Issue No: 120

Aviation Strategy

October 2007

Atlantic battle plans

The Euro-majors are starting to make some big moves in anticipation of next year's US-EU open skies regime.

Air France has announced a comprehensive joint venture with Delta. Mirroring the long-established KLM/Northwest agreement, the two airlines will implement full revenue and cost sharing on all their services between their respective hubs (CDG, Orly and Lyons; Atlanta, JFK, Cincinnati and Salt Lake City), as well as the planned, from April next year, Heathrow operations.

This is only the first phase. All the main SkyTeam members have applied for extended anti-trust immunity, the main effect being that the AF/DL operation would combine with the KL/NW joint venture, generating an estimated €20-30m net benefit for the Air France Group.

The assault on Fortress Heathrow has been launched with the transfer of three daily LHR slot pairs from Air France to Delta, enabling the US carrier to fly double dailies to/from JFK plus a daily to Atlanta. Air France itself will operate from LHR to Los Angeles (and from there connect to Tahiti, which is legally part of France). AF/KL has another 22 daily slots at LHR, though not all are suitable for transfer from short to long haul operations.

How the passenger will benefit from all this consolidation is rather unclear - unlike the KL/NW agreement which rationalised numerous thin O&D city-pairs by hubbing passengers over Amsterdam and Detroit, the AF/DL alliance focuses on cooperation on thick hub-to-hub routes, though it also should intensify competition on the very lucrative LHR-JFK market.

For BA this incursion means that it has become more important to get its business-orientated Atlantic subsidiary successfully off the ground. Project Lauren, as it is known, is scheduled to start up with 757s in the summer of 2008. Incidentally, just how seriously the network carriers are taking the new wave of business-class carriers may be indicated by Delta starting a JFK to Orly service in direct competition against L'Avion, while American has started Stansted to counter the impact of Maxjet and EOS.

For Lufthansa, Air France's moves make it more likely though not inevitable that it will make an offer for bmi when the present sell option on bmi's part turns into a buy option on Lufthansa's part next year (see Briefing, page 14). With a consolidation trend apparently in motion, Iberia, for not particularly logical reasons, has probably become a more attractive target for BA or Lufthansa or Air France or indeed Grupo Marsans (the owner of Spanish long-haul charter Air Comet and Aerolineas Argentinas, which has just signed an MoU for 61 Airbuses including four A380s).

Observing all this is Michael O'Leary who is apparently determined to create a long-haul low cost carrier, separate from Ryanair, and dubbed Ego Air. Intensely commercial as always, he states that the right time to start up is in a recession when he can pick up equipment cheaply as opposed to today's very strong aircraft market.

www.aviationeconomics.com

CONTENTS

PUBLISHER

Aviation Economics

James House, 1st Floor
22/24 Corsham Street
London N1 6DR

Tel: +44 (0) 20 7490 5215
Fax: +44 (0) 20 7490 5218

e-mail: info@aviationeconomics.com

Is the leasing market peaking?

Aviation Strategy
is published 10 times a year
by **_Aviation Economics_**

Editor:
Keith McMullan
kgm@aviationeconomics.com

Contributing Editor:
Heini Nuutinen

Contributing Editor:
Nick Moreno

Sub-editor:
Julian Longin
jil@aviationeconomics.com

Subscriptions:
info@aviationeconomics.com

Tel: +44 (0)20 7490 5215

Aviation Economics
Registered No: 2967706
(England)

Registered Office:
James House, 1st Floor
22/24 Corsham St
London N1 6DR
VAT No: 701780947

ISSN 1463-9254

With lease rates still climbing, a continuing shortage in second-hand aircraft and very few spare production slots available at Boeing and Airbus until after 2010, the leasing industry is enjoying its best times since 1996-1999. But is the cyclical upturn that started in 2004 at the very top of its peak, or will the bullish market continue for another few years?

Most of the industry holds strong views that good times are here to stay for a while longer, with the peak not being reached until 2009 or 2010 and a downturn only in 2012-2013. Some are even speaking of a "super-cycle" in the industry. The rationale goes that this leasing upturn is different to others, since this time it is not dependent on US and European airlines but rather on long-term, rising demand from China, India and other emerging Asian markets. Combine this with other factors such as consolidation in the US industry and impending modernisation of the ageing fleet there, along with signs that many airlines have decided to permanently put a larger proportion of their fleet on leases in order to increase flexibility, and the consensus view is that there is no market bubble waiting to burst.

The circumstantial evidence that the peak has not yet been reached is substantial. Many airlines are signing longer leases (up to 10 years in some cases) and the strong narrowbody market has been joined by a strengthening widebody market as airlines try to plug the gap before the A380 is eventually delivered. The operating lessors' share of the world fleet has risen from an estimated 19% to 31% over the last decade (according to research from Aircastle), with some lessors claiming this will continue to rise, reaching 50% in the next decade.

Having said all that, there is a small (but growing?) view that 2007 and 2008 will be the peak of the cycle, with the market likely to soften in 2009 or even before then. One analyst (who, unsurprisingly, prefers not to be named) says there is a lot of "froth" in the leasing market, and that direct evidence for this is the amount of leasing assets and companies that are changing hands, which always tends to happen at the very top of the market. It is a long list. Recently there have been floats for AerCap, Aircastle and GECAS's Genesis, while the Bank of China bought SALE, Terra Firma acquired AWAS and Pegasus, a Macquarie-led consortium bought GATX's portfolio, and Standard Chartered is buying Pembroke.

Of course there has always been a steady change of ownership in the aircraft leasing industry, but it is the growing interest of private equity funds in today's market that some see as a crucial warning sign that the market is at or even past its peak. The activity of UK buyout specialist Terra Firma is particularly attracting criticism, with one analyst regarding its acquisition of AWAS as having "curious timing", while others believe that the company paid too much for AWAS, having chased the deal after reportedly losing out on earlier attempts to acquire debis and Boullioun.

The "bulls" say this criticism is unfair, given that there is more than just one large private equity company looking to buy leasing assets at the moment, with banks that were reluctant to own aviation assets in the years after September 11 also now looking to buy lessors, while there is continuing interest from some lessors to merge with competitors. Indeed Babcock & Brown, Macquarie Bank, Allco Finance, the UK's Standard Chartered Bank, Mitsubishi Corp. and Dubai Aerospace Enterprise are all reported to have bid unsuccessfully for Pegasus or SALE, and may be on the look-out for other potential acquisitions.

And they are being joined from growing interest out of China in the aircraft asset management sector, fuelled by the booming aviation industry there and by government "encouragement" to buy foreign assets. The Bank of China is believed to be looking for further leasing acquisitions, while Beijing-based China Minsheng Bank (the largest privately-owned bank in China) is talking with potential partners, both foreign and domestic, in order to set up a leasing entity, and at least four other Chinese banks are looking to set up leasing ventures.

Yet, unlike most banks and leasing companies, private equity companies tend to have relatively short-term investment horizons, and it's likely that Terra Firma will be looking to sell its assets and make a large profit in around two to four years from now - which some say will be right in the middle of the leasing down cycle.

Among other points that the pessimists bring up are:

• Lease rates have risen faster much than underlying aircraft asset values, which is not sustainable in the medium-term - either asset values will have to increase (which is what Terra Firma may be betting on), or else lease rates will have to come down. Already lease rates appear to be flattening on some models.

• The engine room of the leasing recovery - narrowbodies - is vulnerable, because as plans for the replacement programmes for the 737s and A320s are firmed up, this may affect demand for older models in the next few years (with some airlines becoming reluctant to commit to 10-year 737 and A320 leases if new aircraft are likely to be available around 2016-2018).

• Asian demand is overestimated. John Plueger, COO at ILFC, warns that the Indian aviation infrastructure cannot support the aircraft that its airlines have already ordered, and that in China - while demand remains high - lease rates are relatively low. ILFC currently prefer to sign new business elsewhere, where it can get higher yields (although one analyst counters that ILFC is traditionally "sniffy" about emerging markets.)

• The US credit market crunch may have a trickle down effect into the aircraft leasing market, restricting the ability of some companies to fund portfolio expansion as aggressively as they had previously planned.

So are companies like Terra Firma likely to make stunning profits as the leasing industry peak/super-cycle extends for a few more years, or will the real winners be those companies that will be able to say they have got out at the very top of the market (such as Morgan Stanley, the GATX Corporation, Oaktree, Singapore Airlines and WestLB), prior to a downturn? If the latter occurs, then Terra Firma will have to wait until the next peak before it can sell at a profit - which it may well be prepared to do, but which surely is not what Guy Hands (the CEO of Terra Firma and a legendary UK financier who founded the company after leaving Nomura in 2002) is banking on?

Interestingly, the two powerhouses of the industry - GECAS and ILFC - appear to be partly cashing in too. GECAS raised a substantial sum by floating off a portfolio of aircraft to Genesis, and ILFC is believed to be looking to set up similar deals and has said that it is seeing increased approaches from third party investors and debt and equity providers regarding the potential purchase of aircraft from the ILFC fleet.

The final trend, which may prove to be the most important, is an attempt to shift the geographical centre of the leasing business from Dublin to Dubai. Irish corporate tax rates at 12% maximum were instrumental in building the leasing industry there, pre- and post-GPA; Dubai and other Middle Eastern states are now offering zero percent taxation and other structural support.

The lessors (see table, page four) now have 844 outstanding orders, compared to 662 almost two years ago (see *Aviation Strategy*, December 2005). The "Big Two" - GECAS and ILFC - have a combined fleet of 2,757 aircraft, and as they dominate the outstanding order book (with a combined 399 aircraft, or almost half of all outstanding orders placed by lessors), they look set to continue their domination of the industry for many years to come. Nevertheless, many second-tier leasing companies have been increasing their portfolios, some third-tier companies are making a major push to increase their asset base, and - even given the state of the market - there appears to be a higher-than-usual number of new entrants into the leasing industry.

General Electric Capital Aviation Services (GECAS)

GECAS comfortably remains the world's largest lessor, owning 1,450 aircraft and managing another 300 on behalf of clients. The

AIRCRAFT LEASING COMPANIES' FLEETS

Company	Owned	Managed/ part-owned	Total	Boeing orders	Airbus orders	Total orders
GECAS	1,450	300	**1,750**	89	88	**177**
ILFC	894	113	**1,007**	123	99	**222**
BCC			**500**			
AerCap			**340**		33	**33**
CIT			**300**	20	90	**110**
Babcock			**219**			
ACG			**228**	49	20	**69**
RBS			**200**	9	20	**29**
Pegasus Aviation	82	94	**176**	9	8	**17**
AWAS	140		**140**			
ORIX			**120**			
Aircastle			**100**		15	**15**
GA Telesis			**90**			
MALL	39	49	**86**			
BCI Aircraft Leasing			**86**			
Pembroke	20	59	**79**			
BOC Aviation (SALE)	60	14	**74**	43	20	**63**
World Star Aviation			**58**			
Aircraft Leasing and Management		58	**58**			
Jetran			**57**			
Genesis			**53**			
Sumisho			**50**			
Q Aviation			**45**			
SAFAIR			**44**			
Allco Finance			**41**			
Guggenheim			**40**	9	6	**15**
Deutsche Bank Equipment Leasing			**40**			
Aergo Capital			**36**			
JetWorks Leasing			**33**			
Alafco	19	14	**33**	28	25	**53**
Aircorp			**32**			
Airbus Asset Management			**30**			
Oasis			**30**			
Sojitz Aircraft Leasing			**23**			
Volito Aviation			**22**			
Bavaria			**21**			
Jetscape			**19**			
Republic Financial			**17**			
Goal			**14**			
Automatic			**10**			
Itochu Airlease			**10**			
Tombo Aviation			**10**			
Deutsche Structured Finance			**10**			
Skytech-AIC			**9**			
Central Air Leasing			**8**			
Aerostar Leasing			**8**			
Intrepid Aviation			**-**		20	**20**
LCAL			**-**	15		**15**
Oak Hill Capital Partners			**-**	6		**6**
Total	**2,704**	**701**	**6,356**	**400**	**444**	**844**

Note: This table includes jet lessors with at least eight owned or managed aircraft. We exclude entities set up solely to manage the leasing activities of a specific airline, as well as companies that largely arrange finance deals only.

portfolio has continued to grow over the last few years, with owned aircraft increasing by 150 in just 18 months and the portfolio's asset value rising from $30.5bn in 2002 to $44bn today.

Part of General Electric, GECAS also has the largest sales network of any lessor, with 23 offices around the world placing its owned aircraft with 230 customers in 70 countries. In 2006 GECAS saw revenue rise

19.2% to $4.2bn, with a "segment profit" of $1.1bn, a substantial 45% up on 2005. According to GE's annual report, in 2006 GECAS benefited from a "reorganization of aircraft leasing operations", which led to "growth in lower-taxed earnings from global operations". With increasing amounts of business in China, India, Brazil and Russia, GECAS's bottom line is boosted considerably from a lower tax liability on revenue generated outside the US. Indeed the lessor is continuing to push into the Chinese market and currently has 14 Chinese airline clients, with its latest deal signed in August last year for nine 737-800s for Xiamen Airlines, to be delivered in 2008.

Interestingly, last year GECAS appeared to recognise that the leasing cycle is close to its peak by selling 41 aircraft to a new entity called Genesis Lease, which was floated on the New York stock exchange (see page 11). Soon afterward, in January this year, GECAS announced an order for 39 Boeing aircraft - 24 737-800s and 15 777s, with delivery of all aircraft in 2008-2010, while orders for six 777Fs and 60 A320s were revealed at the Paris air show. GECAS's current order book stands at 89 Boeing aircraft (64 737s, two 747s and 23 777s) and 88 Airbus aircraft (18 A319s and 70 A320s).

International Lease Finance Corporation (ILFC)

ILFC, a subsidiary of US financial services giant AIG, has a portfolio of 1,007 aircraft, 894 of which are fully owned and the rest either on finance leases or managed on behalf of clients. The overall total has increased by more than 100 aircraft in just over a year, reflecting deliveries from the large amount of orders that ILFC had placed previously with both Airbus and Boeing.

Based in California, ILFC now has 222 aircraft on outstanding order with the two manufacturers, for delivery through to 2015: 99 Airbus aircraft (25 A319s, 30 A320s, eight A321s, 10 A330s, 16 A350s and 10 A380s) and 123 Boeing aircraft (32 737-700s, eight 737-800s, nine 777-300ERs and 74 787s - of which 63 aircraft were announced at the Paris air show in June). Though this total has come down considerably from the 360 aircraft it had on order back in 2004, this is still the largest order book of any lessor, and sources in the US indicate that ILFC is soon to announce an order for another 50 787s.

Three-quarters of the aircraft on order will be delivered by the end of 2009, and around 50 aircraft are due to arrive in the remainder of 2007 alone - although all of the 2007 arrivals have already been placed with customers, and every aircraft in the ILFC portfolio is believed to be out with a customer.

Around 90% of ILFC's aircraft are placed with airlines outside of the US, and almost 50% of ILFC's entire fleet is placed with European airlines, which is a direct consequence of ILFC's strategy to "maximize lease placements in regions that are strengthening, such as in Asia, Europe and the Middle East, and to minimize placements in regions that are under stress".

Though ILFC took another $20m hit during 2006 arising from termination of leases on 11 aircraft placed with Varig, for the year ILFC posted a net profit of $499m, 13.9% up on 2005 and based on revenue of $4.1bn, 14.7% up on the previous year.

Boeing Capital Corporation (BCC)

BCC has approximately 500 aircraft in its portfolio, which the company claims are worth $9.5bn. BCC finances aircraft sold by Boeing where "third party financing is not available" - i.e. it is essentially a lender of last resort, and although BCC admits that while it can provide financing for most of Boeing's orders, "customers typically seek lower cost financing from others sources". This largely means that BCC ends up financing higher risk customers.

As at the end of March 2007, BCC's portfolio was heavily concentrated on US airlines, with just five carriers - AirTran, United, American, Midwest and Hawaiian - accounting for 51.2% of BCC's portfolio value In fact exposure to US carriers is increasing at BCC (which probably affects the relative difficulty US airlines are having in arranging aircraft finance of their own, compared with non-US airlines), and BCC says that "certain customers have requested a restructuring of their transactions with BCC". 75.3% of BCC's portfolio value was placed with US airlines at the end of March 2007 (compared with 73.7% at the end of 2005), with 12.8% in Europe (12.7% in 2005), 6.6% in Asia (6.8%), and 5.3% elsewhere in the world (6.8%). Boeing warns that "the credit ratings of some airlines - particularly in the US - have remained at low levels", so that while passenger load factors are at record levels, there is a limited supply of used aircraft, and lease rates are increasing, "values for the various aircraft types that are collateral in BCC's portfolio generally have not increased".

BCC employees 200 staff and has four offices in the US, as well as in Brussels, Stockholm, Moscow and Hong Kong. The business has two divisions - Space & Defence, and Aircraft Financial Services, although most of BCC's assets and business is in the aviation sector. In 2006 BCC's revenue rose 6.1% to just over a $1bn, and net income increased by 39.6%, to $194m, thanks partly to a higher net gain on disposal of assets, while in the first quarter of 2007 revenue fell 10.1%, to $213m, and net income rose by just 2%, to $50m, which BCC says is related to "the sale of certain aircraft in 2006".

As a lender of last resort, BCC is also overexposed to older aircraft models, and at the end of March this year, $2.6bn of its portfolio by value was in 717s and $0.7bn in MD-11s. Just over 9% of the portfolio by value is in aircraft more than 16 years' old, with another 11.6% in aircraft made between 1992 and 1996, and 39.6% manufactured in 1997-2001.

AerCap

Based in the Netherlands, AerCap has a portfolio of 340 owned and managed aircraft, worth around $4bn, including narrowbodies (A320 family, A300s, MD-80s, 737s and 757s), widebodies (A330s, A340s, 767s and MD-11s) and regional jets (F100s, F70s). These are currently placed with more than 80 airlines in 45 countries, the majority of which are in Europe (43 clients), Asia (23) and North and South America (20).

AerCap, which also has offices in the US and Ireland, was known as debis AirFinance until it was bought from DaimlerChrysler and a consortium of banks by New York-based private equity firm Cerberus Capital in 2005. However, Cerberus floated AerCap on the NYSE in November last year, raising $444m for existing shareholders and $156m for the lessor, the latter used primarily to repay debt and to pay for its 2006 purchase of Miami-based AeroTurbine, an engine lessor. This last deal was a continuation of a diversification strategy for AerCap, and in 2006 just 54.5% of revenue came from leases, with a substantial 37% coming from aircraft sales. In 2006 AerCap recorded a net profit of $88m, 6% up on 2005, based on revenue of $814m, 65% higher than in 2005.

AerCap's portfolio has risen substantially in the last few years, with an extra 103 aircraft added in 2006 alone. In April last year AerCap signed a $1bn credit facility with UBS to finance new aircraft purchases over the next few years (which came just seven months after an aircraft securitisation raised another $1bn). In August 2006 AerCap bought a 22-strong portfolio of aircraft with a "diversified age profile" from GATX, including A319s, A320s, 737-300s and 757-200s, and which were placed with 10 airlines around the world.

In December 2006 AerCap ordered 20 A330-200s, for delivery from 2008 to 2010, and in May this year ordered another 10 A330-200s, which join two A320s and an A321 already on order. Another $1.7bn worth of aircraft securitisation bonds was issued in May, and this July AerCap announced it was planning a secondary public offering of up to 23m shares for later this year.

CIT Aerospace

The New York-based lessor has a mixed portfolio of 300 aircraft - including A310s, A320 family, A330, 737s, 747s, 757s, 767s and 777s - placed with 94 customers. The average age of the fleet is six years, and as at the end of March 2007 the portfolio was worth an estimated $7.3bn, of which $5.4bn was in narrowbody aircraft, while Airbus aircraft accounted for 56.7% of the portfolio by value and Boeing 43.2%.

CIT also has offices in Ft. Lauderdale, Toronto and Dublin, and opened a Singapore office this May, which will aim to build on the 24% of the CIT Aerospace portfolio by value that is currently placed with Asian airlines (with 39% in Europe, 17% in the US and Canada, and 13% in Latin America).

The lessor is part of the CIT Group, a NYSE-quoted commercial and consumer finance group, and is making a concerted effort to draw ahead of its second-tier rivals by building a large order book that is second only to that of GECAS and ILFC. In April this year CIT ordered five 737s-700s, while at the Paris air show it announced orders for 25 A320s and two A350s and in July ordered five more 787s. Altogether CIT has outstanding orders for 90 Airbus aircraft (21 A319s, 42 A320s, five A321s, 15 A330-200s and seven A350s) and 20 Boeing aircraft (10 737s and 10 787s, with five of the 787s ordered this July). CIT also plans to follow the lead of GECAS/Genesis by hiving off a portfolio of 45 aircraft before the end of the year, in order to release capital and reduce its asset exposure.

Babcock & Brown

Babcock & Brown Aircraft Management BBAM) manages a portfolio of 219 aircraft - most of which are narrowbodies - and worth an estimated $5.8bn. The fleet has increased by more than 50% in the last 18 months, and as it has grown its average age has come down, from eight years in 2005 to 7.7 years at present. All but two or three aircraft are currently on lease, to a total of 70 clients.

The aircraft business unit is one of four in Babcock & Brown's operating lease division, and its financial results are not separated out in the parent company's financial results (although the holding company is listed on the Australian Stock Exchange). However, the leasing unit does say that its results in 2006 were driven primarily by two businesses, one of which is aircraft, and that there was "a continuation of demand in the aircraft leasing sector". In September the aircraft unit spun off an entity called "Babcock & Brown Air" via an IPO on the NYSE, which raised $340m to fund the acquisition of an initial portfolio of 47 aircraft with an average age of less than six years from BBAM (which retains a 13% stake in Babcock & Brown Air).

Aviation Capital Group

Based in Newport Beach, California, ACG has a portfolio of 228 aircraft worth approximately $6bn and is primarily a late-model narrowbody specialist, although it does have a handful of freighters and widebody aircraft. Launched in 1989, ACG is a subsidiary of US insurance giant Pacific LifeCorp, and the lessor also has offices in Seattle, Connecticut, London and Santiago in Chile, which have placed the portfolio with 99 airlines in 43 countries.

The current fleet is slightly larger than the 220-strong portfolio it had in June 2005, after ACG bought Seattle-based Boullioun Aviation Services from WestLB for a reported €2.7bn, with Boullioun's 120 aircraft joining the 100 aircraft in ACG's existing portfolio. Although ACG added 15 aircraft to the portfolio in 2006, others were sold, and ACG's revenue rose 69% in 2006, to $563m (thanks primarily to the impact of the Boullioun acquisition).

However, in April this year ACG ordered 20 narrowbody Airbus aircraft - 14 A320s, four A319s and two A321s - and at the same time ordered 20 Boeing aircraft: 15 737NGs and five 787s, worth around $1.6bn at list prices. In September this was followed up by an order for 15 737NGs, worth some $0.9bn at list prices, and altogether ACG has an order book of 69 aircraft.

RBS Aviation Capital

Dublin-based RBS Aviation Capital is both a lessor and a provider of aviation financing to clients around the world, with offices in London, Connecticut, Hong Kong, Shanghai and Tokyo. Launched by the Royal Bank of Scotland in 2001, the aircraft leasing side has been expanding fast, and it currently has a portfolio of more than 200 aircraft that have an average age of 3.5 years. They are placed with 63 leasing customers, of which the majority are in Europe (28 customers, including Iberia, easyJet, Virgin Atlantic, Aeroflot, Lufthansa and Air France), Asia (17 clients, including six in China) and North America (12, including American, United and Continental). RBS Aviation Capital currently has 29 aircraft on order, with 20 from Airbus (all A320s) and nine from Boeing (all 737-800s).

Pegasus Aviation

In May 2007 Terra Firma, a European private equity group, bought Pegasus Aviation Finance for $5.2bn from owners that included its management team and investment fund Oaktree Capital Management. Terra says that AWAS (its other lessor acquisition - see below) and Pegasus combined are the third largest aircraft lessor, although our table shows that the combined fleet (and it is not legally a single company yet) would actually "only" be the fifth-largest.

San Francisco-based Pegasus was founded in 1988, but Oaktree Capital Management invested $250m into the lessor in March 2004, after which the company embarked on a major overhaul of its fleet which traditionally had focussed on older aircraft. Pegasus currently has a portfolio of 82 owned aircraft, with another 94 aircraft managed for third parties, and the fleet has a wide range of types, both cargo and passenger.

Pegasus has offices in Miami, London, Singapore and Buenos Aires, and is making a big push into the Chinese market, with the current client list including Air China, China Eastern, Shanghai, China Southern, Jade Cargo and Sichuan. The lessor has 62 employees, and currently its CEO and president is Richard Wiley, who was one of the company's original founders,

In 2006 Pegasus placed orders for $1bn of new aircraft, including six 787s for delivery in 2009-2011, six A330-200s and two A350XWBs, which was the lessor's first ever order with Airbus. However, any additions to the total of 17 aircraft on outstanding order will depend on the plans that Terra Firma has for Pegasus and AWAS.

AWAS

AWAS was launched back in 1985 and is currently owned by Terra Firma, which bought the lessor in March 2006 from Morgan Stanley (which in turn had bought the lessor in 2000) for $2.5bn plus outstanding liabilities.

Soon after, in July, AWAS appointed a new CEO and president - Franklin Pray, previously managing director of CIT Aerospace, who replaced Charles Graham, who had been CEO of AWAS since 1997. There has also been a raft of senior management appointments at AWAS through the first part of 2007, including new a CFO, head of technical operation and a senior vice president, with the last two being poached from rival lessors.

AWAS is now based in Dublin (it was previously headquartered in Seattle), and currently has a portfolio of 140 aircraft with an average age of around 10 years, comprising eight A300s, six A320s, two A321s, one A330, one A340, 35 737-300s, eight 737-400s, 12 737-500s, four 737-700s, two 747s, 17 757s, 23 767s, one 777, 17 MD-80s and three Fokker 70s.

The portfolio has been cut back by 15 aircraft in the last 18 months, (its latest disposal came in January, when it sold three 767-300ERs to Hawaiian Airlines), and it currently does not have any orders disclosed with the major manufacturers.

The fleet is placed with 74 customers in 47 countries, of which 14 are in North and South America, 41 are in Europe, the Middle East and Africa, and 19 in Asia. AWAS currently has five other offices around the world - in Seattle, New York, Miami, Singapore and Sydney - and 90 employees.

ORIX Aviation

Dublin-based ORIX Aviation was founded in 1991. Owned by Japan's Orix Corporation - a financial services group - it has steadily grown its fleet over the last few years, from 68 in 2004 to 120 aircraft today, with the portfolio (plus engines) worth an estimated $3.25bn.

Whereas it used to be a narrowbody specialist, its fleet now includes a wider range of aircraft, including A319s,A320s, A321s A330s, A340s, 737s, 747s, 757s, 767s, 777s, MD81s and MD80s. The portfolio is fully leased out with clients, although in the first half of 2008 it will have two A319s, three A320s and five 737s available for lease.

Despite the overall growth, like other lessors ORIX has taken the opportunity of a strong market to prune its portfolio, selling two MD82s to MidAmerican Aerospace in January this year and two A320s to AeroTurbine in June. ORIX currently does not any aircraft on outstanding order, but in September acquired eight aircraft from Q Aviation.

Macquarie Aircraft Leasing Limited (MALL)

MALL - a consortium led by Macquarie Bank that includes the Och-Ziff Capital Management Group hedge fund - completed the acquisition of the assets of GATX Air, previously owned by the GATX Corporation, in January this year for around US$1.46bn. According to Bran Kenney, the CEO of the GATX Corporation, it sold its aviation leasing assets as it did not have "a competitive advantage in the commodity business of aircraft leasing", and therefore could not compete effectively with "the two largest players in the industry, which have portfolios many times the size of other lessors". That is a view not shared by MALL, which acquired GATX's assets of 39 owned aircraft and stakes in 49 aircraft held in "various joint venture partnerships"

At the time of acquisition GATX Air had 60 employees based in its headquarters in San Francisco as well as in offices in London, Toulouse and Tokyo. All the aircraft are narrowbodies, (with more than 80% of the portfolio by value comprising A320s and 737-800s), with an average age of five and a half years and placed with 37 airlines in 23 countries.

BCI Aircraft Leasing

Chicago-based BCI Aircraft Leasing also has offices in Los Angeles and the Netherlands (and is just opening an office in Buenos Aires) and specialises in "mid-life" narrowbodies (which it defines as aircraft of between five and 15 years of age) as "this market is not currently competitive, with a handful of players being active", although it also has a handful of widebodies in an 86-strong portfolio.

It had an estimated $1bn in assets at the end of 2006, compared with less than $800m a year earlier, and is continuing to grow steadily, with a medium-term target of pushing past the 100 aircraft mark. Most of its clients are in Europe and North and South America (and which currently include Air France, BA, Delta and US Airways), so a major aim is to build up a client base in Asia. It currently has around nine 737s available to lease, most of which were manufactured in the 1970s and 1980s.

Pembroke

Dublin-based Pembroke has a fleet of 20 owned and 59 managed aircraft worth around $2.5bn, which are placed with 30 airlines around the globe. It is a narrowbody specialist, with its fleet comprising five A320s, six A321s, 12 717s, 31 737s, five 767s, two MD-83s, five CRJs, seven F100s and six RJ-85s.

Pembroke was launched in 1993 and had been owned 50% by GATX Capital and 50% by Rolls-Royce, but by early 2006 neither company regarded Pembroke as a core asset, and so in July 2006 Pembroke was sold to its existing management team, led by CEO Garry Burke, through an investment vehicle called Medulla Asset Managers. After the MBO Burke said that Pembroke wanted to double its portfolio of owned aircraft "in a relatively short space of time", but this September Standard Chartered announced it had agreed a deal to buy Pembroke from Medulla Asset Managers before the end of 2007 for an undisclosed sum.

Aircastle

Connecticut-based Aircastle was launched in 2004 by the Fortress Investment Group, which currently own 80% of equity after the lessor raised

$209m in an IPO on the NYSE in August last year, used largely to repay debt. In February it made a secondary sale of stock to raise another $512m, which is also being used to repay debt.

Aircastle has a portfolio of 100 mostly passenger aircraft worth $2.7bn. They are placed with just under 50 clients in 27 countries, with the two largest clients being US Airways and Hainan Airlines, which accounted for 22% and 8% respectively of revenue of $189m in 2006, although 45% of the current portfolio by book value is with European clients and 23% with Asian airlines.

In January this year Aircastle agreed to buy 38 aircraft with an average age of 10 years from the Guggenheim Aviation Investment Fund for $1.6bn, of which 28 aircraft will be transferred in 2007 and all the rest by February 2009. These are currently with 16 customers in 12 countries, and almost two-thirds of these aircraft are freighters. At the Paris air show Aircastle ordered 15 A330-200 freighters, for delivery in 2010-2011.

Aircastle has 53 employees and offices in Dublin and Singapore, and in the first six months of 2007 reported revenue of $155m (compared with $72m in 1H 2006) and a net profit of $59.6m ($16.2m in 1H 2006).

BOC Aviation (formerly SALE)

The Bank of China bought 100% of Singapore Aircraft Leasing Enterprise (SALE) in December last year from its then owners - Singapore Airlines (which owned 35.5%), WestLB (35.5%), Temasek Holdings (14.5%) and the Government of Singapore Investment Corporation (14.5%) - for the sum of $965m, after those entities decided to maximise a profitable exit at the peak of the leasing cycle.

The Bank of China says it wants to "accelerate the expansion" of the lessor (which changed its named to BOC Aviation in July) with a doubling of the portfolio over the next five years, and indeed in January this year BOC placed an order for 40 narrowbodies - 20 A320s and 20 737NGs, all for delivery between the second quarter of 2009 and the first quarter of 2012. The 737 order is an exercise of previously-placed purchase rights, and with 23 other 737s on order, the total firm order book now stands at 63 aircraft. BOC says that it is likely to place other orders, potentially to include a requirement for widebody aircraft.

BOC currently has a fleet of 74 aircraft (60 of which are owned) that have an average age of three and a half years, which makes it among the youngest lessor fleets in the world. The vast majority of the portfolio are narrowbodies, with 50 A320s, 10 737s, seven A330s, a single 747-400F and six 777s. They are placed with more than 30 airlines around the world, and the lessor has offices in the UK (at Heathrow) and in the US (in Seattle, San Diego and Washington DC). According to BOC it has A320s and 737s "available for lease in 2007 and 2008".

In the financial year ending March 2007, BOC recorded record net profits of US$70.5m, more than double the US$34.7m net profit of 2005/06. This came from US$341m of revenue, 34% higher than in 2005/06. BOC says that "investor appetite in aircraft ownership also rebounded strongly during the year", and as a result the lessor sold 17 of its older aircraft in 2006, with nine new aircraft coming in as replacements.

Genesis Lease

Shannon-based Genesis was established in 2006 with portfolio of 41 aircraft - 20 737s, 14 A320 family, one A330, two 747s, two 767s, two ERJs - that it acquired from parent GECAS prior to its IPO carried out in December 2006 on the New York stock exchange. The net proceeds of the float (which raised $641m gross) as well as a placement of $79m of shares with General Electric (which now has an 11% stake) and an $810m securitisation were used to pay for the 41-strong aircraft portfolio, which has an average age of five years.

In April Genesis agreed a $1bn credit facility with a syndicate of lenders to fund future growth, and in September increased its portfolio to 53 aircraft (leased to 34 airlines) when it bought two A319s, three A320s and three 737-700s from GECAS.

Guggenheim Aviation Partners (GAP)

GAP was launched in 2003 and is owned by Guggenheim Partners, a diversified financial services company whose aviation interests increased this May when it partnered with UBS to launch a specialist aviation financing company for corporate jets called GaFCo.

GAP currently has a portfolio of 40 aircraft with an asset value of more than $1bn. About half its business is in the purchase and conversion of passenger aircraft into freighters, which it says "is a market that currently is underserved". The lessor has steadily built up a portfolio of aircraft and in October 2006 ordered four 747-8Fs (plus two options), adding to three 747s already on order. In December 2006 it followed this up with an order for three 777Fs (plus one option) at a list price of $708m, and in January this year it placed an order for six A330-200Fs.

Alafco

Kuwait-based Alafco - owned by the Kuwait Finance House - is a specialist in Sharia-based leasing and is planning a substantial expansion of its fleet, with a planned portfolio of 50 aircraft by 2010 and 80 by 2015. In 2005 it placed an order worth $2.9bn for 12 A350s plus six options, and in 2006 it added nine aircraft to the portfolio (five new 737-800s and a A320, and three second-hand 777-200ERs), and sold two A310s, thereby increasing the owned fleet to 19 aircraft (nine 737-800s, four 777s, three A310s, three A320s), with 14 other managed for clients.

The portfolio is worth an estimated $840m and placed mostly with nine customers in Asia and the Middle East (with five aircraft at Chinese airlines and three with Air India). Alafco was also listed on the Kuwait stock exchange in 2006, and a sign of its ambition was shown in March this year when it placed an order for 12 787-8s (plus six options) and six 737-800s (plus six options) at list prices of $3.5bn. In June it ordered seven more A320s (joining six A320s already on order) and in July added 10 more 787-8s, bringing total outstanding orders to 53 aircraft, with at least 10 of these being delivered this year. The lessor suffered a blow this August when a planned deal to place 19 aircraft with Kuwait Airways (which owns 11% of Alafco) was cancelled by the Kuwait government, although Alafco insists it will have no problem in finding replacement customers for the aircraft.

Oasis

Abu Dhabi-based Oasis International Leasing was founded 1997 by the Abu Dhabi Investment Company, BAe and the Gulf Investment Corporation, and is listed on the Abu Dhabi stock exchange. Oasis does "big-ticket" business in the aviation, shipping and infrastructure sectors, and in 2006 reported a 240% rise in net profit, to $26.1m.

Oasis currently has a portfolio of 26 aircraft - two A319s, six A320s, one A321, six A330s, two A340s, five 737s, two 777s and two CRJ-100s - all but two of which are placed with customers around the world. However, much of Oasis's business is still with Middle Eastern airlines such as Emirates, Etihad, NAS and Sama, and the lessor is trying to diversify its portfolio as much as possible. To help with this, in February Oasis appointed Erik Dahmen - previously EMEA managing director for lessor BCI - as its senior marketing director.

Other lessors

GA Telesis is a Florida-based lessor with more than 90 aircraft, while **World Star Aviation** is based in San Francisco and manages a fleet of 58 mixed passenger and freight aircraft for 26 airlines in 16 countries. In the UK, **Aircraft Leasing and Management** manages 58 aircraft for clients.

Jetran is based in Texas with a 57-strong fleet of 737s, MD80s and DC-9s, while another Texas-based lessor is Q Aviation. The latter was founded in 2003 by investment management company Q Investments, but in September last year said it was looking to sell its portfolio of 45 aircraft (two thirds of which are narrowbodies), which have an asset value of around $1bn. The aircraft are placed with a variety of clients, including United, Northwest and US Airways, and Q has reportedly instructed Deutsche Bank to find a buyer for its assets; in September eight aircraft were sold to ORIX.

Sumisho Aircraft Asset Management is the Netherlands-based subsidiary of the Sumitomo Corporation, and has a mixed fleet of 50 aircraft, while South African lessor **SAFAIR** has a portfolio of 44 narrowbody aircraft and Australia's **Allco Finance** has 41 aircraft.

New York-based **Deutsche Bank Equipment Leasing** has 40 737 and A320 aircraft in its portfolio, while Dublin-based **Aergo Capital**, launched in 1999, is also a narrowbody specialist, with a portfolio of 36 aircraft, (comprising 19 737-200s, 15 737-200s and two 737-400s) that are leased to clients that include LanChile, Alitalia, Merpati and AdamAir.

JetWorks Leasing is based in Connecticut and was launched in 2005 by former founders of Boullioun Aviation Services. It has a portfolio of 33 mixed aircraft, including freighters, narrowbodies and widebodies. Texan lessor **Aircorp** has 32 Boeing aircraft, while **Airbus Asset Management** remarkets used aircraft for Airbus, with an estimated 30 aircraft in its portfolio.

Formerly known as Sunrock, **Sojitz Aircraft Leasing** is a subsidiary of Japan's Nissho Iwai Corporation and has a fleet of 23 Boeing aircraft.

Volito Aviation is a Malmo-based lessor formed in 2001 that has a portfolio of 22 owned and managed narrowbodies, placed with 15 clients in Asia, Europe and the Americas, which intends to increase its portfolio to 50 aircraft within the next year. Earlier this year it said it was planning to combine 17 of the aircraft in its portfolio with 18 aircraft owned by the Goldman Sachs Special Situations Group to form a new leasing company called VSG Holdings.

Munich-based **Bavaria International Aircraft Leasing** - which started off as a charter airline back in 1958 and is owned by German corporate group Schorghuber - has a fleet of 21 narrowbody aircraft, comprising 717s, 737s and A320s. They are all currently with clients, with the latest placement being a 737-700 that Bavaria leased to Sterling Airlines from this May. At the end of 2005 it had 30 aircraft, but in October 2006 it sold its entire fleet of eight 737-300s (on lease to Varig) to US-based Matlin Patterson, which describes itself as a "global distressed private equity firm".

Florida-based **Jetscape** was launched in 2001 by team that previously built up Indigo Aviation and has 19 aircraft on lease to 16 airlines in 13 countries. Another US-based company is **Republic Financial**, with an estimated 17-strong portfolio. **Goal** is based in Munich and was launched in 1998 as a joint venture between Lufthansa (which owns 40%) and KG Allgemeine Leasing (60%), and currently has a portfolio of 14 aircraft - eight 737s, one 757s and five A310s.

Automatic is headquartered in Florida and has a portfolio of 10 aircraft, while Seattle-based **Itochu Airlease** also has 10 aircraft. California-based company **Tombo Aviation** (owned by Japan's Matsui & Co) has a portfolio of 10 aircraft, while **Deutsche Structured Finance** has approximately 10 aircraft in its portfolio.

Two UK lessors are **Skytech-AIC**, with a fleet of nine aircraft, and **Central Air Leasing**, with eight MD11s. Also with eight aircraft is Singapore-based **Aerostar Leasing**.

New entrants

Among the wave of new entrant lessors are Dubai-based **LCAL (Low-Cost Aircraft**

Leasing), which was set up in 2005 by a group of shareholders that include the Al-Jomaih Group of Saudi Arabia. It is a 787 specialist, and placed its first order for six 787-8s at the Dubai air show in 2005. It added an order for eight 787-9s at the end of 2005 and another 787-9 in March 2007, bringing the total order book to 15, and recently announced that it has placed the first three of its incoming aircraft with Royal Jordanian, for delivery in 2011.

In April this year US private equity house Oak Hill Capital Partners placed an order for six 777 freighters worth $1.4bn at list prices, for "a new aircraft leasing platform". In May US-based Bravia Capital Partners launched an aircraft leasing joint venture with IL&FS, an Indian Bank, which will "serve the aircraft fleet requirements of the rapidly growing Indian airline market", while DAE Capital is the aircraft leasing part of **Dubai Aerospace Enterprise,** which was launched in 2006 to build up a series of aviation businesses. DAE Capital tried unsuccessfully to buy SALE and was believed to be interested in Pegasus, and in April this year appointed Robert Genise, former CEO of Boullioun, as its chief executive. It is aiming to build up a portfolio of 125 aircraft over the next five years, and is expected to announce a substantial order for new aircraft at the Dubai air show in November this year.

This June US lessor **Intrepid Aviation** ordered 20 A330-200 freighters, with delivery from 2010 onwards, while in the same month Germany's HSH Nordbank announced a $1.3bn aircraft fund that will invest in up to 30 narrowbody aircraft, saying that "the timing for an entry into the market is good". The portfolio will be managed by Amentum Capital, a subsidiary of HSH Nordbank and Deutsche Anlagen Leasing (DAL).

In November 2006 AerCap set up **Dragon Aviation**, a China aircraft leasing joint venture with the China Aviation Supplies Import & Export Group Corporation (CASGC) and Calyon Airfinance, a specialist subsidiary of Credit Agricole. Dragon Aviation is based in Beijing (and for tax reasons has an associated company in Shannon) and will specialise in narrowbody aircraft that are being demanded by the growing Chinese aviation sector. It intends to build up a portfolio of $1bn worth of aircraft over the next few years, and will compete with **Shenzhen Financial Leasing**, which leases an unknown number of 737s to Chinese airlines, and a wave of new aircraft lessors that four or five leading Chinese banks aim to set up over the next 12 months.

Lufthansa: ready for a major acquisition?

The Lufthansa group is set to make more than €1bn of operating profit this year, thanks to cost-cutting, the disposal of loss-making assets, a resurgence of premium bookings and the successful turnaround of SWISS. But will Germany's flag carrier be satisfied with a steady accumulation of profits, or will the incessant drive to maximise shareholder return tempt Lufthansa into making a major - but risky - acquisition sometime in the next couple of years?

After a poor 2003 (see *Aviation Strategy*, March 2005), the Lufthansa group has undergone a significant turnaround over the last few years and has increased both operating and net profit in every year since then (see chart, opposite). In 2006 group operating profit rose 46% to €845m and net profit rose 77%, to €803m, based on a 4% rise in passengers carried to 53.4m, and a 9.9% increase in revenue.

The upward trend in financial results is continuing, in the first-half of 2007 the group reported a 4.6% rise in revenue, to €10.1bn, with operating profit up 65% to €486m and a significant rise in net profit, up to €992m compared with €85m in the first half of 2006. However, the net figure included a €503m profit from the sale of the group's 50% stake in Thomas Cook to German retailer KarstadtQuelle (now renamed as Arcandor) for €800m.

The half-year performance has encouraged the group to revise upwards its forecast for full 2007 operating profit to "significantly above" €1bn (reaching as much as €1.3bn, it is believed), but management says that there is still room for improvement, as the stated goal is to become more profitable than its two main European rivals - Air France/KLM and British Airways. That's still some way off, as Lufthansa's 2006 operating margin (adjusted for provisions) of 4.9% was well below the 6% of Air France/KLM and the 7.2% of BA.

How much more scope for margin enhancement is there at Lufthansa? To answer that, the group's overall performance needs to be analysed in its constituent parts. The Lufthansa group now comprises a number of aviation business units, each operating independently, with scheduled passenger airlines grouped together in the "passenger transportation" segment. This segment not only includes mainline Lufthansa but also the regional airlines - CityLine (100% owned by the group), Air Dolomiti (100%), Eurowings (49%), Contact Air and Augsburg Airways - as well as SWISS. In the first-half of 2007 "passenger transportation" reported a 6.6% rise in revenue, based on a 7.7% increase in passenger traffic, and a doubling of operating profit, to €278m. Passengers carried rose 5.9%, to 27m in January-June 2007, and with capacity rising by 4.6%, load factor rose 2.1 percentage points, to 76.1%.

That's impressive, but it should be remembered that altogether the airlines contributed just 60% of the group's total revenue and 55% of overall operating profit. As can be seen in the table, page 12, the Technik division (maintenance, repair and overhaul) delivers almost a quarter of group operating profits, while both IT services and the service/financial segment have higher margins than the passenger transport division. Lufthansa has now disposed of the major loss-making part of the group - Thomas Cook - but the overall margin is being dragged down by catering and cargo operations.

Cargo (known as "Logistics" within the group) saw revenue fall by 5.8% in the first half of 2007, and operating profit plunge by almost 40%, due primarily to intense competition and falling yield, particularly on Asia/Pacific routes (where yield dropped 13.1% in 1H 2007). This is prompting the cargo division to switch capacity from the Asia/Pacific region to North and South America routes, but it is too early to see just how successful this strategy is, as other cargo operators are believed to be pursuing the same strategy. In September Lufthansa

Cargo announced a 50:50 joint venture with DHL Express, in which a new, unnamed carrier based at Leipzig-Halle will operate a fleet of 11 leased 777Fs from April 2009. Also hanging over the Logistics division is just how much "restitution" it will be required to pay following the investigation by the US Department of Justice over Lufthansa's role in the alleged global air cargo cartel. While Korean Air and BA have been given hefty fines, Lufthansa is co-operating with US investigators under the DoJ's leniency policy, but this does not mean that the airline will escape a substantial financial penalty.

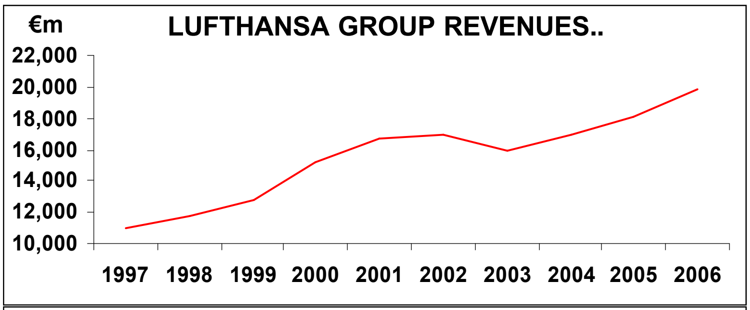
Perhaps more of a worry for the group is its catering operation, called LSG Sky Chefs. Although its performance has improved recently, thanks largely to cost-cutting, this segment employs a hefty 30,000 people (the total group employs 97,000), and the return on the capital employed is just not good enough if the group - as a whole - wants to improve its margins to that of its key rivals. Strategically, catering adds little to the group, and it would surely be much more cost and capital effective to sell LSG and outsource the catering needs of the group? An IPO had been planned for LSG prior to September 11, and the unit's recent improvement presents the group with the ideal opportunity to offload this under performing business.

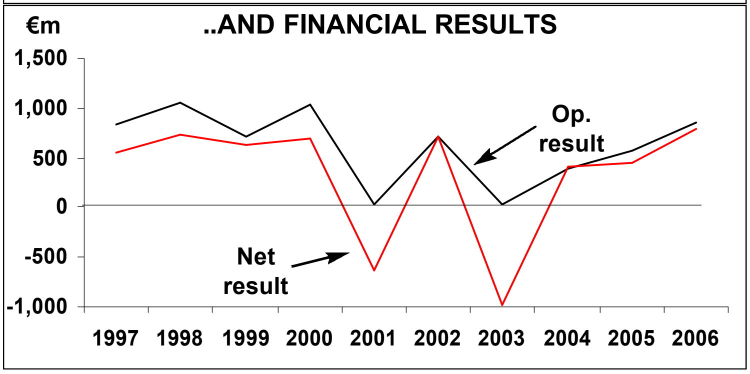
While fine-tuning of the rest of the group is still necessary, the passenger airlines will continue to be "at centre stage", according to Wolfgang Mayrhuber, chairman and CEO of Lufthansa group. He says that the passenger airlines "are the engines driving the group forward and spurring all other group activities".

Strategic success

The passenger transport division's strategy is based on the "four multiples" - multiple brands, markets, hubs (Frankfurt, Munich and now Zurich) and product (i.e. three classes).

At the heart of this is a so-called "multi-offer" appeal, offering products and services for every part of the passenger spectrum, from economy to premium. Rather than shoehorn this multi-offer into the mainline Lufthansa, the variety of airlines and brands in the Lufthansa empire target specific customers and markets, and while this may lead





to some brand dilution and even customer confusion as to which airline does what, overall the strategy has been very effective.

In the economy segment, in 2005 the airline started offering discounted fares (what Lufthansa calls "taster" fares) of €99 on selected European routes out of Hamburg, with dedicated aircraft stationed there in a new operational model that linked in with improved feed by CityLine into Hamburg, with the regional airline also basing more aircraft at the airport. This increased aircraft productivity at Hamburg by 20%, according to the group, and such was the customer response that Lufthansa expanded what it now calls its "betterFly" fares to all German airports from last year. Accompanied by a major expansion of capacity within Europe, with ASKs up by 7.4% in the first-half of 2007, and this extra capacity and lower fares (together with services from budget airline Germanwings) "betterFly" fares have provided real competition to the LCCs, in particular to Air Berlin.

But Air Berlin, the second-largest airline in Germany, hasn't been inactive either, and after an IPO in 2006 it accelerated the process of consolidation in Germany. After acquiring Gexx and dba, it bought LTU this year and now intends (subject to agreement by the German regulator) to merge its fleet

LUFTHANSA GROUP RESULTS JANUARY - JUNE 2007	Share of revenue*	Share of operating profit	Operating margin
Passenger transport	59.9%	55.3%	3.8%
Technik (MRO)	15.3%	24.7%	6.6%
Cargo	11.0%	5.8%	2.2%
Catering	9.5%	6.2%	2.7%
IT services	2.8%	2.8%	4.1%
Service & Financial	1.6%	5.4%	14.1%

Note: * = Pre group eliminations

with Condor in a two-stage share swap in which Thomas Cook will acquire a 29.9% stake in Air Berlin in 2009, in exchange for which Air Berlin will obtain 75.1% of Condor in 2009 and the remaining 24.9% in 2010. This last part of the deal will occur once Thomas Cook has acquired the 24.9% of Condor still owned by Lufthansa, which it is entitled to do by 2009 as long as Lufthansa does not exercise an option it retains to buy back the entire Condor airline now that a buyer has emerged. Lufthansa is contemplating its response to the Thomas Cook/Condor/Air Berlin deal at the moment - tempting as it would be to sink the deal, Lufthansa is unlikely to want to be burdened with Condor. There are now more than 100 aircraft in the Air Berlin group fleet (pre the merger with Condor, which will add another 20-plus aircraft), with almost 130 aircraft on outstanding order.

Ryanair remains an annoying thorn in the side of Lufthansa, with continuing complaints by Ryanair about "state aid" to the German flag carrier through the dedicated terminal Lufthansa uses at Munich airport. Lufthansa has also been battling against Ryanair in the German courts over the latter's deal with Frankfurt Hahn airport, at which Ryanair has built up a major base that serves more than 40 European destinations.

Despite Lufthansa's strong counter-attack against the LCCs, the challenge to Lufthansa's economy business in Europe continues to grow. Yield on the passenger airlines' European routes fell 2.3% in 2006, falling to -5.4% in the first-half of 2007. Strategically, it would be very difficult for Lufthansa to reverse the fare cuts it has been introducing on short-haul, and so the only other answer the group can have in combating the LCCs is to keep up the cost-cutting pressure.

Group annual costs have been reduced by €1.2m over the 2004-2006 period under the so-called "Action Plan" programme, but Lufthansa will have to cut even deeper if it wants to keep some kind of margin on short-haul, given the continuing fall in yield. There is scope for further improvement, as revealed with analysis of Lufthansa’s ambitions in the "Action Plan" and what it actually achieved. In 2004, management targeted €300m of group savings in each of four segments: employees, external suppliers, internal suppliers and "production processes". In fact, both the "production process" and employee cost targets were missed, with the former saving just €208m on an annual basis, and staff just €196m. These shortfalls were made up by higher-than-anticipated cost cuts in the other two areas, but this underperformance in two targeted areas suggests there is scope for further cost-cutting - but only if management is prepared to get tough with unions.

That's a very big if, because - with some justification - the unions believe they have already given enough concessions away, they see little reason to concede more on pay and conditions with profits rising sharply. In 2006 Vereinigung Cockpit, the union that represents 4,000 pilots at the mainline and cargo business, agreed an 18-month deal with management following the end of a two-year wage freeze. Pilots received an immediate 2.5% pay rise followed by a further 1.5% rise in March 2007, but in return agreed to a gradual reduction of normal working hours before overtime kicks in, which gives the airline greater cost flexibility when seasonal demand is low.

While cost comparisons with earlier years are difficult because of changes in the composition of the group, Lufthansa can be criticised on one key efficiency measure - productivity. As can be seen in the chart, page 14, productivity as measured by ASKs per employee in Lufthansa passenger business rose considerably over the 2002-2004 period while employees remained flat at around the 34,500 level and large capacity increases were implemented. However, in 2005 and 2006 productivity plunged as the effect of the rise in the number of employees from new "acquisitions" in passenger business (2,000 staff have been added through the full consolidation of Eurowings, for example) has more than overcome the accompanying capacity increase, and there was only a minor improvement in productivity in the first-half of 2007.

A key problem facing management here is that relations with unions are tricky at present. In July Lufthansa came to an revised agreement with the Ver.di union for 14,000 cabin crew, following disputes in which the union claimed the airline was in breach of a deal only signed last May. The amended deal included an extra 0.9% pay rise for staff on top of the previously agreed 2.5% rise, as well as participation in a profit sharing scheme.

A new clash with Ver.di has broken out, this time at regional carrier CityLine. While Ver.di primarily represents ground workers, it has recruited some pilot members at the regional carrier who are dissatisfied with the actions of the union Vereinigung Cockpit. Ver.di wants to reduce the pay differential between the 750 CityLine pilots and mainline Lufthansa crew, which Jan Kahmann, the head of Ver.di, says on average is around 40%. A deal reducing the differential had been agreed with CityLine pilots represented by Vereinigung Cockpit, but this was rejected by a number of pilots, and those objectors have now become members of Ver.di.

Following stalled talks, minor industrial action took place in August and while the dispute is likely to be settled soon, the atmosphere just does not exist for management - even if it wanted to - to try and obtain any cuts in employee pay and conditions, and in any case the Ver.di union is already warning Lufthansa to abandon its "shareholder-value ideology".

If further employee cost savings are ruled out, there seem to be few other areas of the airline operation with serious cost cutting potential, although the group has launched an "Upgrade to Industry Leadership" programme to identify new areas to trim costs. Lufthansa has already taken out infrastructure costs in Germany under a plan called "Air Traffic for Germany", which has included buying a 9.9% stake in Fraport, the German airport operator.

A new service agreement signed with Fraport for the Frankfurt hub will deliver "considerable cost savings in the double-digit millions", according to Lufthansa.

Fleet overhaul

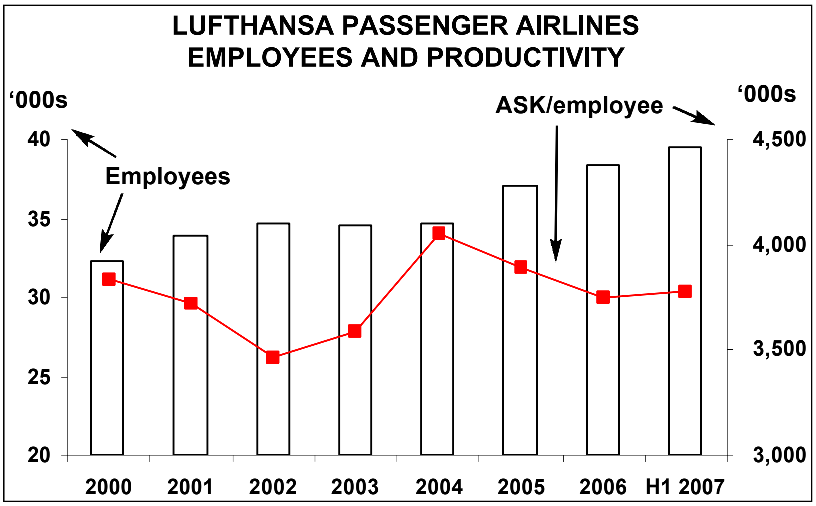
One area of future cost improvement will be in the fleet, where lower unit operating costs will result from the massive renewal programme that is currently underway. The mainline fleet currently stands at 244 aircraft (see table, below), but 137 aircraft are on order, which is a reflection that more than 100 aircraft in the mainline fleet are more than 12 years' old. On the back of improving financials, Lufthansa has placed major orders over the last couple of years in an effort to completely overhaul its regional, medium-haul and long-haul group fleet.

On long-haul, an order for five A330-300s was placed in 2006, for 2006-2008 delivery, while an order for nine A330-300s was placed on behalf of SWISS in September this year, which will replace A330-200s from early 2009 onwards. Lufthansa also became the launch customer for the passenger version of 747-8 in December 2006, when it ordered 20 aircraft and placed options for another 20 aircraft, to be delivered in 2010-2013. Some analysts saw this order as a stop-gap reaction to the delay in receiving the 15 A380s that Lufthansa has on order, and which will now arrive from 2009 onwards, but the airline insists this is not the case, and says the 400-seat 787s are part of the planned overhaul of the long-haul fleet, filling in a gap between the smaller capacity A340-600s (seven were ordered in December 2006) and the 550-seat A380s.

On medium-haul, in September 2007 the Lufthansa board approved an order for six A319s, four A320s (plus two A320s for SWISS) and 20

LUFTHANSA GROUP FLEET

	Fleet	Order	Options
Lufthansa			
A300-600	14		
A319	20	11	
A320	36	14	30
A321	26	35	
A330	10	5	
A340	45	7	
A380		15	
737-300/500	63		
747-400	30		
747-8		20	20
E-190		30	50
Total	**244**	**137**	**100**
CityLine			
CRJ100/200	25		
CRJ700	20		
CRJ900	12	15	
RJ85ER	18		
Total	**75**	**15**	**0**
Lufthansa Cargo			
MD-11F	19		
Total	**19**	**0**	**0**
Swiss			
A319	7		
A320	17	2	
A321	6		
A330	11	9	
A340	10		
RJ85ER	1		
RJ100ER	20		
Total	**72**	**11**	**0**
Air Dolomiti			
BAe 146	5		
ATR 42/72	14		7
Total	**19**	**0**	**7**
Group total	**429**	**163**	**107**



A321s, which will replace ageing 737s and A320s in the European fleet. 30 other A320s were already on order, for delivery from late 2007 onwards, so the mainline has a total of 60 medium-haul models on order.

Lufthansa group's five regional airlines operate a fleet of 149 aircraft, but 37 of them are ageing BAe 146s (with an average age of 18 years) and Avro RJs. In June this year Lufthansa ordered 30 Embraer E-190 regional jets, with delivery from early 2009. This order "replaced" an existing SWISS order for 30 E-170s and E-190s, and the 100-seat aircraft will operate in a two-class configuration for the various regional airlines. However, in order to operate the E-190s the Lufthansa group will have to reach new agreements with pilot unions, as current deals restrict its regional carriers to operate aircraft with no more than 70 seats. After agreement with the unions, there is an exception at CityLine, where RJs and CRJ900s are flown, and a deal for the E-190s should be agreed with unions soon. In May last year Lufthansa also ordered 15 CRJ900s (plus purchase rights for 15 further aircraft), which was a confirmation of a planned order by Swissair, and further regional aircraft orders will follow as the 45 aircraft on order are not sufficient to replace the older models currently operated.

All these orders mean a sizeable capex by the group over the next few years, although the group's financial position is healthy. Long-term liabilities and provisions are relatively static, totalling €7.9bn as of the end of June 2007, just €43m higher than a year earlier. Of this, a hefty €3.7bn is for retirement benefit obligations, while there is €2.9bn in long-term debt. Cash flow from operating activities was €1.1bn in the first half of 2007 (54% up on 1H 2006), and cash and cash equivalents stood at €699m at the end of June 2007 (compared with €455m a year previously).

Premium success

With short-haul yield falling and the scope for further cost-cutting reduced, it is on premium customers that the future of the mainline - and perhaps the entire group - really depends, indeed within the "multi-offer" strategy there is a big push in first- and business class that is designed to protect and improve Lufthansa's overall yield position.

Around half of Lufthansa's revenue - and a large majority of its profits - on long-haul come from first- and business classes, and the airline says that first-class passengers have risen by more than 20% over the last couple of years. Unlike some of its rivals, Lufthansa has kept a three-class configuration and its decision to keep first-class on all but a handful of aircraft appears to be paying dividends as premium traffic has returned over the last year or so. In fact the airline is reconverting back to a three-class configuration the few aircraft it did change to two-class, and is now fitting more premium seats on aircraft at the expense of economy seats. In May the airline also completed an overhaul of business class cabins in its entire long-haul fleet, while on short-haul more storage room and a free middle seat have been added in the business section. A new first-class cabin is also being developed, and will be introduced across the entire long-haul fleet in 2009, once the A380s start arriving.

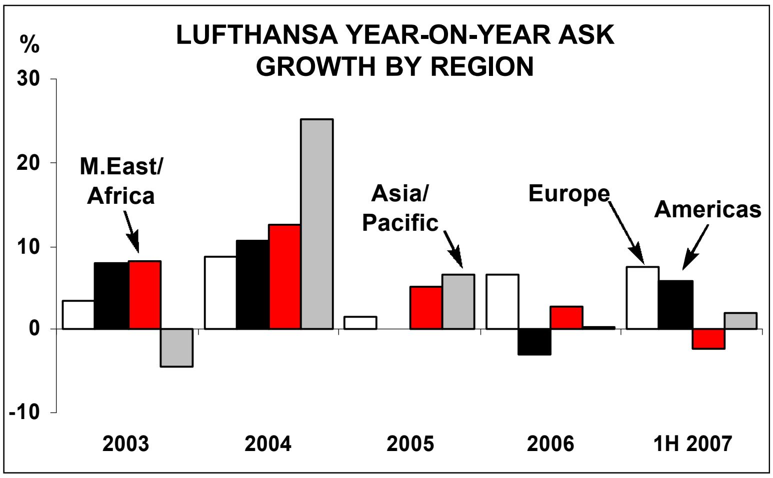
In 2005 Lufthansa also introduced a first-class only terminal at Frankfurt, and the airline believes this has been a major factor behind the resurgence in first-class ticket sales. A first-class lounge costing €6m was also opened at Munich airport in August this year, although this time it is within the Terminal Two building, rather than in a separate facility as at Frankfurt. Interestingly, although SWISS and Austrian first-class passengers are allowed to use the facility at Munich, all other Star first-class passengers have to use the business class lounge.

Lufthansa will also open a new first-class lounge at New York JFK early next year, and business lounges at Dusseldorf and Frankfurt are also being upgraded as part of a €100m investment over the next couple of years on premium-class lounges and other ground facilities. For its premium passengers Lufthansa also operates private jet flights in Europe in a joint venture with NetJets that started in 2005. The service operates around 300 flights a month, and after extending the partnership with NetJets for another five years, Lufthansa is now analysing the introduction of onward private jet flights at some of its long-haul destinations in the Middle East and the Asia/Pacific region.

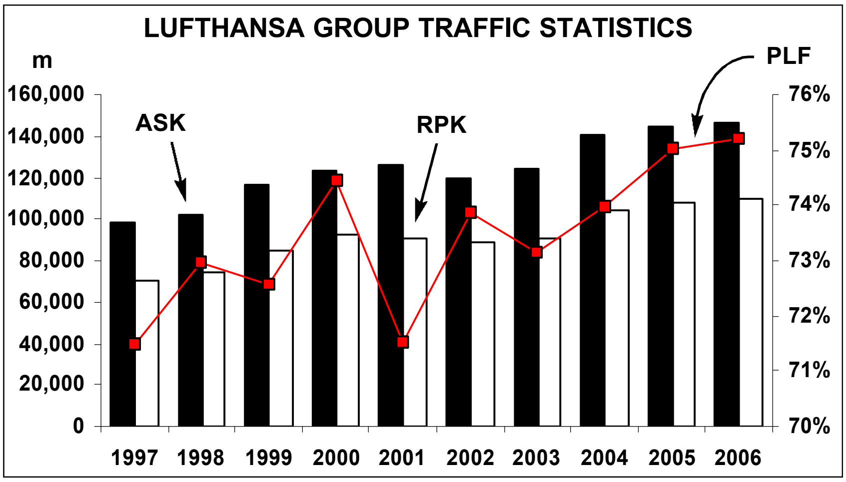
Improvements in the premium product are being accompanied by expansion into markets Lufthansa believes have the best long-term potential for premium traffic. Two-thirds of passenger traffic turnover in the first-half of 2007 came from Europe (66%), with North America (15%) and the Asia/Pacific region (14%) accounting for the bulk of the rest. However, the contribution to profits is believed to be the reverse of this, thanks to the high margin premium traffic on the long-haul routes.

Including codeshares, the North America and the Asia/Pacific regions account for 204 out of 249 long-haul destinations served by the group, and for 82% of all long-haul revenue. After a year or so of static or even negative growth on Americas and Asia/Pacific routes (see chart, above), capacity growth is starting again on these two sectors. A Munich-Denver route started in March this year, helped by an "incentive package" of $2m given by the local development corporation, while a five-times-a-week service between Frankfurt and Orlando launches in October this year. Other long-haul routes launched or shortly to open this year include Buenos Aires, Busan (South Korea), Karachi and Lahore (the last two restarted after being mothballed for a number of years), while Lufthansa has signed an MoU with Brazil's TAM over a codesharing deal (which would help fill in the gap created by the withdrawal of Varig from the Star alliance last January).

The renewed focus on premium was a major reason behind the acquisition of SWISS, in which Lufthansa initially acquired 49% in July 2005. Via a holding company - AirTrust - Lufthansa completed full operational takeover of SWISS in 2006 when the airline was delisted from the Swiss stock exchange, although the Lufthansa group only acquired 100% legal control of SWISS in July this year, after finally acquiring the required traffic rights. Lufthansa had hoped to fully incorporate SWISS onto its balance sheet in 2006, but the renegotiation of bilaterals (which previously required majority Swiss ownership of the airline with which the traffic rights were agreed) took much longer than anticipated, particularly in Russia, China and India.



The SWISS fleet has now been consolidated, new collective agreements have been signed with unions, extensive cost-cutting has been implemented and SWISS has been integrated with Lufthansa timetables, products and fares. Importantly, the decision to keep SWISS running as a separate brand within the Lufthansa group appears to be very successful. As well as access to a swathe of lucrative SWISS business passengers, the deal fills in a relative weakness in the group's long-haul network through the addition of SWISS's routes into Africa. Capacity is now being added on a number of routes (such as to Los Angeles and Sao Paulo), while for the first time since its emergence from the wreckage of Swissair, SWISS is starting to increase its long-haul network, with a Delhi route starting in November and a service to Shanghai



from March next year.

Lufthansa says that synergies between the two airlines in 2006 totalled more than €200m, well ahead of the €70m it previously expected. Synergies in 2007 are expected to be €224m, compared with the forecast €156m, of which €120m will come from extra revenue and €104m from cost savings. However, that has to be set against an estimated one-off integration cost of €45m, on top of the purchase price, which in a complicated process will cost anything between €47m and €300m, depending upon the performance of the Lufthansa share price, which is part of a debtor warrant to the former SWISS shareholders.

However, it must be noted that SWISS has structurally high costs due to Switzerland's high infrastructure and labour costs, and how far SWISS's unit costs can be reduced through integration with the Lufthansa group remains to be seen. Lufthansa argues that larger average aircraft size, a reduction in turnaround time from 40 to 30 minutes and an optimised hub structure will lower costs at SWISS, but there are certain structural costs at the Zurich hub that Lufthansa simply will not be able to reduce. Nevertheless, the Lufthansa group may believe that this is a price worth paying in order to access the premium customers that are loyal to SWISS. Additionally of course, the deal gives Lufthansa a third major hub to add to Frankfurt and Munich, and Zurich has the key advantage that - unlike most German airports - it has plenty of capacity. Indeed the ease of transiting in Zurich has enabled SWISS to build up a large transit market, with 90% of its traffic going to points beyond Switzerland.

Nevertheless, in the medium-term the Frankfurt and Munich hubs remain the core of the Lufthansa passenger airline network, even despite the capacity problems they face. 78% of all Lufthansa's traffic currently goes though either Frankfurt or Munich, and the group operates an extensive feed operation into them (60% of CityLine's flights feed into Frankfurt and Munich, and 90% of Air Dolomiti's services go into Munich). Of the two hubs, capacity restrictions are more severe at Frankfurt, so Munich will be the focus of most of Lufthansa's expansion over the next few years. The plan is to build up Lufthansa's long-haul fleet at Munich to 30 aircraft by 2011, while on short-haul, routes are being expanded to south and east Europe.

Even here though, Lufthansa faces short-term difficulties, as Munich's second terminal - which opened in 2003 and is dedicated to Star airlines - carried 22m passengers last year, and its maximum capacity is 25m. Although the terminal will be extended in the future to add another 17m passengers a year capacity, no timetable for its building has yet been agreed, so while construction of a third runway is scheduled to begin in 2011, it's likely that neither an extended terminal nor a new runway will be opened until 2012 at the very earliest, which leaves Lufthansa with a short-term - but potentially severe problem - once the second terminal reaches capacity, which it is likely to occur in 2008 or 2009.

Mayrhuber says that German bureaucracy is getting in the way of Lufthansa's growth, citing the delays in expanding Frankfurt and Munich airports (as opposed to the rapid development of new airports in Dubai, for example). But given the tight timescales, little can be done about the Munich problem, and the group has little option to develop Zurich and - potentially - open up a third hub in Germany.

Traditionally, the group's two-hub strategy in Germany has been based on the argument that there is not enough demand at other German airports for direct long-haul flights, and that business passengers are happy to feed into Munich and Frankfurt in order to reach their destinations. But prompted by the capacity problems at its hubs, Lufthansa is having a rethink about this - though sceptics might claim that a bigger incentive is being provided by competitors, who are keen to develop viable long-haul hub competition to Munich and Frankfurt.

US carriers offer a number of routes into other German cities, but it is Emirates that may be causing Lufthansa most concern. It already operates a daily route between Hamburg and New York, and there have been persistent rumours - completely denied by all concerned - that Emirates is interested in buying a stake in Lufthansa (which is believed to have caused upwards pressure on Lufthansa's share price this summer). At the very least Emirates is interested in increasing capacity into the German market, and it has reportedly asked the German government for permission to operate routes to Berlin and Stuttgart - which would be a direct challenge to Lufthansa's operations at Frankfurt and Munich.

Under the current air services agreement, there are no restrictions on the number of flights from the UAE into Germany, but there are restrictions on the airports that can be served, which are Frankfurt, Munich, Hamburg and Düsseldorf. Negotiations with the UAE are believed to have begun, and the German transport ministry is reportedly willing to give Emirates permission for the new services, but only as long as it sticks to the current limit for its flights into Germany (63 per week). Whether the German government will be able to agree such a deal with the UAE and maintain the cap on flights into Germany remains to be seen, but Lufthansa knows that sooner rather later Emirates will build up more routes into Germany.

A further concern for Lufthansa is that in August the German authorities cleared the takeover of LTU by Air Berlin. Air Berlin wants to turn LTU into a scheduled airline that targets the business market, and as the two airlines have large operations at Düsseldorf, this will be built up into a substantial operation, with many of the 25 787s that Air Berlin has ordered likely to be based there.

These twin threats - combined with the capacity restraints at Munich and Frankfurt - have undoubtedly prompted Lufthansa's decision to start building up Düsseldorf as a long-haul airport, and create some competition to its long-haul rivals. Currently Lufthansa stations 30 aircraft at the airport, mostly serving European and domestic routes. The exceptions are services to New York and Chicago operated on Lufthansa's behalf by PrivatAir, using 48-seat A319s. Lufthansa has now come to the conclusion that the tiny amount of capacity offered by PrivatAir out of Düsseldorf is not adequate, and so the PrivatAir aircraft will be taken out of service in April next year (and will be redeployed to another German city, it is believed).

In its place Lufthansa will launch A340 services (with a 221-seat, three-class configuration) out of Düsseldorf to the two US cities as well as Toronto. Almost 500 new jobs will be created at Düsseldorf as a result, and it's likely that further long-haul routes will be added in the future. Three A340-300s will be based at Düsseldorf from next year, and these aircraft will compete directly with services to New York and Toronto operated by LTU. Meanwhile Lufthansa's other PrivatAir route - from Munich to Newark using a 44-seat Boeing Business Jet - is also being transferred, to operate out of Frankfurt from this October, and will be replaced by a mainline service out of Munich using a three-class A330. The Munich-Newark route was lunched in 2003, but Lufthansa says the Newark service is being transferred to Frankfurt as this has earlier departure times, thus allowing business passengers to get better connections in Newark.

A troubled future?

While the prospects for full year results are very good, the Lufthansa group faces mounting pressure on yield in Europe, and with relatively little scope for further cost cutting or the sale of substantial non-core assets (apart from the catering business, which management appears reluctant to dispose of), revenue growth looks the main strategic option for the group. Management insists this will be organic, and that there are not any immediate plans for a major acquisition. While there is probably scope for driving more revenue and profit out of the existing airline portfolio, most of the internal synergies are already exploited to their greatest extent, and revenue growth will largely be dependent on signing new partnership deals with other airlines. For example, in July Lufthansa signed an MoU with AirUnion, the alliance of five Russian airlines launched in 2004 (see *Aviation Strategy*, April 2007). The MoU envisages codesharing, FFP links and reciprocal ticket selling from 2008 onwards, and will ensure substantial feed for Lufthansa out of Russia, as in 2006 AirUnion carried 4.9m passengers to 35 domestic destinations, making it second only to Aeroflot for carrying passengers in Russia.

Lufthansa operates to almost 20 destinations in the former USSR, and to Moscow alone operates 70 flights a week from Munich, Frankfurt, Hamburg, Düsseldorf and Berlin, carrying more than 0.6m passengers each year. The deal has encouraged Lufthansa to switch its Moscow operation from Sheremetyevo to Domodedovo airport from the summer of 2008, once its current contract with the airport expires. Sheremetyevo airport reportedly offered Lufthansa a long-term contract to remain there, but Domodedovo is not only the prime Moscow hub for AirUnion, but also receives flights from other Star members (including SWISS, bmi and SIA, with Austrian moving its flights there from Sheremetyevo earlier this year). The move will cement Domodedovo at the Moscow hub for Star, where it will compete against operations there by oneworld airlines (with Sheremetyevo left only with SkyTeam flights).

Partnerships with this potential are few and far between, and the Lufthansa group will have to be very creative elsewhere if its wants to increase revenue organically. One area may be long-haul economy. Lufthansa is introducing individual television screens for all seats on long-haul aircraft from November onwards, following the successful trial on selected routes though the summer, but more ambitiously Lufthansa is examining the introduction of all-sleeper cabins for economy class on long-haul. This would entail a bunk-style layout with beds stacked three at a time, and as it is unlikely that these would be convertible into normal seats, this could only be used on routes with overnight flights. The concept is currently being tested with focus groups, but it must be noted that a number of airlines have already taken a close look at beds in economy class, and all of them abandoned the idea because of the amount of space required.

Without an organic revenue panacea, the Lufthansa group is vulnerable to any threat to its long-haul yield, for example during the next aviation down cycle - when premium passengers may fade away yet again - or from competition on long-haul out of Germany. If long-haul yields did fall for any reason, then combined with what will surely be continuous competitive pressure on short-haul, the whole group's profit base would be under tremendous pressure.

A related factor here is that Lufthansa's shareholder base is slowly changing. Lufthansa is now in danger of breaching the 50% foreign ownership cap, (on which its traffic rights and operating licence depends), and in April the percentage of German shareholders fell to less than 56%. If the proportion of foreign owners keeps rising Lufthansa will be forced into a share buyback of foreign shares, or into issuing new shares to German investors, a complication that the group could well do without. The issue of foreign ownership is sensitive in Germany, and although French insurance firm Axa holds a 10.6% stake in Lufthansa, it is the almost 30% of Lufthansa's shares in the hands of US and UK investors that unions and some politicians see as potentially leading to the major disadvantage of encouraging an Anglo-Saxon/US short-term investment horizon. At the first sign of any erosion in long-haul yield, the foreign shareholder base at Lufthansa may be less forgiving than the more "friendly" German shareholders of the past, so from a strategic viewpoint the temptation for the Lufthansa group in 2008 may be to pre-empt any trouble on the long-haul yield front by making a major acquisition, or at least a number of medium-sized takeovers.

The targets?

If this happens, who will Lufthansa move for? The "usual suspects" are Iberia and

Alitalia, but while Lufthansa has also continually been linked with a bid for the Spanish flag carrier, earlier this year Lufthansa said the Spanish carrier was too expensive (or as Mayrhuber put it, the share price had been driven upwards by bid speculation to a price that was "not affordable" for Lufthansa). Although a last ditch bid for Iberia cannot be ruled out if the BA/Texas Pacific Group bid falls through, it's unlikely that Lufthansa will make a move for Iberia. Interestingly, Stephan Gemkow, CFO of Lufthansa group, has stated that the group would never want to partner with private equity investors in making a bid for any major airline, as financial investors "do not add value for us".

Debatably, a better strategic fit for Lufthansa would be Alitalia, but - rather sensibly - the German airline has never been a serious bidder for the troubled airline, either previously or currently (now that it is back on the market). Lufthansa claims that the conditions on the sale of Alitalia were too restrictive, though it might look at the option again if conditions "changed dramatically", according to Gemkow. However, it's likely that Gemkow is being polite towards its close neighbour, given the catastrophic position the Italian flag carrier finds itself in.

If this analysis is correct, then ostensibly Lufthansa would have to turn to a more "medium-sized" target if it decides to go down the acquisition route. As with all major airlines, Lufthansa is continuously linked with a raft of potential targets, and these have recently included:

• Austrian Airlines (possibly delivering substantial cost savings thanks to overlap in the airlines' networks, particularly in eastern Europe - though this deal may be difficult to pull off politically);
• JAT Airways, the Serbian flag carrier that is undergoing a privatisation process; and
• Spanair, which has been put up for sale by owner SAS. Spanish newspapers claim that Lufthansa is analysing a joint bid for the airline along with fellow Star member TAP. Lufthansa calls this story a "rumour", which may be corporate-speak for potential interest in the deal.

Any of these deals would be interesting for Lufthansa and provide some premium feed for long-haul, but they surely wouldn't deliver any meaningful strategic value to the group, particularly in terms of securing valuable new long-haul routes? And that's where bmi comes into the reckoning. Lufthansa has a 30% stake (minus one share) in bmi, but now that SAS's 20% stake in bmi is up for sale, sources indicate the German airline has been in discussion with SAS over the potential purchase of those shares - though Lufthansa, of course, will not confirm this.

Lufthansa, like SAS, has been in partnership with bmi through the European Co-operation Agreement, which was signed back to the late 1990s as a profit-sharing scheme for short-haul operations at the Star alliance. This deal has been nothing short of disastrous, having turned out to be a loss-sharing agreement for both SAS and Lufthansa, and as soon as it expires (on December 31st this year) SAS will sell its bmi stake. While at one point Lufthansa was also tipped to sell its bmi shares, it now far more likely that Lufthansa may buy SAS's stake, with the key prize being bmi's 12% share of slots at London Heathrow. In August bmi stated it would use its Heathrow slots for Middle Eastern and African routes in the medium-term, rather than for transatlantic routes, but Lufthansa (or any other potential buyer) would surely find more lucrative uses for those slots. Potentially the 50% plus one share owned by Michael Bishop, the founder of bmi, may also be in play, and Lufthansa would be well positioned to persuade Bishop to sell to it rather than anyone else.

But over and above bmi, there may be other less obvious targets on the horizon. Right now reports are emerging that Lufthansa is in talks looking to buy the 25% stake of LOT Polish Airlines that was owned by Swiss Air.

With a healthy balance sheet, the Lufthansa group is - if it wants to - strong enough to make a play for virtually any of the world's major airlines, particularly if the other carrier was open to a "merger of giants". A Lufthansa equity tie-up with, say, Emirates or an Asia/Pacific carrier appears unlikely at the moment, but if Lufthansa figures out that this would be the best strategic move, then the unlikely could well become possible.

		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
	Apr-Jun 07	904	827	78	46	8.6%	5.1%	10,448	8,196	78.5%	5,329	9,748
American	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
	Apr-Jun 07	5,879	5,412	467	317	7.9%	5.4%	68,632	57,402	83.6%		85,500
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	
	Apr-Jun 07	3,710	3,447	263	228	7.1%	6.1%	47,622	39,626	83.2%	18,120	45,000
Delta	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
	Apr-Jun 07***	5,003	4,513	490	1,592	nm	nm	61,358	50,818	82.8%	28,305	55,542
Northwest	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
	Apr-Jun 07**	6,054	5,496	558	1,857	nm	nm	38,070	32,495	85.9%	17,400	29,589
Southwest	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
	Apr-Jun 07	2,583	2,255	328	278	12.7%	10.8%	40,204	30,606	76.1%	23,442	33,261
United	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
	Apr-Jun 07	5,213	4,676	537	274	10.3%	5.3%	64,451	55,049	85.4%	18,190	51,400
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
	Apr-Jun 07	3,155	2,866	289	263	9.2%	8.3%	37,144	30,631	82.5%	22,232	35,485
JetBlue	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%**	0.0%	**46,016**	**37,522**	**81.6%**	**18,565**	**9,265**
	Jan-Mar 07	608	621	-13	-22	-2.1%	-3.6%	11,861	9,562	80.6%	5,091	9,260
	Apr-Jun 07	730	657	73	21	10.0%	2.9%	12,981	10,840	83.5%	5,587	9,421

Notes: ** = April to May Predecessor Company, June Successor Company; ***= April Predecessor Company, May to June Successor Company - During Q2, Delta and United were emerging from Chapter 11

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

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group employees
Air France/	Apr-Jun 05	6,257	5,982	275	135	4.4%	2.2%	57,936	46,041	79.5%	17,948	101,886
KLM Group	Jul-Sep 05	6,790	6,154	636	864	9.4%	12.7%	60,472	50,961	84.2%	18,705	
YE 31/03	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	
	Year 2006/07	**30,773**	**29,129**	**1,644**	**1183**	**5.3%**	**3.8%**	**245,066**	**199,510**	**81.4%**	**73,484**	**103,050**
	Apr-Jun 07	8,011	7,486	724	566	9.0%	7.1%	63,376	51,567	81.4%	19,325	103,978
BA	Apr-Jun 05	3,716	3,398	318	162	8.6%	4.4%	36,706	27,768	75.6%	9,177	46,079
YE 31/03	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	**14,585**	**13,352**	**1,233**	**829**	**8.5%**	**5.7%**	**144,194**	**109,713**	**76.1%**	**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
	Jan-Mar 07	3,792	3,731	61	-140	1.6%	-3.7%	36,405	26,003	71.4%	7,269	42,073
	Year 2006/07	**16,149**	**15,004**	**1,145**	**578**	**7.1%**	**3.6%**	**148,321**	**112,851**	**76.1%**	**33,068**	**43,501**
Iberia	Jul-Sep 05	1,439	1,368	71	53	4.9%	3.7%	16,659	13,619	81.8%	7,656	25,069
YE 31/12	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	**5,894**	**5,426**	**468**	**490**	**7.9%**	**8.3%**	**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	**6,545**	**6,391**	**154**	**72**	**2.4%**	**1.1%**	**65,802**	**52,493**	**79.8%**	**27,799**	**23,901**
	Jan-Mar 07	1,745	1,734	16	16	0.9%	0.9%	16,104	12,798	79.5%	6,318	22,661
	Apr-Jun 07	1,829	1,752	75	83	4.1%	4.5%	16,458	13,307	80.9%	6,863	22,324
Lufthansa	Apr-Jun 05	5,487	5,138	349	140	6.4%	2.6%	37,700	28,178	74.7%	13,583	
YE 31/12	Jul-Sep 05	5,798	5,411	387	501	6.7%	8.6%	38,967	30,466	78.2%	14,203	
	Year 2005	**22,371**	**21,656**	**715**	**561**	**3.2%**	**2.5%**	**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	**24,979**	**23,913**	**1,066**	**1,014**	**4.3%**	**4.1%**	**146,720**	**110,330**	**75.2%**	**53,432**	**93,541**
	Jan-Mar 07	6,258	6,184	74	593	1.2%	9.5%	35,028	26,109	74.5%	12,329	95,696
	Apr-Jun 07	7,267	6,506	761	663	10.5%	9.1%	39,573	30,544	77.2%	14,629	97,067
SAS	Jul-Sep 05	2,140	2,036	104	68	4.9%	3.2%	13,599	9,838	72.3%	9,325	
YE 31/12	Oct-Dec 05	2,050	1,966	84	25	4.1%	1.2%	12,880	8,646	67.1%	8,945	
	Year 2005	**4,877**	**4,796**	**81**	**-6**	**1.7%**	**-0.1%**	**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**
	Jan-Mar 07	1,978	2,025	-47	-7	-2.4%	-0.4%	12,844	8,543	66.5%	9,088	26,136
	Apr-Jun 07	2,383	2,247	136	89	5.7%	3.7%	15,091	10,915	72.3%	11,045	26,916
Ryanair	Jul-Sep 05	652	409	244	208	37.4%	31.9%				9,500	2,987
YE 31/03	Oct-Dec 05	439	381	58	44	13.2%	10.0%			83.0%	8,600	2,963
	Year 2005/06	**2,096**	**1,639**	**457**	**380**	**21.8%**	**18.1%**	**39,070**	**30,302**	**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
	Year 2006/07	**2,887**	**2,278**	**609**	**518**	**21.1%**	**17.9%**	**48,924**	**40,118**	**82.0%**	**42,500**	
	Apr-Jun 07	934	722	212	187	22.7%	20.0%			82.0%	12,600	
easyJet	Oct-Mar 05	1,039	1,116	-77	-41	-7.4%	-3.9%	14,526	12,150	83.8%	13,500	
YE 30/09	**Year 2004/05**	**2,478**	**2,356**	**122**	**109**	**4.9%**	**4.4%**	**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	**2,917**	**2,705**	**212**	**170**	**7.3%**	**5.8%**	**37,088**	**31,621**	**84.8%**	**33,000**	**4,859**
	Oct-Mar 07	1,411	1,333	-47	-25	-3.3%	-1.8%	19,108	15,790	81.2%	16,400	

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**	**30,322**
	Year 2006/07	**12,763**	**11,973**	**790**	**280**	**6.2%**	**2.2%**	**85,728**	**58,456**	**68.2%**	**49,500**	**32,460**
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**	
	Jan-Jun 07	4,440	4,031	409	341	9.2%	7.7%	49,836	38,938	79.6%	8,474	19,207
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**	**3,061**	**3,012**	**49**	**86**	**1.6%**	**2.8%**	**55,692**	**37,659**	**67.6%**	**15,375**	**20,789**
	Year 2004/05	**3,141**	**3,555**	**-414**	**-421**	**-13.2%**	**-13.4%**	**64,115**	**44,226**	**69.0%**	**17,536**	**22,513**
	Year 2005/06	**3,602**	**3,685**	**-83**	**-37**	**-2.3%**	**-1.0%**	**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	33,725
	Year 2006/07	**11,975**	**11,106**	**869**	**568**	**7.3%**	**4.7%**	**112,119**	**97,622**	**80.0%**	**36,450**	**34,267**
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
Jul-07	31.6	24.0	76.0	23.3	20.0	85.7	15.8	13.5	85.3	54.5	46.9	86.0	82.5	68.4	83.0
Ann. change	6.3%	6.3%	0.0	5.1%	4.0%	-0.9	0.4%	1.9%	1.3	3.5%	4.2%	0.6	4.6%	5.4%	0.6
Jan-Jul 07	199.7	136.8	68.5	138.5	112.4	81.1	106.6	87.4	82.0	350.6	286.8	81.8	525.5	408.2	77.7
Ann. change	4.9%	5.2%	0.2	4.5%	3.0%	-1.2	1.1%	3.7%	2.1	3.7%	4.4%	0.5	4.6%	5.2%	0.4

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
Q4	223.2	174.3	78.1	46.0	36.1	78.5	27.8	22.8	81.9	25.8	19.2	74.2	99.6	78.1	78.4
2006	**902.7**	**719.7**	**79.7**	**189.2**	**153.2**	**81.0**	**110.8**	**92.8**	**83.7**	**106.6**	**81.1**	**75.7**	**406.7**	**327.1**	**80.4**

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

JET ORDERS

	Date	Buyer	Order	Delivery	Other information/engines
Boeing	05 Sep	Aeroflot	22 x 787-8		
	06 Sep	China Southern	55 x 737-700/800		mix not identified
	12 Sep	Arik Air	10 x 737-800, 4 x 787-9, 1 x 777-300ER		
	08 Oct	Jet Airways	30 x 737-800	3Q 2012 onwards	plus 10 options
	12 Oct	SAS	2 x 737-800		converted options
Airbus	06 Sep	Aegean Airlines	6 x A320		IAE V2500
	10 Sep	Aviation Capital Group	6 x A319, 15 x A320, 4 x A321		
	12 Sep	Hong Kong A/L	30 x A320, 20 x A330		
	13 Sep	CSA Czech A/L	8 x A319		converted options
	08 Oct	Tiger Airways	30 x A320		plus 20 options
	09 Oct	Wizz Air	50 x A320		
	11 Oct	Grupo Marsans	42 x A320, 5 x A330, 10 x A350, 4 x A380		
Embraer					
Bombardier					

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