the math works", commented Merrill Lynch analyst Michael Linenberg in a research note in early May.

JP Morgan's Baker predicted in April (before APA's announcement) that AMR's per-share earnings could fall by 29% to $2.37 in 2008 (based on $700m or 10% higher labour costs in the second half of 2008). Currently, the consensus forecast for AMR for 2008 is still $4.11, indicating that most analysts no not assume any labour cost impact at all (the estimates range from $2.07 to $5.50).

The problem is that American already has a labour cost disadvantage compared to the four legacies that were in bankruptcy (see chart, left). Because of that, American is targeting $300m additional savings in 2007 through areas such as distribution, scheduling, fleet enhancements and fuel conservation (though it has to be said that nearly all of the US airlines continue to be in a cost-cutting mode).

Also, American needs to continue to de-leverage itself because it is in desperate need of re-fleeting. Even though its debt and lease obligations have declined by $2.2bn in the past year, they were still a substantial $17.5bn at the end of March. AMR's adjusted debt-to-capital ratio is still 98%, its credit ratings are five notches below investment grade, and it has a heavy pension burden.

American has a relatively old fleet, averaging 13.9 years in age at the end of March. The main challenge is replacing 300 MD-80s (average age over 17 years), which account for nearly half of the fleet. The process began in March, when American pulled forward deliveries of 47 737-800s to the 2009-2012 timeframe - possible because of its flexible long-term purchase contract with Boeing. Replacing all the MD-80s with 737s would require an investment of almost $10bn.

The other legacy carriers also have a substantial burden of debt and leases - even Delta and Northwest, despite their recent Chapter 11 visits (reasons: most of their debt was secured, and they did not downsize significantly). However, there is more variation in re-fleeting needs.

The best positioned of the legacy carriers is Continental, which continued to take deliveries through the post-2001 crisis and has an average fleet age of only 10 years. Delta and United are also reasonably well positioned because they reshuffled or restructured their fleets in bankruptcy; they have aging aircraft but do not absolutely need to make fleet decisions for several years.

Northwest has the oldest fleet, averaging 18 years in age, and needs to start replacing 69 DC-9s that are at least 25 years old. The airline is fortunate to have firm orders in place for 18 787s, plus 50 options, for delivery from August 2008. Financing all those aircraft will be a challenge and will stretch an already heavily leveraged balance sheet, but at least the bulk of the spending should be out of the way by the time labour cost pressures build. Northwest's CFO David Davis estimated recently that aircraft spending would peak at $1.8bn in 2008 and then fall in 2009-2010.

US Airways has older 737s and 757s that need replacing, and the airline has been in talks with

Airbus and Boeing about ordering around 60 aircraft. CFO Derek Kerr said at the recent Merrill Lynch conference that the company expects to announce its long-haul aircraft choice (either the A350 or the 787) by the end of June.

According to a recent Boeing analysis using Airclaims data, published in the Wall Street Journal, the US major carriers have 126 aircraft that are 25-40 years old. Without new orders, that number would grow to 384 aircraft by 2012 and 840 by 2015. Therefore, the airlines need to start placing orders in 2007-2008 to avoid a crisis later on.

The ordering got delayed as the airlines waited for financial stability and Boeing and Airbus to develop new-generation narrowbody aircraft. There will not be any mad rush now, because production lines are full until 2011 and next-generation aircraft may not be ready until 2014 or beyond. Also, the industry can be expected to continue to exercise financial restraint until profit margins and balance sheets improve.

American's CFO Tom Horton cautioned in recent speeches that airlines need to be very careful about allocating further capital until they can be certain that they can get a return on that capital. Perhaps American and other carriers could tie the new aircraft orders to getting reasonable labour agreements.

One way forward on the labour front would be to tie pay increases to productivity improvements, as in the past. However, APA is structuring its proposals so as to minimise such chances; it plans to present separate proposals later for variable compensation, because the pilots are determined not to trade off work-rule changes for pay restoration.

APA's argument that the industry can simply offset higher labour costs by raising ticket prices is not realistic. It was possible in the late 1990s but much less so in the post-2001 environment (especially now that domestic demand is weakening).

Pay demands like APA's are totally out of line with the "reformed legacy carrier" cost structure that is emerging in response to the growth of LCCs. The industry is profitable only because it shed $7bn from its labour cost structure post-2001. The legacy carriers cannot afford to add back $5bn of those costs, as Baker's scenario envisages.

Executive compensation issue

The executive stock awards granted by the airlines are all perfectly legitimate and proper. They are part of long-running compensation plans that were approved by boards and, in the case of Chapter 11 carriers, also by creditor committees and bankruptcy courts. Labour unions typically sat on the creditor committees.

Such awards are standard practice at large US companies, where a substantial portion of top executive pay is typically tied to company performance and is therefore at risk. Sometimes the risk pays off, as was the case when industry recovery prompted an extended rally in airline shares.

By contrast, rank and file at airlines prefer guaranteed compensation. According to ALPA, pilots want reasonable base wages (the practice at Southwest, for example), though they are also interested in stock on top of solid base wages. Several airlines, including United and American, have made the point that their unions turned down opportunities to link more member compensation to stock or buy stock at a special low price. But the reason is obvious: when a person's base pay is at a very low level (like the $35,400 top annual flight attendant pay at Northwest), the bulk of it goes to pay the mortgage and necessary living expenses and therefore it cannot be at risk.

Like other companies, the major airlines feel that they need to offer competitive compensation packages in order to attract and retain top-tier management. Recent years have seen many top airline executives attain equally or better-paying positions outside the industry. For example, AMR's former CEO Don Carty is now CFO of Dell and former CFO James Beer is now CFO of Symantec.

In contrast, employment trends for rank and file airline workers have been negative. The industry's financial losses and restructuring have weakened employees' negotiating position. Also, because of seniority, groups such as pilots have few, if any, other employment opportunities unless they are prepared to accept substantial pay cuts.

Several analysts have suggested in recent months that labour should accept this new market reality. Merrill Lynch's Linenberg argued that, as the world has become a harsher place for airlines, with the industry earning only 1-3% pre-tax margins even though this may be the cyclical peak, compensation for airline employees "may have been permanently altered" and therefore "pay restoration may be an unrealistic goal in light of the industry change". Linenberg noted that this is not unique to airline employees; for example, medical professionals' compensation fell dramatically as HMOs (a form of health insurance) proliferated in the US.

UBS' Sam Buttrick called the widening executive-worker pay differentials "simply a resetting of market rates". He criticised labour for thinking that the former market rates reflect "some level of birthright".

Executive pay has surged in most US companies in recent years (to a level many people consider unjustifiable, regardless of an individual's leadership skills), and so has the gap between executive and worker pay. Because of the growing popularity of stock awards, the gap has widened when the stock market has risen and will obviously narrow when equity prices fall.

However, the situation with airlines is quite unique and there are unresolved issues. In other industries, labour has not made such enormous sacrifices to keep their companies afloat and employees are better paid.

The worst thing about the recent executive stock awards is that they are, as one Northwest lawyer put it, "out of spirit of any notion of shared sacrifice". The awards at American make mockery of the "pull together, win together" slogan used by the management and the highly successful "working together" initiative (collaboration between management and labour) that has led to significant additional cost savings and revenue enhancements in recent years.

In other words, by accepting the stock awards, the top executives are conforming to the letter of the law but not the spirit of the law.

At AMR's annual shareholder meeting in May, APA proposed a so-called "say on pay" resolution - a vehicle for shareholders to voice approval or disapproval of executive compensation on an annual basis. The proposal was rejected, with many investors praising CEO Arpey for the significant achievement of keeping AMR out of bankruptcy and rebuilding its market value (which, of course, he deserved). However, the proposal got 38% of the vote and may well be adopted in the future. "Say on pay" has gained popularity in the US this year, after being recently authorised in a House bill. It was on the agendas of numerous AGMs this spring; in many cases it was defeated, but some large companies have adopted the rule voluntarily. There is talk that it could become widespread next year.

"Say on pay" would be a useful vehicle for monitoring executive pay on an ongoing basis, enabling investors to weigh in on what is reasonable as industry conditions and the company's circumstances change. It would be advisory only, but a vote of disapproval would obviously put much pressure on top executives to decline stock awards that particular year.

Delta's outgoing CEO Gerry Grinstein refused a Chapter 11 exit bonus, and officers and directors there will not receive pay increases until frontline employees have reached industry standard pay. In addition, Delta distributed \$350m worth of stock and \$130m in cash lump sum payments to 39,000 ordinary employees, which was in addition to the benefits secured by members of two unions as part of their concessionary new contracts. Given how inflammatory the executive stock awards have been with labour at the other legacy carriers, and in light of the earlier "shared sacrifice/shared reward" promises, it is frankly surprising that other legacy airline CEOs have not followed Grinstein's lead.

By accepting the stock awards, American's management effectively made the commitment to work with unions to negotiate contracts that workers will find acceptable. At the AGM, Arpey made promises to that effect. The problem is that American cannot afford to restore pay, so it is hard to see how this could be resolved.

If American and the other legacy carriers get away without restoring pay, it would further weaken morale and possibly even lead to a labour shortage. According to recent articles in the Wall Street Journal, airlines are having trouble retaining and hiring qualified workers especially in expensive locations such as the Northeast. Low pay, reduced retirement benefits, increased stress and loss of prestige and fun - the WSJ called many airline jobs now "more akin to those at a fast-food restaurant" - have led to airline workers starting over with new careers.

Reduced staffing levels, less experienced workers and weakened morale could have serious ramifications for service levels and punctuality, reducing productivity at peak times and ultimately hurting the bottom line.

Even if there are no strikes or work slowdowns (none are currently on the cards), unhappy workers mean a lack of goodwill. American recently found that out the hard way: it had to withdraw its Dallas-Beijing route application after its pilots refused to sign a deal allowing them to work the longer hours necessary on that route.

By Heini Nuutinen
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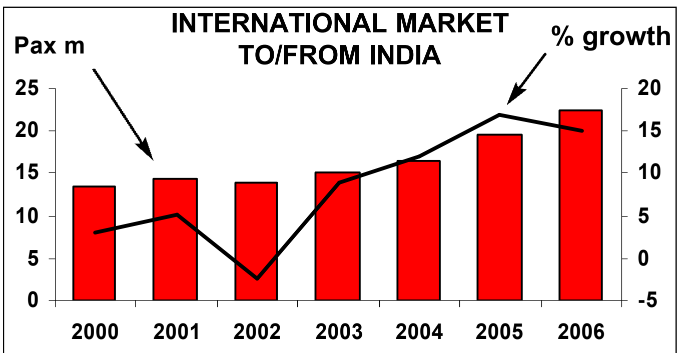
Jet/Sahara *vs* Air India/Indian in the battle for international markets

Following the imminent acquisition of Air Sahara by Jet Airways and the merger of Air India and Indian, two large airline groups will compete head-on for the growing international market to/from India. How successful will the integration of Air India/Indian and Jet/Sahara be, and how will they fare in the battle for international passengers?

The Indian market has long been recognised as having great potential but in the last three years the Indian government's gradual liberalisation of the aviation industry has sparked a huge increase in capacity, particularly domestically. Until four years ago only Jet Airways and Air Sahara provided domestic competition to Indian, but in 2007 competition comes from Air Deccan, Kingfisher, Go Air, SpiceJet, Paramount, Indus and IndiGo, and at least four new airlines are seeking approval to being domestic services.

According to the Airports Authority of India (AAI) passengers carried on Indian domestic routes have risen from 13m in 2002 to more than 25m in 2006, with domestic traffic increasing by around 28% in 2006 compared with 2005. The domestic rate of growth is expected to slow down to "just" 15%-25% per annum over the next few years, but it will continue to be fuelled by the expansion of the Indian urban middle classes (who number around 300m at present) and a steady conversion of passengers from rail to cheap air routes. Longer-term, many analysts see further potential from the tourism market, which is relatively underdeveloped.



Source: AAI

However, in the short-term, as more domestic capacity has flooded into the market and fares have dropped, the industry has had to contend with falling domestic yield. So while over the last three years the size of the fleet at Indian airlines has more than doubled, from 130 aircraft to approximately 300, and although passengers carried have risen almost as fast, load factors still hover in the mid-60s, and the Indian aviation industry is expected to report a collective loss of some $400m-$500m in 2006/07 (at least for the full-service airlines).

On international routes, according to AAI, passengers have risen from 14m in 2002 to more than 22m in 2006 (see chart, left), and international traffic is expected to keep rising in the double digits per annum over the next few years.

Until recently the government has been reluctant to encourage international competition, and non-domestic routes were offered by just the two state-owned carriers (Air India and Indian Airlines) and two private airlines (Jet Airways and Air Sahara). But increasingly liberal bilaterals and a recognition of the fact that Indian airlines have just a 25% market share of international traffic to/from India have prompted the government to ease restrictions on other Indian airlines that want to operate internationally. At the moment only airlines with a minimum of 20 aircraft and a five-year track record of operating domestically are allowed to apply for international route licences, but the Indian civil aviation ministry is reviewing these rules, and it is likely that the five-year regulation will be the first to be eased, although on certain international sectors only.

Those sectors will include south Asia - on which any private Indian airline is now allowed to compete (although within the existing restrictions as listed above) - and the Gulf region, the latter of which the government plans to open up to more private Indian airlines in 2008.

In preparation for this opening up of the international market, the government has finally pushed through the long-awaited merger of Air India and Indian Airlines, but at the same time Jet Airways is completing its on/off acquisition of Air Sahara (the only private airlines currently allowed to operate internationally). The scene is now set for what will be a hard-fought battle between these two airline blocks internationally, with each wanting to establish itself on the most lucrative international routes before competition from other private Indian airlines pours in.

Jet and Sahara

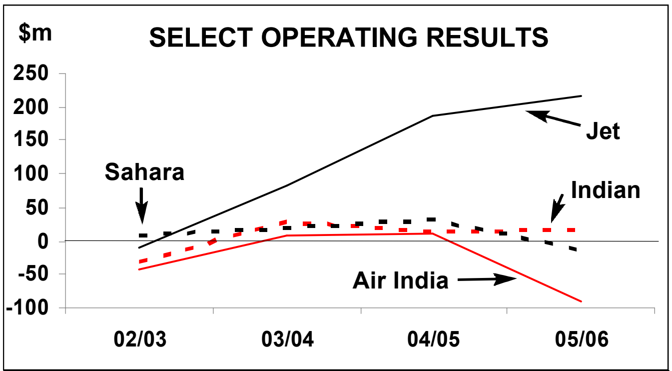
Mumbai-based Jet Airways was launched in 1993 and initially flew a handful of 737-300s on domestic routes, before becoming the first private airline to launch an international route, to Colombo in 2004. Jet carried out an IPO on the Bombay stock exchange in early 2005, with 20% of equity currently on free float and 80% held by Tailwinds, which is owned by Naresh Goyal, the billionaire (in US$ terms) chairman of Jet.

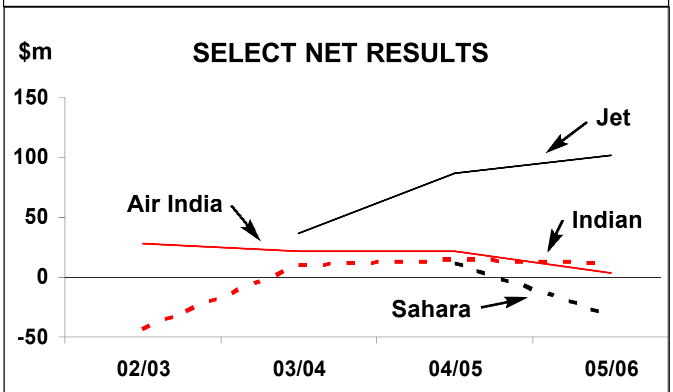
Following the IPO, Jet began to expand its fleet and both its domestic and international network, and today the airline has almost 10,000 employees and operates to 51 destinations (with Brussels the latest, added in May), of which seven are foreign, and with hubs at Calcutta, Chennai, Delhi and Bangalore. Jet is easily the largest private airline in India and it is now the market leader domestically, with a 28.4% share as at September 2006 (according to Indian government figures), ahead of Indian Airlines (21.7%), Air Deccan (19.3%), Air Sahara (9.1%), Kingfisher (9.4%) and SpiceJet (6.8%).

In 2005/06 (with the financial year ending on March 31), Jet reported a 17.4% rise in both operating profit, to $218m, and in net profit, to $102m, and in the third quarter of Jet's current financial year (October-December 2006, which is the company's busiest quarter), revenue rose 35.4% to Rs20.3bn ($457.3m), of which international revenue accounted for 22% (up from 14% in September-December 2005). However, EBIT fell 10.4% to Rs2.3bn ($52.9m) in the quarter, and net profit fell 34.4%, to Rs400m ($9m), thanks to increasing competition and higher fuel costs, which rose 36% in the quarter, to Rs6.1bn ($138m). Passengers carried in the quarter rose 14% to 2.7m, with traffic growth of 31.6% just behind a 33.3% rise in capacity, leading to a 0.8 percentage point fall in load factor, to 69.3%.

Domestic load factor of 70.1% was down 2.4% compared with October-December 2005, reflecting the increase in domestic competition, with Jet's domestic capacity up 15%. Pre-tax profit on domestic services was Rs733m ($16.5m), 43.7% down on the same quarter in 2005. International load factor was 67.6%, 5.2% down on the previous year, but international routes made a pre-tax loss of Rs113m ($2.5m) in the quarter, an improvement on the $7.7m loss in 3Q 05/06. Jet hints that all its international routes are profitable other than those to the UK, and it is addressing those routes through better yield management

However, these 3Q net profits were





Source: Aviation Economics/HSH Nordbank Note: Financial year to March 31 wiped out by losses in the first two quarters of the financial year (April-September), and for the first three-quarters of the FY (April-December 2006), although revenue rose 32.7% to Rs55.3bn ($1.2bn), EBIT fell 51.2%, to Rs4.1bn ($92.4m), and the airline recorded a net loss of Rs601m ($13.5m), compared with a Rs2.2bn ($50.7m) net profit in 1Q-3Q 05/06. In the first three quarters of 2006/07, Jet made a pre-tax loss of $44m on international routes, and a $28m pre-tax profit on domestic routes (with a $28m loss internationally and a £108m profit domestically in 1Q-3Q 05/06).

The trend in domestic business is clear, and in the third quarter of 2006/07, while Jet's overall yield fell 2.4% compared to a year earlier, international yields rose 18.2%, thanks to a higher proportion of business class passengers. Unsurprisingly, the airline sees its future profitability driven by international expansion, and in April this year Jet finally agreed terms to buy Delhi-based Air Sahara, after a saga that had gone on since January 2006, when a "deal" between the two was first unveiled, at a price of around $500m. But that agreement collapsed over the summer of 2006, leading to a fierce legal battle between Jet and the Sahara Group, the conglomerate owners of Air Sahara, with the Group accusing Jet of walking away from the deal.

An arbitration panel was assembled to rule on the legal dispute, and the end result was the surprise resurrection of the deal this year, although at reduced price. The acquisition is expected to be completed formally by the summer, and Jet has agreed to pay the Sahara Group a total of Rs14.5bn ($327m) in instalments (with the last payment due to be made in March 2008).

Some analysts are critical of the rationale and pricing deal for a loss-making airline that has seen its share of the domestic market fall by 2.4% over the year to September 2006. But increasing domestic competition has hit Jet too, with its market share falling from by 12.6% over the same period. Together however, the two airlines will have around a 37% domestic market share (after some domestic rationalisation).

Jet refutes comments that the deal was effectively forced upon it, for fear of losing the legal argument and having to face costly litigation and financial penalties, and insists that that not only does the deal shore up Jet's domestic position, but that it also allows Jet to benefit from Air Sahara's order for 10 737-800s, which are due for delivery in 2009-2011. Additionally, Jet says that Air Sahara traffic should feed into some of Jet's international routes and - crucially - Jet will gain valuable slots for both domestic services (in 2006 the Indian government passed a law allowing slot transfers between merged airlines) and for international services, including some key Air Sahara slots at London Heathrow.

As the only other private Indian airline that has permission to fly internationally, Air Sahara operates to Colombo, Kathmandu and Singapore, had planned to launch a Delhi-London Heathrow route in July, and wanted to expand into other destinations, such as Guangzhou and Dhaka. However, Jet is to axe all of Air Sahara's international services (some of which will be transferred to Jet) and rebrand and relaunch Sahara as JetLite in July, using it for domestic operations only. The intention is to use Air Sahara/JetLite as a "complement" to Jet Airways' domestic operation, with the rebranded airline positioned between full-service airlines and the swathe of domestic LCCs (though formally it will not be a LCC, as it will offer frills such as free in-flight catering and entertainment). Air Sahara currently has a fleet of 23 737s and CRJs, although the latter will be replaced by ATRs, Jet's preferred short-haul aircraft.

Under a team parachuted in from Jet and led by Gary Kingshott, Jet's chief commercial officer, JetLite will operate as a separate entity, and Goyal says his team will make JetLite profitable within a year, due to lower unit costs and synergies with Jet. At least Rs4bn ($90m) will be invested in "upgrading" Air Sahara as JetLite, including improvements in basic areas such as engineering support and maintenance, with Jet executives saying that Sahara's maintenance standards are not as high as at Jet.

But there will be difficulties: Sahara's pay and conditions are lower than at Jet, and Jet wants to keep salaries at those levels, while the culture of Sahara is described as "lax" by one analyst, and the integration of Sahara employees into Jet's operational practices may lead to some staff departures. Although Air Sahara has a higher employee to aircraft ratio than Jet (see chart, page 16), pilots in particular are in short supply in India, and Jet has had to open a pilot training school in Brussels, which will train up to 200 pilots per year. How Air Sahara's pilots will react to the takeover by Jet is hard to predict, as last year a number of Air Sahara's pilots went on a "sick-out" in protest at the impending deal.

Financial stretch?

Some analysts also believe JetLite will cannibalise Jet's revenue, where around 20% of economy capacity is already offered at very low fares, but perhaps more of a concern is that the acquisition will stretch Jet financially. As of the end of 2006, Jet had debt of Rs53.4bn ($1.2bn), some 72% up on a year earlier, and in 2006 shareholders gave approval for the airline to raise up to $800m in equity and bonds in order to finance the acquisition of Air Sahara, improve the balance sheet and fund fleet purchases. This year Jet aims to raise $400m of that, but after initially talking with private equity companies, it now plans to raise the cash via a rights issue.

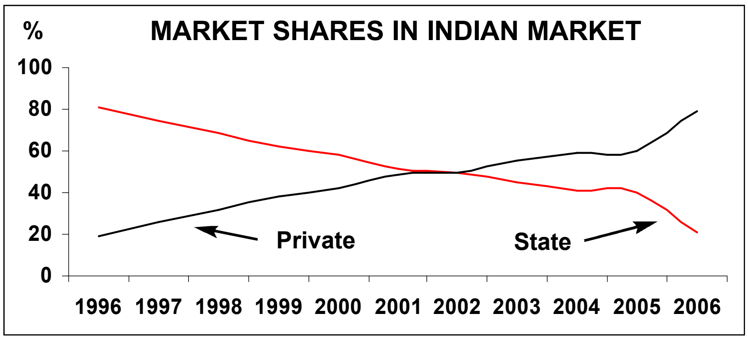
The cash raised will be used partly to pay for deposits on $3.7bn of new aircraft that Jet will receive over the next few years. Currently Jet's fleet of 62 aircraft have an average age of just over five years (while Air Sahara's 23-strong fleet have an average age of more than eight years), but between April this year and October 2008 Jet will take delivery of 20 widebodies. 10 777-300ERs are on order (with a further 10 on option), the first of which will arrive this June and with eight due to be delivered in 2007, while the first of 10 A330-200s arrived this April. Jet also has outstanding orders for 10 787s for delivery from 2011 onwards, although these are switchable for other Boeing models.

By March 2011, Jet (excluding Sahara) plans to have a fleet of 97 aircraft, and this new capacity will be used primarily to underpin a huge push on international routes, with Goyal aiming for revenue of $3bn-$4bn by 2012, with half of that from international routes.

Currently Jet operates to Colombo, Kathmandu, London Heathrow, Kuala Lumpur, Singapore and Bangkok (launched in January from Delhi and Kolkata, the former in competition with Air India, Indian Airlines and Thai Airways) using its fleet of 28 737-800s as well as five leased A330s and A340s but, as the widebodies arrive, routes into North America, Europe, Asia and Africa will be added.

The US is the prime target for Jet, although the launch of routes into the US has been delayed by a US State Department investigation into allegations that the finances of the airline and its chairman were linked to Dawood Ibrahim, an Indian-born terrorist suspect. Once the State Department found the allegations baseless, the US DoT gave approval at the end of 2006, and this May Jet unveiled plans for a European hub at Brussels airport, which it is setting up in partnership with Brussels Airlines. Starting in August, Jet will operate 777-300ERs on a route from Mumbai to Newark, stopping at Brussels, and later in the year it will add a daily Delhi-Brussels-Toronto service.

The medium-term goal is to build services up to 10 flights a day between India and North America via Brussels, and among the destinations that may be connected are Los Angeles, Chicago and New York in North America, and Delhi, Bangalore and Chennai in India. The link with Brussels Airlines entails adding Brussels' code to selected Jet flights, with Jet codesharing on five Brussels' routes into Europe, which they aim to expand to 25 routes.



Elsewhere in Europe, and encouraged by liberalisation of the India-UK bilateral, Jet has plans for direct routes into the UK regions, most likely to commence with Birmingham. Jet currently operates to London Heathrow from Mumbai, Delhi, Amritsar, and Ahmedabad, most of which compete against Air India. Jet is also in talks with Lufthansa over co-operation on routes to Germany, with Munich the most likely destination, and is also negotiating with the German carrier on both a maintenance tie-up in India as well as a cargo venture, with Jet intending to launch a cargo subsidiary some time before the end of 2007.

As long-haul capacity increases, Jet will expand onto other destinations, such as South Africa, Kenya and Mauritius. A Mumbai to San Francisco via Shanghai route will launch at the end of 2007, also using 777-300ERs, while several routes will be launched into the Gulf in 2008, with likely destinations to include Dubai, Saudi Arabia, Bahrain and Doha.

On all these routes the new widebodies will incorporate revamped products in three classes (including first-class for the first time) on the 777s and two classes on the A330s. The 777s will include flat beds in an attempt to raise Jet's first and business class products to the same standards as British Airways and Virgin Atlantic, and Jet's focus on business travellers includes more than 1,300 deals with Indian-based corporates, which Jet wants to increase to 2,000 by March 2008. Jet also introduced a new booking engine for corporates and travel agents earlier this year, to complement existing distribution agreements with Indian travel portals such as Yatra.

Along with the push into intentional markets, in April Jet unveiled an updated livery and branding (designed by brand consultants Landor Associates), which will be used in a new marketing campaign being planned by agency M&C Saatchi (which won an account worth $11m in January, and is opening up an office in Mumbai to service Jet). And an indication of the growing rivalry with Air India came in March when Jet poached Perfect Relations - Air India's PR company - which according to sources has deeply angered Air India executives.

Jet isn't yet a member of a global alliance, but over the last year has expanded codesharing to Qantas, Continental and United, and also has FFP partnerships with Air France and South African Airways. Wolfgang Prock-Schauer, Jet's CEO, was previously head of alliances at Austrian Airlines, part of Star, and the Star alliance has said it would like Jet to join. However, Jet has so far not been drawn into any commitment, and both it and the global alliances will want to see how successful Jet's costly international expansion will be before they commit to any partnership.

Air India and Indian Airlines

Air India dates back to 1932, and launched its first international route in 1948. Today the international flag carrier operates from 14 Indian cities to 31 destinations around the world, the majority of which are in the Asia-Pacific (10 destinations) and Gulf regions (nine). The 100% state-owned airline has hubs at Mumbai and Delhi, and employs more than 15,000 staff. In the 2005/06 financial year, ending in March 2006, Air India posted revenue of Rs87.5bn ($1,971m), 15% up on the previous year, although net profit fell 82% to Rs163m ($3.7m), due largely to increasing competition and a 44% rise in fuel costs.

The underlying problem that Air India faces is that it just does not have the ability to compete with the private sector, and as a result its market share continues to fall. In an attempt to find a solution the Indian government finally approved, in March, the long-awaited merger of Air India and Indian Airlines, the 100% state-owned domestic carrier (which sometimes drops "Airlines" from its formal name for marketing purposes) that made an $11m net profit in 2005/06 (down by a quarter on 2004/05).

A merger has been on the government's agenda for many years, but fierce resistance has come from unions and politicians, who feared substantial job losses. However, a ministerial panel appointed in 2006 to consider the merger decided in its favour in early 2007 (with - crucially - a recommendation that there should be no job losses at the merged airline, and no changes to pay and conditions), and formal government approval followed soon after, in March this year.

The government has an ambitious target of July 15th for the merger's legal completion, although operational integration could take another two years to carry out. Although there will be no job losses, many analysts expect the merger will be slow and painful at times - particularly as the airlines have different networks, operational procedures and fleets - but it's a process that the two airlines have to drive through if the state-owned entity wants to have any hope of survival against private competition. This includes domestic LCCs, full-service Jet Airways and foreign airlines on international routes, and this competition has already eroded the combined international/domestic market share of Air India and Indian from 81% to 21% in a decade (see chart, page 13).

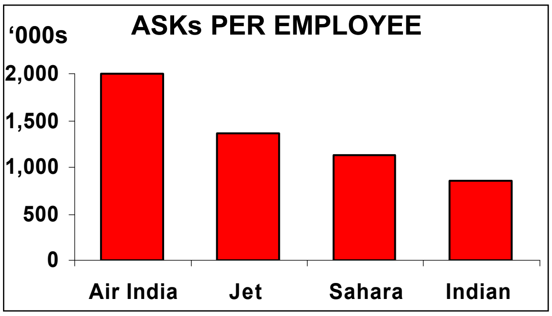
The Indian government has chosen to keep "Air India" as the name for the merged airline, with Air India's logo also retained (although the airline will have a new livery), and with its corporate headquarters in Mumbai (the base of Air India) rather than Delhi (where Indian is located). Following lots of speculation, the new chairman and "joint" managing director will be Vasudevan Thulasidas, who holds the same positions at Air India, while Vishwapati Trivedi, chairman and managing director of Indian, will also become a "joint" managing director. However, Thulasidas is due to retire in March 2008, and it is not yet clear whether Trivedi will replace him at that time, or whether someone new will take over.

The joint managing directors will have much to do, although they will have considerable support from the government, which is amending tax and finance laws so that Air India and Indian can carry forward past losses and unabsorbed depreciation into the merged entity, thereby providing a tax shield against future profits. The enlarged airline will also benefit from a waiver on stamp duty, and altogether these measures will save the merged airline around $171m.

Crucially though, the managing directors will have their hands tied in terms of cost-cutting. Air India currently employs 15,535 and Indian 19,300, and the combined workforce of around 35,000 fares badly when compared against its main rival, in terms of employees per aircraft (see chart, page 16). Under the terms of the merger these figures will not come down, with Air India insisting it will not even introduce a voluntary retirement scheme. Earlier this year Air India did cut the number of cabin crew on international flights, which many analysts had long criticised as being over-manned (e.g. Air India used 19 cabin crew on 747-400s as opposed to the 16 normally assigned by other airlines), but although Air India says this reduction in crew per aircraft will reduce costs by $11m per year, the "cut" staff have been reassigned elsewhere, so their costs will reappear elsewhere as well.

However, the merged airline will have separate "strategic business units" for full-service, cargo and LCC functions, as well as for functional business such as maintenance, ground handling and catering, and this will at least identify the areas that are the most overstaffed, so that action in the future may be slightly easier to implement. At the very least, when the airlines merge there should be substantial non-staff cost-savings made in the fields of maintenance and ground handling.

In terms of fleet size, the merged airline will become one of the top five carriers in Asia, with a combined fleet of 118 aircraft (see table, page 17), approximately a third of all aircraft registered with Indian carriers. More importantly, the two airlines have more than 100 aircraft on order, which is vital given that Air India's fleet has an average age of more than 16 years (with its 16 A310s having an average of more than 20 years), while Indian has an average age of 14 years. Until recently Air India had not ordered aircraft for a decade (instead relying on expensive leased aircraft), and the need for urgent fleet renewal was highlighted in April when two Air India aircraft (an A310 and a 767) made emergency landings on the same day, with an Indian civil aviation official saying that "poor maintenance is the major cause behind the two incidents".

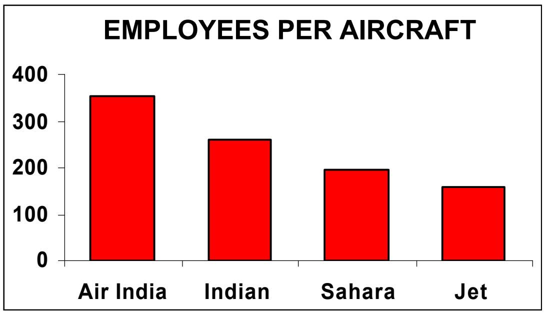


That's why in early 2006 Air India placed the largest ever order by an Indian airline, for 68 Boeing aircraft with a list price of $11.6bn. Altogether 15 777-300ERs, 27 787s, 18 737-800s (for Air India Express) and eight 777-200LRs will be delivered by 2012. The first aircraft - a 737-800 - was received in December 2006 (becoming the first new aircraft to be delivered to Air India since 1996), while the first 777 is due to be delivered this June. Altogether 17 of the 50 long-haul aircraft on order will arrive by early 2008, and the rest will be delivered by 2010.

These new aircraft will replace everything in the current fleet other than six owned 747-400s (which will continue in service until at least 2014). Indian also placed an order for more than 40 Airbus aircraft in 2005, at a value of $2.2bn and for delivery by 2011, and did have plans to acquire up to 10 widebodies, although this will have to be confirmed now that the merger is going ahead. At the moment, with leased aircraft being phased out (around 60% of Air India and Indian's fleet are currently leased), the merged airline plans to have a fleet of around 125 by 2010.

Pilot worries

Although the merged airline will receive an aircraft a month until 2011, a key problem will be to find enough pilots to fly this equipment. As of this April Air India had a pilot shortfall of around 120, and this is getting worse as the 737-800s arrive, with the airline estimating it needs another 100 pilots a year for the next seven years.



Although Air India will be helped by a new MoU signed with the Indian Air Force, which will release batches of retiring pilots (up to 20 strong at "regular intervals") in order to reduce the shortage, it is estimated that up to 3,000 new pilots will be needed in India over the next five years, and Indian flight training schools are already working at maximum capacity. Although the Indian government has steadily raised the pilot retirement age from 60 to 65 over the last few years, in 2005 it had to introduce a six month notice period for pilots in order to deter airlines from poaching staff from competitors, and Air India (and other Indian airlines) has no option but to recruit more foreign pilots. Unsurprisingly, the shortage is leading to significant pay rises for pilots at Air India and other airlines.

Air India first recruited from abroad back in 2004 and is now hiring pilots direct from Brazil and Serbia, as well as looking to training schools in the US and New Zealand for other pilot intakes. Indeed in November last year the pilot shortage became so acute that Air India was forced to wet lease a 767-300ER for six months from Edinburgh-based Flyglobespan, prior to the arrival of the 777s this summer, and this April it also wet leased an A310 for a year from Czech airline CSA.

Despite this problem, the new widebody aircraft will be a vital boost to Air India, which has increased international capacity substantially over the last few years, particularly to the US and Europe. In North America Air India operates to New York JFK, Newark, Los Angeles, Chicago and Toronto, with more than 30 flights a week between the US and India. However, Air India faces increasing competition for a slice of the 1.5m passengers a year that travel on US-India routes. Delta, Continental and American all offer US-India services and are increasing flights (with Continental, for example, launching daily, non-stop Newark-Mumbai services this October), but Air India plans to fight back with the launch of services to Dallas, Houston and San Francisco by March 2009.

In Europe, Air India operates to London Heathrow, Paris CDG, Frankfurt and Birmingham, and the airline aims to develop at least one hub in Europe, in direct competition with the Brussels operation of Jet.

Currently, the biggest proportion of Air India's revenue comes from the Asia and Middle East regions, and it is here that the merger with Indian will provide most benefit outside of India. Indian operates medium-haul routes into the Gulf with narrowbodies, and - for example - on the India-Kuwait sector the government estimates the airlines will save $18m a year from rationalisation of flights. Similarly, the two airlines operate around 10 flights each day onto Singapore, but load factor is believed to be hovering around the 60% mark, and this will be another area for rationalisation.

Air India also has another long-haul network via Air India Express, its low cost subsidiary, which will merge with Alliance Air, Indian's domestic LCC, once the two parents merge. Express is based in Mumbai and launched its first route in 2005, but with initial load factors in the 90s has expanded rapidly and currently operates from nine Indian cities to nine destinations a maximum four hours flying time away - Abu Dhabi, Al Ain, Dubai and Sharjah (all in the UAE); Muscat and Salalah in Oman; Bahrain, Doha and Singapore.

Express initially flew with leased 737-800s, but with new capacity from the 737-800s ordered by Air India, further routes will be launched later this year. Express will have a fleet of 25 aircraft by 2008 and also has ambitions to build up a route network outside of the Gulf region. Express's first service outside of the Middle East was to Singapore, a five-times-a-week service launched in October last year from Chennai (and competing against Indian Airlines, Singapore and Jet), and this May Thulasidas said that low cost services to destinations further than Express's current four-hour limit were also under consideration, with Asian cities such as Kuala Lumpur and Bangkok believed to be the initial targets. Express may also place an order for further 737-800s, (for delivery in 2009 at the earliest), which according to T.P. Singh, COO of Express, "is not going to be a small order".

One major decision for the new Air India/Indian will be its choice of global alliance. Air India had been due to make a decision by the end of the year, but this is likely to be postponed until the merger is completed, when the new airline will be a lot more attractive to the alliances. SkyTeam and oneworld will be keen to sign-up the merged airline, particularly if Jet does go with Star, which would leave the alliance that Air India/Indian didn't choose out of SkyTeam and oneworld with a significant gap in its route network and with no obvious means of filling it. But Air India has also been linked strongly with Star, thanks to Air India's existing codeshares with Lufthansa and United, although informal negotiations are believed to be taking place between Air India executives and all three of the global alliances at present.

According to the Indian government, although the costs of integration are estimated at Rs2bn, the merger will improve profits by Rs6bn (£135m) in the third year after the merger. That's an ambitious target for a state-owned entity where staff costs are "fixed", but a necessary one if the government wants to achieve its ambition of an

MAJOR INDIAN FLEETS

	Fleet	Orders	Options
Air India/Air India Express			
A310	16		
737-800	13	12	
747-300C	2		
747-400	8		
747-400C	1		
777-200	1		
777-200ER	3		
777-200LR		8	
777-300ER		15	
787-8		27	
Total	**44**	**62**	**0**
Indian			
A300	3		
A319	6	20	
A320	48	4	
A321		20	
Dornier 228	2		
Total	**59**	**44**	**0**
Alliance Air			
737-200	11		
ATR-42	4		
Total	**15**	**0**	**0**
Air India/Indian total	**118**	**106**	**0**
Jet Airways			
A330-200	2	10	10
A340-300	3		
737-400	6		
737-700	13	2	
737-800	28	4	
737-900	2		
777-300ER		10	10
787-8		10	
ATR 72-500	8		
Total	**62**	**36**	**20**
Air Sahara			
737-300	2		
737-400	3		
737-700	5		
737-800	7	10	
CRJ200	6		
Total	**23**	**10**	**0**
Jet/Sahara total	**85**	**46**	**20**

IPO. Both airlines had been due to IPO in 2006, partly in order to finance new aircraft orders, but an IPO has been postponed until the merger is well underway, with 2008 now the earliest possible date.

At that date it is likely that the IPO will float only a minority stake of around 25% in Air India/Indian, with the government retaining a majority, but getting in non-governmental investors - no matter how small the initial stake - is crucial for the future of the merged airline for two reasons.

First, fresh financing is needed. Air India's fleet expansion is being financed by a $7bn line of credit with ABN Amro, but interest on the merged companies' existing debt is already approaching $1bn per year, and at some point Air India will need to place an order for larger A380 or 747 models for delivery after 2012, and these aircraft will have to financed somehow.

Second - and perhaps more importantly - new investors are needed in order to shake up Air India/Indian's management. Worryingly, Indian aviation minister Praful Patel says that though the merged airline may undergo an IPO, it would still remain what is termed a "public sector enterprise", and that in terms of hiring professional management: "I do not think businessmen are the only solution … I have been in government long enough to understand that there are excellent bureaucrats who can handle absolutely difficult situations."

Who will win?

Both Jet/Sahara and Air India/Indian aim to become among the very best airlines in Asia by 2010 (and Goyal says he wants Jet to be among the top five carriers in the world in the next five years), but as they grow they will compete fiercely on international routes out of India.

They will also have to battle against foreign airlines and from competition closer to home. For example, Bangalore-based Kingfisher has five A380-800s and five A350s on order, and is putting intense pressure on the government to operate internationally. Kingfisher may get around the existing "five-year" requirement by using Kingfisher International, its US-based subsidiary, to operate non-stop routes such as Mumbai-New York and Bangalore-San Francisco in 2008. Other Indian airlines will follow Kingfisher's example, and it's entirely feasible that when the current 49% limit restriction on foreign investment in Indian airlines (with foreign airlines not allowed to invest at all) is eased, then aggressive foreign carriers may take direct stakes in expanding Indian airlines, which would present formidable extra competition to Air India and Jet.

In the short-term, however, the two airlines may be forgiven for focussing on making their mergers work. The key difference between the two airline blocks is efficiency - although in terms of ASKs per employee Air India appears more efficient than Jet (see chart, page 16), this is skewed by the higher average stage length at Air India, and by another measure - employees per aircraft - both Air India and Indian have higher ratios than Jet and Sahara (see chart, page 16). And while there have been recent managerial changes at Jet, some analysts believe that the management at Jet is far superior to that at Air India.

Nevertheless, the giant Air India/Indian block should not be underestimated, as the two airlines carried a combined 13.7m passengers in 2005/06 and, according to one analyst, control more than 70% of airport infrastructure at Delhi and Mumbai.

Jet says that with its planned expansion, it and JetLite will offer more destinations than Air India/Indian by 2008, and that it will operate them at a higher load factor than its main rival. However, Jet may be forgetting the continuing government support for Air India/India. The government is committed to a massive increase in investment in Air India/Indian in order to fund fleet expansion, with the official state "allocation" for Air India rising from $111m in 06/07 to $1.4bn in 07/08 and for Indian from $79m to $565m, and against that kind of ongoing support, Jet will do well to achieve its ambitions.

Freighter values and lease rates

FREIGHTER VALUES (US$m)

	New	5 years old	10 years old	20 years old
A300F4-200				8.55*
A300-600RF		56.70	42.73	
737-300QC			15.01	8.51
747-200M				4.82
747-400M		104.09	80.22	
747-400F	149.65	125.50	101.35	
747-400ERF	159.69			
757-200PF			30.89	16.48
767-300F	75.86	61.51	47.17	
MD-11C			44.10	
MD-11F			55.43	

Note: * = 1984 build

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

	New	5 years old	10 years old	20 years old
A300F4-200				157
A300-600RF		477	406	
737-300QC			200	156
747-200M				197
747-400M		806	702	
747-400F	1,395	1,203	1,011	
747-400ERF	1,526			
757-200PF			285	236
767-300F	583	523	490	
MD-11C			467	
MD-11F			605	

Note: As assessed at end April 2007
***Source**: AVAC*

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Alaska	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
	Oct-Dec 06	790	808	-18	-12	-2.3%	-1.5%	9,261	6,828	73.7%	4,107	9,485
	Year 2006	**3,334**	**3,422**	**-87**	**-53**	**-2.6%**	**-1.6%**	**43,306**	**33,012**	**76.2%**	**24,025**	**12,933**
	Jan-Mar 07	759	778	-18	-10	-2.4%	-1.3%	10,652	7,552	71.0%	5,471	13,236
American	**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%	23,606	85,200
	Year 2006	**22,563**	**21,503**	**1,060**	**231**	**4.7%**	**1.0%**	**280,052**	**224,423**	**80.1%**	**98,139**	**86,600**
	Jan-Mar 07	5,427	5,179	248	81	4.6%	1.5%	72,362	56,063	77.5%	23,299	85,100
Continental	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	
	Year 2006	**13,128**	**12,660**	**468**	**343**	**3.6%**	**2.6%**	**178,500**	**144,060**	**80.7%**	**67,119**	**44,000**
	Jan-Mar 07	3,179	3,115	64	22	2.0%	0.7%	43,853	34,519	78.7%	16,176	
Delta	**Year 2005**	**16,191**	**18,192**	**-2,001**	**-3,818**	**-12.4%**	**-23.6%**	**252,327**	**193,042**	**76.5%**	**118,853**	**55,600**
	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
	Year 2006	**17,171**	**17,113**	**58**	**-6,203**	**0.3%**	**-36.1%**	**238,168**	**186,892**	**78.5%**	**106,649**	**51,300**
	Jan-Mar 07	4,144	3,989	155	-130	3.7%	-3.1%	56,774	43,794	77.1%	25,325	52,260
Northwest	**Year 2005**	**12,286**	**13,205**	**-919**	**-2,533**	**-7.5%**	**-20.6%**	**147,694**	**122,017**	**82.6%**	**70,300**	**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
	Oct-Dec 06	2,980	2,886	94	-267	3.2%	-9.0%	37,386	30,564	81.8%	16,600	30,484
	Year 2006	**12,568**	**11,828**	**740**	**-2,835**	**5.9%**	**-22.6%**	**149,575**	**125,596**	**84.0%**	**67,600**	**30,484**
	Jan-Mar 07	2,873	2,672	201	-292	7.0%	-10.2%	36,845	29,964	81.3%	15,600	30,008
Southwest	**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
	Year 2006	**9,086**	**8,152**	**934**	**499**	**10.3%**	**5.5%**	**149,123**	**108,936**	**73.1%**	**96,277**	**32,664**
	Jan-Mar 07	2,198	2,114	84	93	3.8%	4.2%	38,105	25,924	68.0%	19,960	33,195
United	**Year 2005**	**17,379**	**17,598**	**-219**	**-21,176**	**-1.3%**	**-121.8%**	**225,785**	**183,898**	**81.4%**	**67,000**	**55,000**
	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
	Year 2006	**19,340**	**18,893**	**447**	**22,876**	**2.3%**	**118.3%**	**255,613**	**208,769**	**81.7%**	**69,325**	**53,000**
	Jan-Mar 07	4,373	4,465	-92	-152	-2.1%	-3.5%	61,900	49,415	79.8%	16,350	51,500
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**
	Jan-Mar 07	2,732	2,616	116	66	4.2%	2.4%	35,411	27,039	76.4%	19,935	36,000
JetBlue	**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
	Year 2006	**2,363**	**2,236**	**127**	**-1**	**5.4%**		**46,016**	**37,522**	**81.6%**	**18,565**	**9,265**

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

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

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group employees
Air France/ KLM Group YE 31/03	**Year 2004/05**	**24,641**	**21,744**	**641**	**453**	**2.6%**	**1.8%**	**214,606**	**168,998**	**78.7%**	**64,075**	**102,077**
	Apr-Jun 05	6,257	5,982	275	135	4.4%	2.2%	57,936	46,041	79.5%	17,948	101,886
	Jul-Sep 05	6,790	6,154	636	864	9.4%	12.7%	60,472	50,961	84.2%	18,705	
	Oct-Dec 05	6,430	6,205	225	91	3.5%	1.4%	58,266	46,644	80.0%	17,120	102,291
	Year 2005/06	**25,901**	**24,771**	**1,136**	**1108**	**4.4%**	**4.3%**	**234,669**	**189,253**	**80.6%**	**70,020**	**102,422**
	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	
	Oct-Dec 06	7,593	7,260	333	302	4.4%	4.0%	60,999	48,663	79.8%	17,829	
BA YE 31/03	**Year 2004/05**	**14,681**	**13,666**	**1,015**	**472**	**6.9%**	**3.2%**	**144,189**	**107,892**	**74.8%**	**35,717**	**46,065**
	Apr-Jun 05	3,716	3,398	318	162	8.6%	4.4%	36,706	27,768	75.6%	9,177	46,079
	Jul-Sep 05	3,887	3,427	460	301	11.8%	7.7%	37,452	29,812	79.6%	9,767	46,144
	Oct-Dec 05	3,664	3,362	301	212	8.2%	5.8%	37,119	27,499	74.1%	8,530	45,624
	Jan-Mar 06	3,692	3,530	162	144	4.4%	3.9%	36,657	26,780	73.1%	8,160	45,171
	Year 2005/06	**14,813**	**13,588**	**1,227**	**812**	**8.3%**	**5.5%**	**147,934**	**111,859**	**75.6%**	**35,634**	**47,012**
	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 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
	Oct-Dec 06	1,811	1,750	61	-12	3.4%	-0.7%	16,458	13,132	79.8%	6,682	
	Year 2006	**5,388**	**5,266**	**122**	**57**	**2.3%**	**1.1%**	**65,802**	**52,493**	**79.8%**	**27,799**	**23,901**
Lufthansa YE 31/12	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**	**90,811**
	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	
	Year 2006	**26,206**	**25,090**	**1,116**	**1,060**	**4.3%**	**4.0%**	**146,720**	**110,330**	**75.2%**	**53,432**	**93,541**
SAS YE 31/12	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
	Oct-Dec 06	2,215	2,121	94	679	4.2%	30.7%	13,405	9,162	68.4%	9,611	25,534
	Year 2006	**5,270**	**5,010**	**260**	**169**	**4.9%**	**3.2%**	**36,971**	**27,506**	**74.4%**	**25,100**	**31,965**
Ryanair YE 31/03	**Year 2004/05**	**1,727**	**1,301**	**426**	**345**	**24.7%**	**20.0%**	**36,611**	**31,205**	**84.0%**	**27,593**	
	Apr-Jun 05	488	392	96	84	19.7%	17.2%			83.4%	8,500	2,764
	Jul-Sep 05	652	409	244	208	37.4%	31.9%				9,500	2,987
	Oct-Dec 05	439	381	58	44	13.2%	10.0%			83.0%	8,600	2,963
	Year 2005/06	**2,045**	**1,598**	**447**	**371**	**21.9%**	**18.1%**			**83.0%**	**34,768**	**3,063**
	Apr-Jun 06	711	539	172	146	24.2%	20.5%				10,700	
	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 YE 31/03	**Year 2003/04**	**1,963**	**1,871**	**92**	**74**	**4.7%**	**3.8%**	**25,448**	**21,566**	**84.5%**	**24,300**	**3,727**
	Oct-Mar 05	1,039	1,116	-77	-41	-7.4%	-3.9%	14,526	12,150	83.8%	13,500	
	Year 2004/05	**2,364**	**2,278**	**86**	**76**	**3.6%**	**3.2%**	**32,141**	**27,448**	**85.2%**	**29,600**	**4,152**
	Oct-Mar 06	1,095	1,177	-82	-50	-7.5%	-4.6%	16,672	13,642	81.8%	14,900	
	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	**Year 2004**	**5,024**	**4,350**	**674**	**581**	**13.4%**	**11.6%**	**74,062**	**57,283**	**77.3%**	**13,664**	**15,054**
YE 31/12	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	
	Year 2006	**7,824**	**7,274**	**550**	**526**	**7.0%**	**6.7%**	**89,117**	**71,171**	**79.9%**	**16,730**	
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**
	Year 2006	**8,498**	**7,975**	**523**	**363**	**6.2%**	**4.3%**	**71,895**	**52,178**	**72.6%**	**22,140**	**16,623**
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	**Year 2003/04**	**7,838**	**7,079**	**759**	**448**	**9.7%**	**5.7%**	**104,200**	**81,276**	**78.0%**	**30,076**	**33,862**
YE 30/06	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**
	Jul-Dec 06	6,099	5,588	511	283	8.4%	4.6%	61,272	49,160	80.2%	18,538	
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**
	Year 2006/07	**9,555**	**8,688**	**866**	**1,403**	**9.1%**	**14.7%**	**112,544**	**89,149**	**79.2%**	**18,346**	**13,847**
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**
	Year 2006	**5,647**	**5,331**	**316**	**338**	**5.6%**	**6.0%**	**79,383**	**60,276**	**75.9%**	**31,490**	**18,872**
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**
	Year 2006	**5,808**	**5,769**	**39**	**26**	**0.7%**	**0.4%**	**97,044**	**69,575**	**71.7%**	**49,200**	**45,000**
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**
	Year 2006	**3,825**	**4,201**	**-376**	**-416**	**-9.8%**	**-10.9%**	**70,428**	**50,243**	**71.3%**	**35,020**	**35,000**
Air Asia												
YE 30/06	**Year 2005**	**152**	**122**	**30**	**25**	**19.7%**	**16.4%**	**6,525**	**4,881**	**74.8%**	**4,410**	**2,016**
	Year 2006	**230**	**173**	**57**	**34**	**24.8%**	**14.8%**	**8,646**	**6,702**	**77.5%**	**5,720**	**2,224**

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 %
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
2006	329.9	226.6	68.7	230.5	188.0	81.5	182.7	147.5	80.7	588.2	478.4	81.3	874.6	677.3	77.4
Apr-07	28.7	20.2	70.5	19.8	16.4	82.6	14.9	12.2	81.6	49.4	40.4	81.8	74.6	58.5	78.4
Ann. change	5.5%	3.9%	-1.1	4.1%	1.7%	-1.9	0.1%	1.0%	0.7	3.2%	1.9%	-1.0	4.3%	2.9%	-1.1
Jan-Apr 07	107.8	69.9	64.8	71.2	55.6	78.0	60.4	49.6	82.0	192.9	155.9	80.8	286.9	218.1	76.0
Ann. change	5.0%	6.1%	0.6	3.6%	2.7%	-0.7	2.0%	4.8%	2.2	3.8%	4.7%	0.7	4.7%	5.6%	0.6

Source: AEA

NINE LARGEST US PASSENGER AIRLINES 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 %
2005 Q1	227.9	170.0	74.6	38.2	29.4	77.0	26.5	21.6	81.5	26.9	19.9	73.9	91.6	70.9	77.4
Q2	237.5	188.8	79.5	45.6	39.1	85.6	27.6	23.2	84.1	25.4	17.9	70.6	98.6	80.2	81.3
Q3	239.1	192.4	80.4	49.5	42.2	85.3	28.9	24.2	83.7	25.0	18.8	75.2	103.4	85.2	82.4
Q4	225.1	172.2	76.4	41.9	33.2	79.2	27.4	22.3	81.4	24.2	17.2	71.1	93.5	72.7	77.8
2005	**929.6**	**723.4**	**77.8**	**175.2**	**143.9**	**82.1**	**110.4**	**91.3**	**82.7**	**101.5**	**73.8**	**72.7**	**387.1**	**309.0**	**79.8**
2006 Q1	219.2	169.3	77.2	39.6	29.7	75.0	26.1	21.7	83.2	28.2	21.1	74.8	93.9	72.5	77.2
Q2	228.1	188.3	82.6	49.7	42.1	84.7	28.2	23.9	84.7	26.3	20.4	77.6	104.2	86.4	82.9
Q3	232.2	187.9	80.9	54.0	45.3	83.9	28.7	24.4	85.0	26.3	20.4	77.6	109.0	90.1	82.7

Note: Legacy airlines are American, Continental, Delta, Northwest, United and USAirways. Statistics also include Alaska, America West and Southwest.

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	20 May	Royal Jordanian	2 x 787		
	29 May	S7 Group	15 x 787		10 x purchase rights
	31 May	Ryanair	27 x 737-800s		converted options
Airbus	14 May	AerCap	10 x A330-200s		
	30 May	Avianca	33 x A320 family, 5 x A330-200		plus 32 options
Embraer					
Bombardier					

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

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