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Will it be all change at London Heathrow?

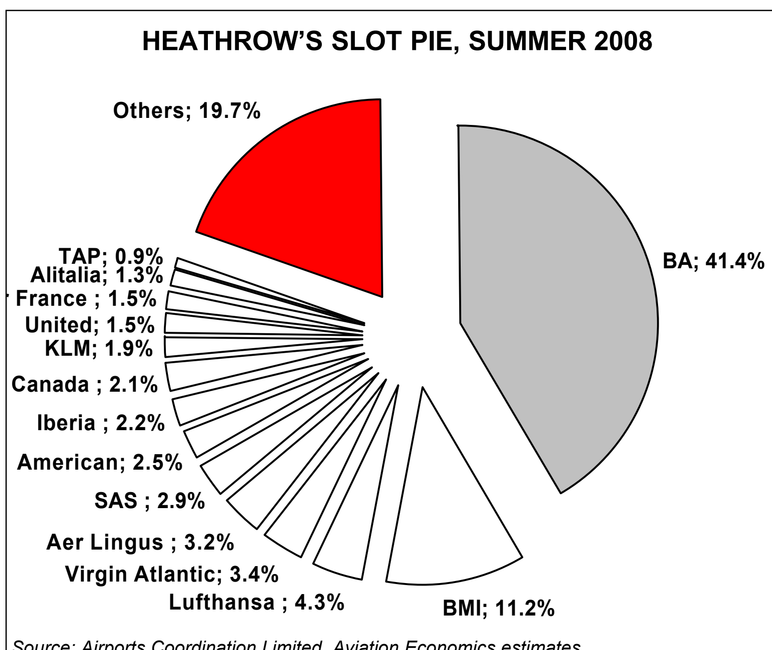
Frantic buying of slots at London Heathrow in time for the 2008 summer season has resulted in the four US non-Bermuda II carriers gaining access to Heathrow to varying degrees.

Continental has reported in a SEC filing that it paid $209m for its four daily (28 weekly) slot pairs to operate Newark and Houston flights; Delta (JFK and Atlanta) and Northwest (Detroit, Minneapolis and Seattle) have acquired three daily slot pairs while US Airways has acquired a single daily slot to operate a Philadelphia service.

Sellers of slots at LHR include: GB Airways (four), Alitalia (three), KLM (two) and Air France (two). The chart below shows that the European flag carriers retain a sizeable presence at Heathrow should they wish to either sell their slots, operate long-haul services in conjunction with alliance partners or - as in the case of Air France with its new Los Angeles service - operate their own metal, gate permitting.

The two most interesting slot portfolios to keep an eye on for 2009 are bmi and Alitalia, the former of which may be about to embark on a transformational transaction that may see it become part of the Lufthansa group, and the latter of which is likely to become part of the Air France/KLM empire (see Briefing, page 10).

HEATHROW'S SLOT PIE, SUMMER 2008



Source: Airports Coordination Limited, Aviation Economics estimates

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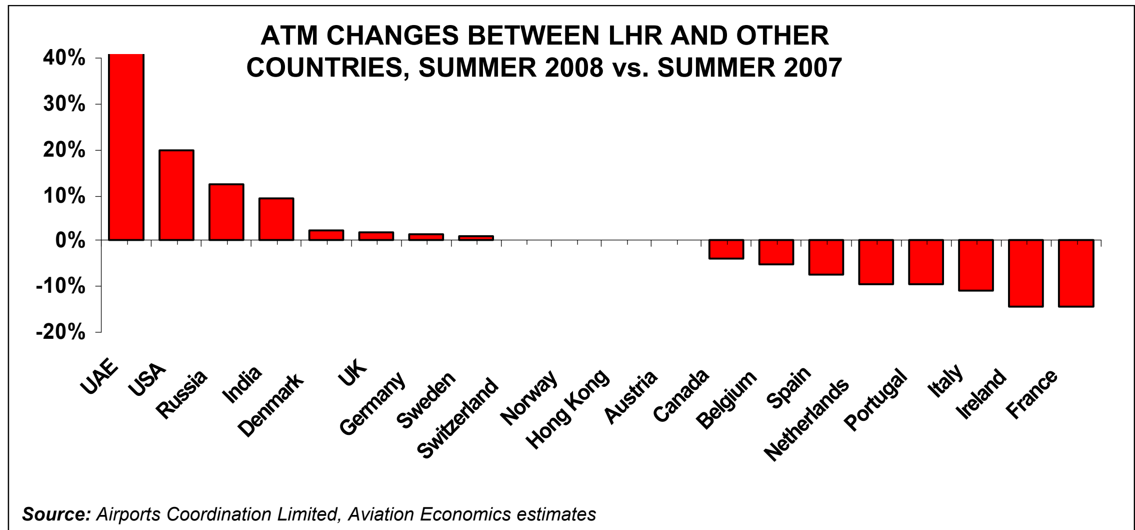

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While planned capacity and movements from London Heathrow to the US have increased by a headline inducing level of more than 20% in the summer of 2008 compared with the summer of 2007, the total capacity between all five London airports and the US has increased by just over 9%, reflecting the fact that many airlines have shifted certain Gatwick-US operations that could not operate ex-Heathrow due to Bermuda II (e.g. Houston, Dallas and Atlanta).

Price wars

There has been a considerable amount of speculation about a transatlantic price war. We're not sure what form, if any, this will take. Yield per RPK for BA on US routes has historically been lower than that of Air France and Lufthansa operating from their respective continental hubs. There isn't therefore much incentive for the continental network carriers to engage in a price war in order to attract economy leisure passengers, who are profit neutral at best. The UK to US and continental to US markets are in any case largely separate.

However, there is a concern that the mere presence of Delta, Northwest, Continental and US Airways at Heathrow could shut the door for what has been hitherto been a lucrative source of revenue for Virgin and BA: employees of US firms with corporate contracts with one of the four non-LHR US carriers who could exploit the fact that their 'designated carrier' did not serve Heathrow by taking their business to one of the two UK carriers.

These passengers were often booking unrestricted premium travel tickets, and this option may no longer be available to them. This could also impact Eos as well, and Silverjet to a lesser extent.

While the macro-economic indicators are pointing south, the relatively strong pound against the US$ should help to compensate as the number of UK outbound passengers on transatlantic flights is higher than US outbound passengers, and for 2007 remained very strong.

Lastly, Terminal 5 opens on March 27th. We have some concerns about T5 as there seem to be niggling issues with baggage handling systems. Furthermore, there is considerable doubt that passengers are going to be enthused about the newly introduced biometric testing, even for domestic flights.

However, the facility should be impressive, but so too will be the amount of free space in the other terminals created by BA's withdrawal - starting with Terminal 1 at the outset and followed by Terminal 4 once BA has moved across its long-haul operations to Terminal 5 on the planned date of April 30th. It's set to be an interesting summer season at London Heathrow.

Tough times ahead for AirAsia Group?

With a massive 140 A320s on firm order, the AirAsia Group is set to become the largest operator in the world of the model. But while the self-styled "lowest cost airline in the world" has a significant advantage over MAS and other legacy carriers, will AirAsia be able to place these new aircraft profitably once ASEAN countries adopt an open skies regime, after which existing and new LCCs are certain to increase their capacity too?

AirAsia was launched by a government-owned conglomerate in 1996 as a regional airline, but operations were scaled back to domestic services before Tune Air - a holding company owned by AirAsia Group CEO Tony Fernandes and ex-Ryanair director Conor McCarthy - bought the loss-making and heavily indebted airline in September 2001 for a nominal fee of RM 1 (US$0.27). The airline was relaunched as an LCC in January 2002, and the AirAsia Group raised US$227m in an IPO on the Kuala Lumpur market in November 2004.

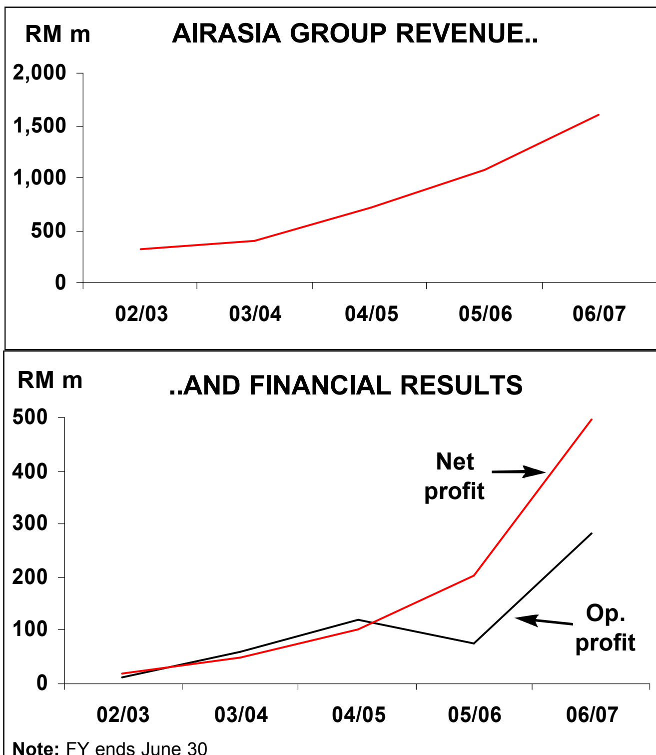
Today the shareholders include not only Tune Air (which has a 30.9% stake) but also a number of investment companies and private shareholders, and they have seen the Kuala Lumpur-based AirAsia Group rack up substantial profits over the last few years (see charts, page four). In the 2006/07 financial year (ending June 30th), AirAsia Group recorded a 50% increase in revenue to RM 1.6bn (US$463m), and a net profit of RM 498m (US$144m), compared with RM 202m in 2005/06. The group carried 14m passengers in the 12 month period, 51% up year-on-year, with load factor up 2.1 percentage points to 79.6%. Yield rose 11% in 2006/07 (although the average fare was down 2%, due largely to a 6% reduction in average trip length). However, cost per ASK rose 7% due to rising fuel prices and higher average user and station charges from more international routes, though after stripping out fuel, unit costs fell by 4% thanks to the effect of fewer leased aircraft in the fleet, the impact of low cost terminals at Kuala Lumpur and Kota Kinabalu (the latter opening in February 2007), and productivity improvements (see chart, page six). Impressively, net margin rose from 18.8% in 2005/06 to 31.1% in 2006/07.

Today the AirAsia Group operates 90 routes to 11 countries: the three "home countries" of Malaysia, Indonesia and Thailand, plus China, Myanmar, Philippines, Vietnam, Laos, Cambodia, Brunei and Singapore. The group employs 3,000, most of which are stationed at six bases: Kuala Lumpur, Kuching, Kota Kinabalu and Johur Bahru in Malaysia, with Jakarta in Indonesia and Bangkok in Thailand.

The stunning success enjoyed by the AirAsia Group since 2002 has been due largely to the problems at the legacy carrier, Malaysia Airlines (MAS), where a high structural cost base and ineffective management just couldn't compete with an aggressive LCC that quickly became profitable in the domestic and international Malaysian market. But AirAsia Group has wider ambitions than just the Malaysian market, since the Asia/Pacific region has 250 cities with a population of half a million or more, few of which have any significant international routes, let alone an LCC service. Furthermore, within south-east Asia a large majority of the region's population has never travelled by air, so the AirAsia Group wants to create the so-called "Ryanair effect", with low fares encouraging people to fly who have never previously flown.

AIRASIA GROUP FLEET

	Fleet	Orders	Options
AirAsia (Malaysia)			
A320-200	32	140	50
737-300	9		
Thai AirAsia			
A320-200	3		
737-300	14		
Indonesia AirAsia			
737-300	10		
AirAsiaX			
A330-300	1	15	
Total	**69**	**155**	**50**



This analysis encouraged the group to set up subsidiaries in Indonesia and Thailand (see below), and build a huge order book. The first A320 order (for 60 aircraft) was only placed in March 2005, so the order book has built up rapidly, with the latest addition coming in December 2007 when the AirAsia Group ordered another 25 A320s (firmed up from existing options), bringing total orders for the model to 175 aircraft (of which 140 are outstanding), with another 50 on option.

The first two A320s arrived in December 2005, and the group will receive 23 aircraft in the 2008 financial year, 14 in 2009, 23 in 2010, 24 in 2011, 24 in 2012, 24 in 2013 and 10 in 2014. Of the 175, just under half will be used for "frequency additions", 33 will replace the 737s that the group currently operates, while the rest will be put onto new routes.

Even given the potential of the Asia/Pacific market, that's a large amount of additional capacity - particularly since the group has experienced different levels of success in the three main markets it has already entered. Whereas in the Malaysian market the group has faced weak competition, in both Thailand and Indonesia the group's subsidiaries have been exposed to far greater competition - and in both countries the subsidiaries have found it difficult to make a profit.

Indonesia

The Indonesian subsidiary was launched as Awair in 2000 before becoming Indonesia AirAsia in December 2005, a year after AirAsia Group made a 49% investment (the other 51% is owned by Indonesian investors).

The Jakarta-based carrier operates a fleet of 10 737-300s, with a final 737 transferring from the Malaysian AirAsia in March before the airline starts receiving A320s as direct replacements for the 737s, with the first coming in the summer. Indonesia AirAsia serves 10 domestic and three foreign destinations out of Jakarta (to Kuala Lumpur, Johor Bahru and Bangkok), and a second hub is being set up at Bali this March, which will develop domestic routes to eastern Indonesia and international services to destinations such as Malaysia, Thailand and even Australia.

Indonesia AirAsia made an operating loss in the 2005/06 financial year but - frustratingly - AirAsia Group gave little detail of results at subsidiaries in its 2006/07 annual report, and the group even stopped reporting passenger numbers at its subsidiaries after September 2007 (see chart, page seven). The lack of information can only raise doubt on AirAsia Group's previous prediction that the Indonesian affiliate was "turning around" and would break even in 2006/07, even though the airline was boosted significantly in 2006 by the government's allowing of fare advertising for the first time, which enabled Indonesia AirAsia to launch aggressive promotions and advertising. However, it is known that AirAsia suffered a high number of unscheduled maintenance and aircraft delays and cancellations at the Indonesian operation in 2006/07, and so it's unlikely that the Indonesian operation has broken even yet - and this was confirmed in February when AirAsia said that its "portion of losses" at the Indonesian operation for October-

December 2007 was RM 3.3m (US$1m). Additionally, Indonesian LCC Lion Airlines is expanding rapidly: it currently operates a fleet of 28 aircraft, but it has a hefty 178 737-900ERs on order. The carrier will base 60 aircraft in Indonesia and the rest across the Asia/Pacific region - including Thailand - and will prove a major challenge to AirAsia Group in the region.

Thailand

Thai AirAsia was launched in November 2003, and AirAsia Group currently holds a 49% stake. Already though, the Bangkok-based airline has had a chequered history. It was launched as a joint venture with the Shin Corporation, a telecommunications group owned by the family of former Thailand prime minister Thaksin Shinawatra (who was deposed by a military coup in September 2006 after allegations of corruption) that subsequently sold part of its 50% stake to Thai businessmen Sittichai Veerathummanoon in order to get around foreign ownership limits (since Shinawatra's stake was bought by Temasek Holdings, the Singapore government's investment vehicle in January 2006). Sittichai and Shin then sold their entire shareholding to six of Thai AirAsia's management team in the summer of last year.

The airline received its first A320 at end of 2007 and Thai AirAsia will be an all-A320 operation sooner than originally planned thanks to rising fuel prices, with the last of its current 14 737-300s leaving the fleet in 2010.

Within the Group (and prior to the ASEAN open skies agreement) Thai AirAsia was originally seen as a "launch pad" for new routes into Indo-China, as Thailand has a series of open skies deals with countries throughout the region, and Thai AirAsia became the first LCC to operate into China, from 2005. But, although Thai AirAsia is helped considerably by a 50% discount on airport fees in the country as well as an eight year tax exemption, like its Indonesian cousin the Thai subsidiary is struggling to make a positive contribution to AirAsia Group.

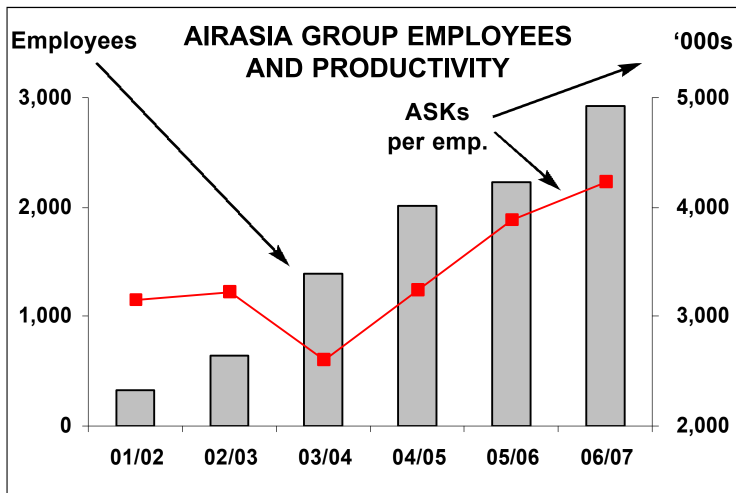
While Thai AirAsia currently operates to 10 domestic and nine foreign destinations, most new routes have been put on hold for at least 18 months thanks to rising fuel prices. The situation hasn't been helped by the rise of other LCCs in Thailand, including Nok Air (a subsidiary of Thai Airways International that has 12 aircraft) and One-Two-Go (owned by Orient Thai Airlines). Additionally, the political situation in Thailand has affected demand there, both from Thai travellers and from visiting tourists, and for 2006/07 AirAsia said that the "financial result from the operations in Thailand is not significant compared with the Malaysian operations".

According to Tassapon Bijleveld - Thai AirAsia's CEO - revenue rose by 40% in 2007 (the calendar year), but the carrier still could not post a profit. Figures just released show a RM 8.2m (US$3m) loss for Thai AirAsia in the October-December 2007 period, although Bijleveld insists that the airline will make a profit in January-December 2008. The airline has also been hit hard by financial penalties for breaking leases on 737-300s returned to lessors, while Bijleveld also blames "intense competition in Thailand through rampant undercutting". But although the group adds that the "current operational pressure" at the subsidiary airlines "is a temporary blip", the medium-term goal for Thai AirAsia of an IPO around 2010 or 2011 must be in some doubt.

Other countries

The AirAsia Group has been linked to a large number of new subsidiaries in other Asian countries - although many of its plans have come to nothing:

• **Sri Lanka**
In 2006 the group was reported to be in negotiations to buy 49% of Sri Lankan carrier Holiday Air, an LCC that planned to launch operations to domestic and international destinations out of Colombo in 2007. A "technical partnership" was agreed whereby Holiday Air changed its name to AirAsia Lanka, with AirAsia Group agreeing to train the pilots of Air Asia Lanka and with the Sri



Lankan airline also using AirAsia's internet booking system, but despite plans for a fleet of seven aircraft, this project did not progress.

• Bangladesh

Again in 2006 an MoU was signed with the Orion Group - a Bangladeshi conglomerate - to analyse a joint venture carrier provisionally called East West Airlines. This venture also appears to have come to nothing.

• Singapore

AirAsia Group seriously considered buying Singaporean LCC Valuair in 2005, and an offer was put to Valuair's shareholders in that year. However, some of Valuair's shareholders were unhappy with the price and with AirAsia's plan to drop some of Valuair routes, and instead Valuair merged with Jetstar Asia.

• The Philippines

Negotiations have also been held between the AirAsia Group and Manila-based Asian Spirit over establishing Philippine AirAsia at Clark airport (which is close to Manila), but apparently any potential deal collapsed following Asian Spirit's insistence that a Philippine AirAsia should focus on domestic trunk routes, leaving Asian Spirit to continue its regional routes.

• Vietnam

An LoI was signed with the Vietnam Shipbuilding Industry Group (also known as Vinashin, and which is owned by the Vietnamese state) in August 2007. Although the idea is still subject to formal Vietnamese government approval, the so-called Hanoi-based Vinashin AirAsia would operate initially on domestic routes before expanding into international services.

But unless the Vietnamese government changes the current limits on foreign ownership (which it says its is considering), the AirAsia Group will be restricted to a 30% ownership stake in the Vietnamese carrier - and in any case reports out of Asia suggest the plans are facing considerable opposition from both Vietnam Airlines and Pacific Airlines (the former of which is owned 100% by the state, and the latter 82% by state bodies and 18% by Qantas). Currently Thai AirAsia operates between Bangkok and Hanoi and has been trying - unsuccessfully - to win permission from the Vietnamese authorities to operate routes to Ho Chi Minh City.

• China

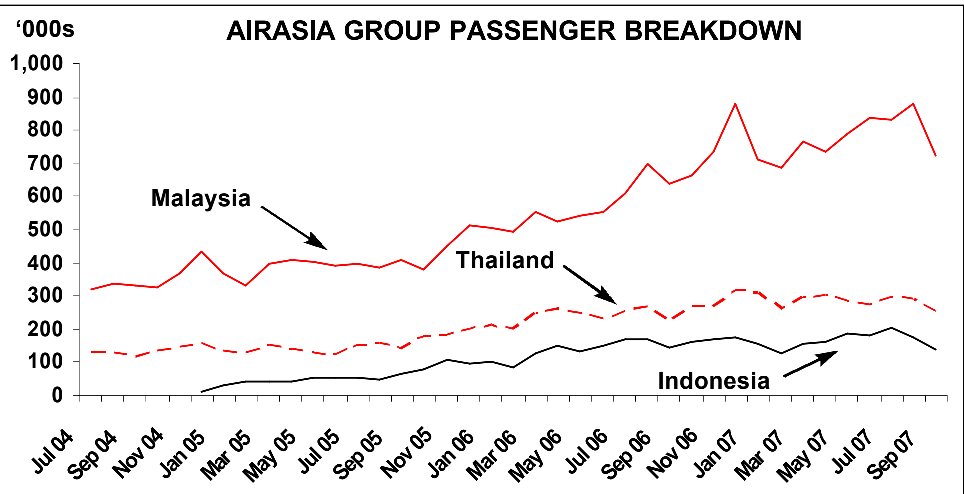
Launching an airline in China is believed to be at the very top of AirAsia Group's wish list, but Fernandes believes that the political power held by the Big Three Chinese airlines means that no local AirAsia subsidiary will be possible within the next five years at least.

Given this reality, the group is making do with a furious expansion on routes into the country, and most of the 15 routes being launched by the group in 2007/08 are to China, with new services to Hong Kong, Haikou, Guilin, Xiamen and Shenzhen from Kuala Lumpur, Bangkok or Kota Kinabalu. A Kuala Lumpur-Guangzhou route was launched this January, where it competes against China Southern and MAS (which codeshare with each other). The airline expects to carry 130,000 passengers a year on the route, which is the fourth Chinese destination out of Kuala Lumpur, joining services to Shenzhen, Xiamen and Macau, and with routes to Hainan, Gueling and Hong Kong also being planned.

AirAsia X

Long-haul LCC AirAsia X was set up last year as a separate company from the AirAsia Group, although it is now owned 48% by Aero Ventures (which includes many of the main shareholders in AirAsia Group,

including CEO Tony Fernandes and deputy CEO Kamarudin Meranun), while 16% is held directly by the AirAsia Group and 16% by the Virgin Group. AirAsia Group paid RM 26.7m (US$7.6m) for its initial 20% stake, while the Virgin Group is believed to have paid a similar sum for its initial 20%. The original investors have now been diluted but in return experienced a massive paper profit because in February this year the Manara Consortium - a Bahrain-based investment company - and Japan-based financial services group Orix Corporation (which owns Dublin-based lessor ORIX Aviation) each bought a 10% stake, for RM 125m (US$39m) each. AirAsia X considers these as "strategic investors", and the funds raised will be used to finance aircraft purchases.



Sarawak-based AirAsia X launched an initial four-flights-a-week route between Kuala Lumpur and the Gold Coast in Australia in November 2007, chosen partly because it is close to Brisbane, at which the LCC Virgin Blue (in which the Virgin Group has a 25% stake) is based. Fernandes says that links with Virgin Atlantic may be developed in the future, though this would stop short of codesharing.

A second route was launched this February: a five-times-a-week service between Kuala Lumpur and Hangzhou (near Shanghai) in China, which is operated with the single A330 that is AirAsia X's only aircraft so far. This is on a six-year lease from AWAS, but in January the airline said it had decided against expanding its fleet in the short-term thanks to a shortage of available A330s, and with those that are available having lease rates that are too expensive.

This is obviously a blow to the carrier's long-term plan to build up a network of up to 50 destinations in the Asia/Pacific and European regions, and further routes will now have to wait until AirAsia X receives the first aircraft from its order for 15 A330-300s (in a high density, 400-seat configuration), the first two of which are due to be delivered in the fourth quarter of this year, after which two more will come in 2009, three in 2010, four in 2011 and four in 2012. But it's possible that alongside this delivery schedule AirAsia could lease more A330s if lease rates start to come down (which should happen once airlines start replacing the model with 787s).

Ten A330-300s are also under option and these are expected to be upgraded to firm orders at some point in 2008. AirAsia X will place an order for 25 further aircraft (plus 25 options) in the second half of this year, with negotiations to buy A350s or 787-900s already under way.

Among routes believed to be under consideration at AirAsia X are other Chinese destinations (such as Tianjin), Japan and services to the UK via the Middle East (probably Dubai or Sharjah). While Fernandes has hinted that an interline agreement is out of the question, AirAsia X may co-ordinate its flight times in order to connect in with other European LCCs. However, a stopover in the Middle East will bring AirAsia X into competition with Emirates and others, although the LCC is confident this will not be a problem thanks to the feed it has in Asia. Routes are also planned to India, and AirAsia X has already carried out negotiations with the airport authority at Amritsar.

Despite these ambitions, and although AirAsia X expects to be profitable in its second year of operation, there are question marks over how much of the LCC business model can be applied to long-haul. While passengers have to pay for frills such as

food and in-seat entertainment, AirAsia X operates alongside Air Asia out of Kuala Lumpur's Low-Cost Carrier Terminal (LCCT), which is 20km away from the airport's main terminal. AirAsia X obviously believes it is crucial to connect with short- and medium-haul AirAsia Group passengers, but Air Asia X must lose some passengers who would prefer to connect at the main terminal.

And whereas the various AirAsia airlines have turnaround times of around 25 minutes, AirAsia X has a turnaround time of at least 75 minutes. Curiously, as part of an "agreement", AirAsia X has vowed never to operate competing flights of less than four hours duration, while the AirAsia Group will not operate competing flights longer than four hours. This will lead to the strange situation in India that AirAsia will serve destinations only in the south of the country, while northern cities will be served by AirAsia X. At least four destinations will be served in India by each of AirAsia and AirAsia X by 2010, Fernandes says.

While AirAsia X is a separate operation to the AirAsia Group, it is doubtless distracting the attention of Fernandes and others from focussing 100% on AirAsia Group. The long-term intentions of Fernandes and the other investors for AirAsia X is almost certainly to make a profitable exit once (or if) the long-haul LCC is established and profitable, and Fernandes has already mentioned a possible float by 2010 at the very earliest.

Cost leadership

Assuming AirAsia X does not become a distraction, the key to AirAsia Group's continued success will be to maintain its low cost base and place its new aircraft successfully, with ASEAN being the immediate focus for AirAsia Group according to Fernandes, as bilateral restrictions are eased ahead of ASEAN open skies.

On the former issue, the group still claims to have the "lowest unit cost in the world", thanks to its location and LCC strategy. Taking a closer look, by far the biggest difference between AirAsia Group's unit costs and its LCC peers is in two key areas: employees and aviation charges. At 0.33 US cents/ASK in 2006/07, AirAsia Group's staff costs are around 0.8-0.9 US cents/ASK lower than the average of rival LCCs Gol, JetBlue, Southwest, Air Tran, EasyJet, Ryanair, WestJet and Virgin Blue - thanks entirely to Asia being such a low cost region. That's a huge cost advantage, and in addition the group's user station/aviation charges of 0.22 US Cents/ASK are 0.7-0.8 US cents lower than the same LCC peer group, thanks again to lower Asian user charges.

But AirAsia Group is not competing against these other LCCs, but against airlines in the Asia/Pacific region, and while the local legacy carriers will never be able to match the unit costs of AirAsia, the region's lower structural costs are available to all LCCs - so the real test of AirAsia Group will come once the challenge from Asian LCCs increases. With roughly the same unit costs as AirAsia Group, the other LCCs will be racing to place capacity on the key Asia/Pacific routes under ASEAN open skies - and so the key indicator for AirAsia Group will be how its yields hold up as it places its massive A320 order into the market.

A foretaste of what AirAsia Group will face will be shown on the Kuala Lumpur-Singapore route, on which AirAsia started a daily service this February after the Malaysia and Singapore governments partially eased the restrictions on their existing air services agreement, in order to allow LCCs to operate on this key route against Singapore Airlines and Malaysia Airlines.

All restrictions on the route will be lifted by December (when the open skies deal between the 10 ASEAN countries - which have a combined population of 500m - starts to come into effect). AirAsia had been lobbying hard to get onto this lucrative route, but while AirAsia Group is undercutting the legacy carriers' fares substantially, it also faces competition from Jetstar Asia and Tiger Airways (owned 49% by SIA), and as HSBC says, "we anticipate Air Asia struggling to rival the more efficient full service carriers and differentiating itself from the other low cost carriers which will also gain access to the routes". There may also be competition from Firefly, a domestic LCC set up by MAS

that aims to launch international services, including Kuala Lumpur-Singapore.

Certainly until recently the AirAsia Group has faced little or no LCC competition in its main markets, but that is changing, and this will inevitably result in yield erosion. SIA's Tiger Airways, for example, started a Singapore-Kuala Lumpur route in February this year, and has 58 A320s on order.

AirAsia Group faces other challenges too, including constraints at its key operational base, at Kuala Lumpur. An LCC terminal costing US30m was only built in 2006, but now that AirAsia has transferred all its operations there from the main terminal (charges are 40% lower at the LCC terminal than the main one), the LCC terminal has already fully used up its capacity of 10m passengers a year, and Malaysia Airports Holding (the government-controlled airport operator) is frantically increasing the capacity to 15m at the moment. But that too is likely to prove insufficient within a few years, so there are further plans to increase annual capacity to 30m.

Fuel challenge

Perhaps the biggest short-term challenge to AirAsia Group comes from rising fuel prices. The group previously forecast higher profits in 2007/08 as long as fuel price rises were not too high - but this is exactly what has happened, and to make matters worse, the group's management of this risk has been nothing short of disastrous. Essentially, Air Asia Group sold call options that bet that oil prices would not break through the US$90 per barrel, but the group called this wrong, and one analyst predicts that Air Asia's "wrong" bets on the price is cutting group profits by around US$3m a month. Fernandes says that although in the past hedging had "ultimately benefited the company", the current volatility of oil prices "is a nightmare".

The group's wish to mitigate risk here is understandable, as each extra US$1 change in the actual price per barrel paid by AirAsia translates into a RM10m (US$3.1m) fall in profits before tax, but the group's hedging of this risk has simply been erroneous. Additionally, the group's hedging policy has led to some investors selling the group's shares, leading to a 15% fall in the share price at the end of 2007, and to some downgrading by analysts.

AirAsia's senior executives were unhappy at the group's share price fluctuation in late 2007, but although Fernandes says that "the stock market needs to understand AirAsia better", the market is only reflecting concern that the group's derivative trading was well outside its area of expertise.

Shareholders should also be concerned that AirAsia Group is benefiting tremendously from the weak US dollar, as only a tiny percentage of its revenue is in dollars, whereas at least 60% of its costs are dollar based. At some point in the future that advantage may disappear, and this will have a significant impact on the profit level.

In the second quarter of 2007/08 (October-December 2007 - although from now on the group will change its FY to January-December) Air Asia Group recorded a 43% rise in revenue to RM 632.8m (US$197m), with operating profit of RM 154.8m (US$48m), compared with RM 86.8m in 2Q 2006/07. Net profit was RM 245.7m (US$76m), compared with RM 142.1m in 2Q 2006/07. It's an excellent result, and furthermore the AirAsia Group is strong financially. Cash and cash equivalents stood at RM 426m (US$132m) at December 31st 2007, while long-term debt rose from RM 2.3bn (US$714m) at June 30th 2007 to RM 3.4bn (US$1.1bn) as at the end of 2007, thanks largely to aircraft purchases.

Nevertheless, it's the medium-term challenge of placing the huge increase in capacity that is the real test of AirAsia Group's strategy. Though Fernandes says that rising costs will slow the establishment of LCCs in the region, he acknowledges that competition is increasing. As the group's track record has shown, entering new markets will not be easy, and Mark Webb of HSBC Global Research says AirAsia yields are expected: "to remain flat amid a saturated domestic market and stiff competition outside Malaysia ….if [Asian economic] growth slows significantly, AirAsia - with its aggressive expansion plans - may find itself unable to generate sustainable levels of return".

Has Alitalia picked the right saviour?

The prolonged and inept attempt to sell the Italian state's remaining 49.9% stake in Alitalia finally appears to be reaching a conclusion, with preferred bidder Air France/KLM set to complete the deal imminently. But although most analysts believe the Franco-Dutch group is the best acquirer of an airline that is losing at least €1m a day, has the ailing Italian flag carrier really picked the best white knight?

The need for Alitalia to be rescued is obvious. Today the airline employs 11,000 and its fleet of 148 aircraft carried 24.6m passengers in 2007, but despite this scale and the prestige of being a flag carrier, the airline has racked up more than €3bn of net losses since 2000 and last made an operating profit back in 1998 (see charts, page 12).

In 2007 Alitalia reported a 2.8% rise in revenue to €4.9bn, with the operating loss falling from €466m in 2006 to €203m in 2007. While no net figure is available until May (Alitalia had a net loss of €626m in 2006), at the pre-tax level the airline reported a €364m net loss in 2007, compared with a €605m pre-tax net loss in 2006. But this reduction in losses was due largely to the falling away of almost €200m of write-downs of aircraft values included in the 2006 results. Ominously, Alitalia says its 2007 net figure will include the result of another revaluation of its fleet, and the direction of any adjustment will only be downwards.

As at the end of 2007, Alitalia has short-term debt of €147m and long-term debt of €1,419m (see chart, right), and after cash and short-term financial credits of €367m are taken away, this leaves the group with net debt of €1.2bn. Alitalia is believed to have enough financial resources to keep going only until the summer of 2008, and certainly does not have enough cash to repay €320m of debt due in 2008 and 2009.

Alitalia's yield fell 3.4% in 2007, thanks largely to LCC competition, and the airline now warns that its 2008 financial results will be worse than it previously forecast, which will mean even deeper cuts into its cost base.

The airline's management blames the usual problems of competition, labour unrest and high fuel costs for recent losses, but the underlying reason for Alitalia's abysmal performance over the years has been a combination of poor management and weak leadership by the Italian government. Incredibly, Alitalia has had nine CEOs in 10 years and there have been at least five major restructuring attempts at Alitalia since 2003, each one associated with a different set of top management. None have succeeded, and in the meantime debts have mounted and the airline is losing at least €1m a day.

A new beginning?

While its predecessors dithered, the centre-left government of Romano Prodi (elected in May 2006) quickly decided to offload the government's remaining 49.9% stake in the flag carrier. Yet the first Prodi attempt to sell the stake - by July 2007 - was a disaster and the government had no choice but to begin the process all over again. Maurizio Prato, previously head of Fintecna - the state holding company - was appointed president of Alitalia in August, and was given a range of executive powers. He described Alitalia's condition as "comatose", and added that he had "been surprised by the general refusal to accept the reality of how critical the situation is".

At the end of August a new plan was unveiled for Alitalia. The so-called "plan for survival/transition" covers the 2008-2010 period (and is being implemented from March 2008) in an attempt to achieve an operating profit in 2010. At its core is a shrinking of operations, with reductions in

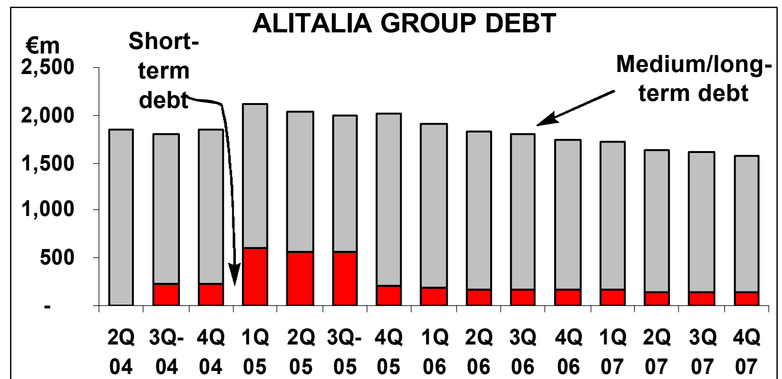
routes and an unspecified number of job cuts, with the airline admitting openly that it cannot continue to rack up the losses it is currently incurring.

In essence the plan admits that the airline is weak strategically thanks to the poor geographical position of Italy, where it has little catchment area other than Italy itself (and even here these catchment areas are widely dispersed), and being sub-optimally placed for all the major international aviation sectors. The plan says it would be almost impossible to close the competitive gap with its major rivals based on the realities of Alitalia today, and if it did try to continue to compete in all current routes and markets in an attempt to remain an independent hub airline, "the only result of this attempt would be to confirm Alitalia's current role as a marginal and 'regional' airline."

Therefore Alitalia believes it has no choice but to scale down its operations, closing both short- and long-haul routes where there is no chance of making a profit in the short-term. This means building up the Rome hub as the prime hub for Alitalia at the expense of Milan Malpensa, which is being downgraded into a point-to-point airport servicing routes not already covered by Milan Linate, and being used much more for Alitalia's LCC Volareweb and charter carrier Air Europe. According to Alitalia, "the company is no longer able to operate efficiently out of two hubs", but providing Rome Fiumicino can cut its charges to Alitalia and improve its infrastructure, Alitalia would increase routes out of the Rome hub.

The survival plan also envisages a significant capital increase over that period by whoever takes over the government's stake, since by 2010 the cash position would otherwise not be "adequate". When the 2007 results were announced, the airline said it would probably need at least €750m of fresh capital in 2008 in order to maintain sufficient liquidity, and the situation will get worse if there are any further delays in implementation of the planned restructuring of Alitalia.

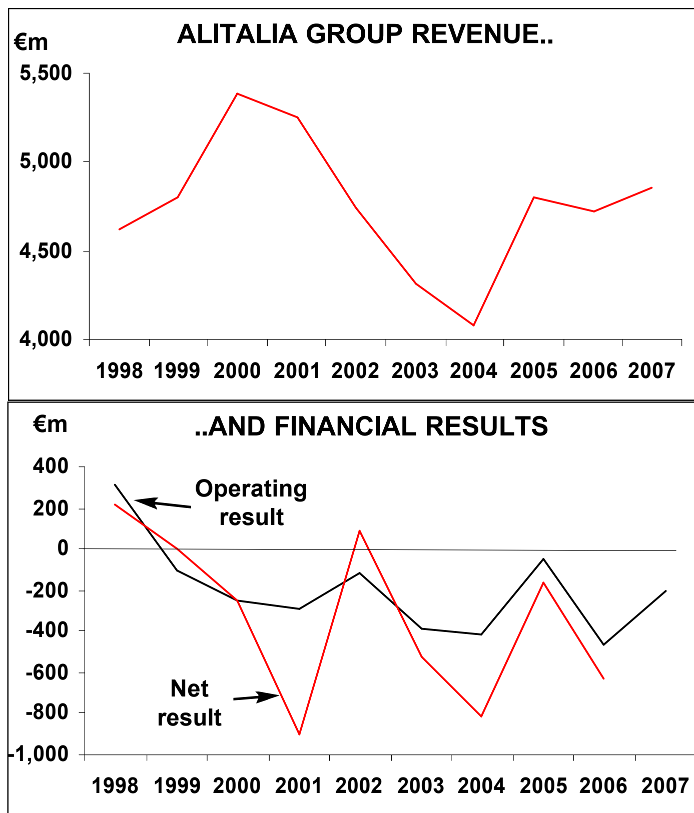
How many redundancies this survival plan will lead to was unknown at the time it was unveiled, but not surprisingly the plan



attracted plenty of criticism within Italy, from all political spectrums and from Alitalia's unions. And it's this plan that has - controversially - effectively framed the government's second attempt to sell off its 49.9% stake, which Prato promised would be completed by the end of 2007 given the extreme urgency of Alitalia's financial position. With the government sticking to its message that it will not put any more funds into the airline, the explicit approval of the survival plan by the government signalled that it now accepted a scaling down of Alitalia was inevitable, and that whoever buys Alitalia would be given a free hand to do whatever they needed to. But with the government "presenting" such a plan as coming from Alitalia's management, those who currently oppose the Air France/KLM bid complain bitterly (and with some justification) that the government has effectively pushed a contraction of Alitalia as being the only possible agenda for a successful bidder.

The new attempt…

For the latest attempt to sell the government stake, the six short-listed candidates named by Alitalia in November 2007 were: Aeroflot, Lufthansa, TPG, Air France/KLM, AP Holdings/Air One and a consortium led by Antonio Baldassarre, an Italian lawyer. However, the process continued to be shambolic, with the deadline for the latest round of bids somehow slipping from November to December. And by the revised deadline - December 7th - only three potential acquirers remained. TPG withdrew in October when it could not put together an



appropriate consortium with enough Italian partners, while Aeroflot withdrew in November, saying that acquiring Alitalia would be unprofitable. Lufthansa - which was widely expected to enter the formal bidding process - at the last minute didn't make a bid, stating that "the risks outweighed the positives" and that any investment in its SkyTeam partner would affect Lufthansa investment rating negatively.

The list of potential acquirers was down to three: Air France/KLM, AP Holdings/Air One and the Baldassarre consortium (headed by Antonio Baldassarre, who was previously chairman of RAI, the state television station), the latter of which had little chance of success, given its lack of aviation experience.

The original plan was to narrow the field of three down to one for exclusive negotiations by mid-December but - unsurprisingly - after yet another delay, on December 28th Alitalia's board of directors unanimously choose Air France/KLM as their preferred bidder, citing its "highly credible" business plan - a plan remarkably similar to the survival plan unveiled by Alitalia back in August.

Unconfirmed Italian reports suggested Prato threatened to resign if Air France/KLM was not chosen as the preferred bidder (which perhaps explains the unanimous nature of the decision by the Alitalia board), and the decision was fully backed by the Prodi government. While Prodi had previously said that best bidder should win Alitalia regardless of its "nationality", the finance minister declared the AP Holdings/Air One bid was "excessively optimistic"; while other government sources hinted that an Air One deal may have led to antitrust problems.

An eight-week exclusive negotiation period between the two airlines formally began on January 11th, (expiring on March 11th) at the end of which the government hopes agreement on the details of the deal will have been reached, with Air France/KLM then taking up its option to submit a binding offer to buy the 49.9% stake, subject to approval by the government.

The Air France/KLM bid

Air France/KLM's shares rose sharply after its bid was confirmed, a reflection of the airline's close links with Alitalia and the general opinion of investors that a merger of the two SkyTeam partners makes sense. Essentially, the Franco-Dutch group - which already owns 2% in Alitalia, acquired back in 2003 - offers Alitalia scale, deep pockets and the experience of integrating KLM, and the deal delivers significant political capital and kudos to the Italian government throughout the EU.

Air France/KLM promises a large expansion of routes out of Rome Fiumicino, making it the third hub for the group and providing a southern European base alongside Paris CDG and Schiphol. Alitalia would provide Air France/KLM feed out of the Italian domestic market, as well as on routes to southern and central Europe, and down to north Africa. While there would continue to be some medium-and long-haul services out of Milan, Malpensa would no longer be a major hub airport, and Air France/KLM

says it would support Alitalia's plan to expand Volareweb flights out of Milan. With Alitalia saying that 92% of passengers originating from northern Italy do not use Malpensa as their departure airport for long-haul flights, Air France/KLM says that "if the Malpensa hub is not significantly downsized, we don't see a reason for a deal".

Jean-Cyril Spinetta, CEO of Air France/KLM, says that "a big majority" of Alitalia's losses arise from the Malpensa operation, with the other major source of losses being long-haul routes. Under Air France/KLM's plans, Italian passengers to North America could travel via Amsterdam and Paris, allowing Alitalia's long-haul operation to refocus on eastward routes to the Middle East and Asia.

With reductions at Malpensa and on long-haul, Air France/KLM plans 1,700 job cuts at Alitalia, equivalent to 15% of the 11,000 workforce - although the government is making it clear that it will finance unemployment benefits for those made redundant.

As for the fleet, Alitalia's 148 aircraft (see table, right) currently have an average age of more than 12 years, thanks to 75 ageing MD80s. Air France/KLM envisages refurbishment of Alitalia's MD80s and 767s in the short-term, with their replacement in the long-term. Regional subsidiary Alitalia Express, launched in 1997, operates a fleet of 30 aircraft, but Alitalia is believed to be considering its sale.

Air France/KLM proposes to invest a total of €6.5bn in Alitalia over the long-term, most of which will go on fleet renewal and the introduction of lie-flat seats onto long-haul aircraft in order to improve attractiveness to business passengers. Of this total, Air France/KLM aims to invest €750m in an initial injection of capital, and after a "recovery phase", it will then invest in the major expenditure need for MD80 and 767 replacement.

Given this massive outlay, questions have to be asked as to the strategic advantage to Air France/KLM of acquiring Alitalia, because even given Air France's experience of integrating KLM and the attraction of securing business passenger feed to/from the Italian market, the process of discarding the unprofitable baggage around this feed at Alitalia is likely to be painful. Spinetta insists that the potential for Alitalia is very strong, with "huge business and tourist traffic flows". Air France/KLM previously stated it would only make a bid for Alitalia if it was certain it would hit a net 8.5% return on its investment by the 2009/10 financial year, so presumably it is confident its plans for Alitalia will achieve this aim, with the Italian flag carrier achieving break-even in 2010 and posting a net profit in 2011.

ALITALIA FLEET

	Fleet	Orders	Options
Alitalia			
A319	12		
A320	11		
A321	23		
747-400			3
767-300ER	12		
777-200ER	10		
MD-11F	5		
MD-80	75		
Total	**148**	**0**	**3**
Alitalia Express			
ATR-72	10		
ERJ-145	14		7
Emb-170	6		6
Total	**30**	**0**	**13**

Air France says that unlike KLM, Alitalia will not be integrated into the Air France group, but rather operate as a separate entity. Spinetta insists that "it has never been our intention to make Alitalia a regional airline, but to strengthen its role as the Italian national flag-carrier and to win back its natural market share".

Clearly Air France/KLM is the preferred option for Alitalia's management, with Prato saying in December that Air France/KLM's plans were based on Alitalia's own restructuring plans (whereas there was little "detail" to Air One's plans for Alitalia at that date).

The only outstanding question on the deal is just how it will be structured financially. Prior to the exclusive negotiations, Air France/KLM indicated an offer of €0.35 per share, a €750m recapitalisation and the purchase of €1.2bn worth of convertible bonds (which mature in 2010) at nominal value.

But although Alitalia's shares have plunged over the last year (see chart, page 15), they are still substantially above €0.35 per share, so it's no surprise that the government wants Air France/KLM to increase its bid. In February Air France/KLM said it would invest €3bn in Alitalia over the next five or six years (and €6.5bn in the long-term), and that it wanted to acquire 100% of the airline and then de-list it, subject to agreement by the Italian government to make a full bid.

Given this level of investment and Alitalia's current financial position, a substantial increase in Air France/KLM's bid is unlikely. A way out of this problem may be a share swap, which is being considered by both the government and Air France/KLM. Unconfirmed reports say that the government's stake in Alitalia could be exchanged for a 3% stake in the enlarged Air France/KLM/Alitalia, and this could even rise to 5% if Alitalia bought back the government's 51% stake in Servizi, the former Alitalia engineering and ground services division that is now owned 51% by state holding company Fintecna.

Servizi employs 8,500 and Alitalia's management is urging the Franco-Dutch group to reintegrate the ground services business, but whether Air France/KLM would really want to be burdened with a 100% stake in the service unit (which some analysts believe is substantially overmanned) remains to be seen.

AP Holdings

The bid from Italian LCC Air One for Alitalia is being carried out through AP Holdings, its parent company, which is in a consortium that also includes four banks - Italian-based retail bank Intesa Sanpaolo, as well as Nomura, Goldman Sachs and Morgan Stanley.

Carlo Toto, chairman and founder of Rome-based Air One, says that its bid for Alitalia would "preserve its national identity", although it is rumoured that an Air One-controlled Alitalia might draw close to Lufthansa in the future (speculation that in January prompted Lufthansa to deny it would be joining the Air One bid for Alitalia).

Air One's ambitious five-year plan for Alitalia targets a breakeven in 2009 and a profit in 2010, with the consortium investing up to €4bn in the airline, largely for medium-haul fleet renewal that would be at the heart of an expansion of business routes out of Rome-Fiumicino. But in contrast with Air France, Air One says that Milan Malpensa would remain a hub airport under its plans, which envisage an eventual Alitalia fleet of 215-222 aircraft.

While there would be 40 long-haul aircraft, Alitalia's long-haul slots might be sold off unless they complemented or enhanced Air One's existing plans to launch long-haul routes in 2008. Up to 20 long-haul aircraft will be leased by Air One over the next four or five years, with approximately four new aircraft a year entering its fleet.

Key to Air One's initial plans for the flag carrier would be renewal of Alitalia's regional and medium-haul A320 and A330 fleet, with up to 130 new aircraft coming in at a cost of €3bn. In particular, Air One is looking to shore up Alitalia's domestic market share, which has fallen to 40% (compared with the 25% of Air One), and there would be rationalisation with Air One's existing domestic network. Air One has 90 A320s on order, and with the planned new aircraft for Alitalia, an Air One/Alitalia group would have large amounts of new aircraft coming on stream over the next few years.

Air One indicated that Alitalia's international services would be run primarily on point-to-point routes between Italian and European destinations, while business routes will be concentrated on Milan Malpensa and leisure routes at Rome Fiumicino - although the number of routes will be roughly equal out of each of these airports. By integrating the networks of Alitalia and Air One, AP Holdings says it will take 16% out of Alitalia's cost base. Its forecasts see revenue reaching €6.2bn by 2012 (with passengers carried of 34.4m), with an EBIT in that year of €375m.

But AP Holdings is offering just €0.01 for each Alitalia share, well below the current share price and the Air France/KLM offer, although this is a more sensible price than the Air France/KLM bid as it allows AP to

maximise investment on the airline going forward.

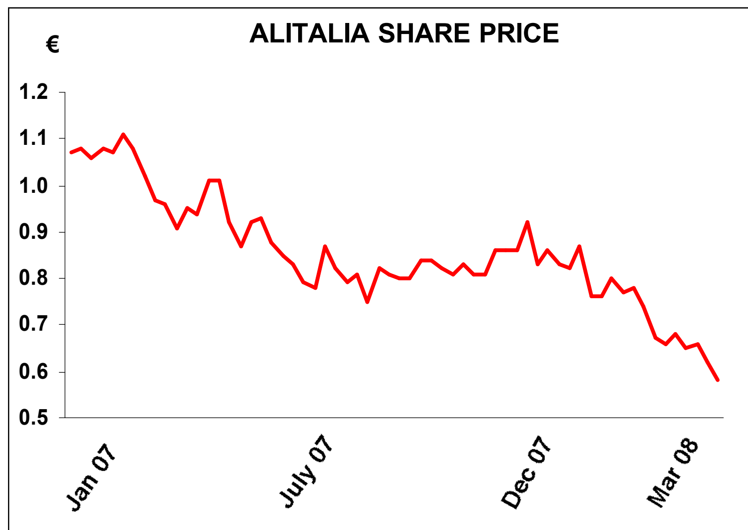
Still in the game

Although Alitalia's choice of Air France/KLM was a huge blow to the AP Holdings consortium, Carlo Toto is still confident that his bid is not yet dead as he believes it is in the best long-term interests of the airline and the country, and there are reports of at least five new private investors joining the bid since the start of 2008.

Indeed while senior Alitalia management and most of the Prodi government prefers the Air France/KLM bid, and while Air One's bid to buy its much bigger rival appears to be very ambitious, AP Holdings does have some key allies on its side: the unions (although some of them are now starting to come round to supporting Air France/KLM, after the latter's lobbying offensive), most of the Alitalia workforce and some powerful political forces, such as the Lombardy regional government. This support is based on Air One's plans to maintain the size of the Milan Malpensa operation, even though Air One says that it would still need to cut a substantial amount of positions at Alitalia (though less than Air France/KLM).

Air One has long been interested in expanding its presence in Milan's airports and has been a fierce critic of Alitalia's takeover of the collapsed Italian Volare group in July 2006. Although the Italian regulator ruled that Alitalia had to give up four pairs of slots at Milan Linate as a condition of its approval, that did not satisfy Air One, which has been pursuing the case legally ever since.

In the latest twist, in early March an Italian appeals court agreed with Air One and ruled that a new tender must be held for Volare. But Volare, which includes charter carrier Air Europe and LCC Volareweb, has already been absorbed into Alitalia as its response to the challenge of the LCCs, and Volareweb is now expanding fast, with its current fleet of four A320s set to increase to 10 by the summer of 2008, most of which are likely to be A319s. It's clear that if Air One loses out to Air France/KLM, then it will battle hard against expansion of Volareweb operations at Milan Malpensa - notwithstanding the recent court ruling, which may completely throw the future of Volare into doubt again.



The future?

If - as seems likely - the Italian government's 49.9% stake is bought by Air France/KLM, the future for Alitalia will still remain uncertain. Most pressingly, the Air France bid has divided Alitalia staff, and the unions at Alitalia may react badly to the new owners of the flag carrier. Securing a deal with staff is the number one priority for Air France/KLM, and Spinetta has already met Alitalia unions, including the key UGL union, since if they cannot be persuaded of the merit of an Air France/KLM takeover then industrial action to prevent the cut-backs of routes and staff is inevitable.

But assuming a scenario of labour unrest doesn't happen, a key problem for Alitalia/Air France/KLM will be what the competition does at Milan Malpensa as Alitalia reduces its presence at the airport. Air One is likely to pile into Malpensa if the flag carrier leaves the door open there, and just how many of the slots will be turned over to Alitalia's charter or LCC operation remains to be seen: LCC subsidiary Volareweb is already starting to increase European routes out of Milan, but following the release of Alitalia's summer schedule, slots Alitalia is no longer using at Malpensa have been released back to the

airport operator - which is infuriating opponents of Alitalia's strategy.

While Alitalia's summer schedule is based around the Rome Fiumicino hub, even at Rome some routes have been closed (such as to Shanghai, Mumbai and Delhi on long-haul, and to Zagreb, Minsk, Lyon and Copenhagen in Europe), although frequency is being increased at certain other routes. From the summer Alitalia will operate to 83 destinations, of which 77 are served out of Rome, 38 from Milan Malpensa and 18 from Milan Linate.

More worrying perhaps for Alitalia is the spectre of Ryanair, which has ambitious plans for Milan Malpensa. The LCC is urging the airport to turn itself into a low-cost hub, and promises hundreds of millions of Euros of investment into Malpensa if the airport does so. Ryanair has long been keen to win more passengers within and to/from Italy, and in December 2007 Ryanair asked the European Commission to block Air France/KLM's bid for Alitalia until both airlines pay back a total of €2.7bn in "illegal state aid" from the Italian and French governments (of which the Alitalia portion is €1.7bn).

If the Air France/KLM deal does go ahead, regional politicians in the north of Italy may well persuade the airport to open itself up to Air One or even Ryanair, and while this will secure local jobs, substantial competition out of Milan Malpensa would have unknown effects on Air France/KLM's projections for Alitalia. The threat to Alitalia of Malpensa being opened up became even more likely once a small but key political partner left the centre-left government coalition in January, leaving Prodi without a working majority in the Italian senate. That development hit the share price of Alitalia in January and it fell by almost 10% on one day, prompting a brief suspension on the Milan market. As of early March the share price had dipped under €0.6, giving Alitalia a market cap of around €820m.

The election...

Alitalia insists the talks with Air France/KLM will not be affected by the uncertainty over the future of the Prodi government, but with a general election scheduled for April 13th and 14th, the political imperative has shifted. The centre-right parties are ahead in the opinion polls, and they are firmly opposed to Air France/KLM's takeover. Forza Italia - the largest centre-right wing party, led by Silvio Berlusconi - is very critical of the current situation, and may prefer Alitalia to go bankrupt and for a new national airline to be launched with new labour agreements. Another right-wing party is the Northern League, which is fiercely opposed to Alitalia cutting back its presence at Milan Malpensa. AP Holdings/Air One's hopes are therefore not yet dead even though a legal challenge launched in January by AP Holding against the government's decision to allow exclusive negotiations between Alitalia and Air France/KLM was rejected by an Italian court in late February (although that decision is being appealed by AP).

Crucially (and slightly confusingly) in mid-February Air France/KLM said that while it will make a decision on whether to make a binding offer by mid-March (well before the Italian general election in mid-April) it added that it would only go ahead with the deal if the new Italian government approved the Franco-Dutch takeover, which might not happen if the centre-right coalition wins the election.

In any case, while Air France/KLM has experience of going through a merger process before, and this is likely to make it aggressive in cutting back Alitalia into the shape it needs to fit into the new Alitalia/Air France/KLM giant, the advantages of the AP Holdings/Air One bid may have been underestimated by many analysts.

Crucially, under AP Holdings the airline would retain the goodwill of unions and politicians alike, and the changes that still need to be made at Alitalia could be carried out in a far less aggressive and much more achievable way by Italian owners than by Air France/KLM. With short-term financial and labour stability assured, an Air One-owned Alitalia would then be in a much stronger position to link up (even with equity) with one of Europe's larger airlines - and preferably Lufthansa. The Air France/KLM bid may offer scale and kudos, but it may not necessarily be the best option in the long-term for Alitalia.

JetBlue: slower growth and new revenue strategies

JetBlue Airways, the largest of the new-generation US LCCs, is in the middle of a financial turnaround, thanks to two years of restructuring and strategy refinements. The New York City-based airline has retained its superior product and low cost structure, but in other ways it looks very different: a new leadership team, more sophisticated revenue management, a disciplined growth strategy, new types of markets and a focus on high-yield passengers and international alliances. Will this new type of hybrid LCC/traditional model work for JetBlue?

JetBlue, which commenced operations from New York JFK in February 2000, had perfect credentials: ample start-up funds, a strong management team and a promising growth niche. It succeeded in attaining Southwest's efficiency levels, despite its high-cost Northeast environment, much smaller fleet and a more up-market product. JetBlue became profitable after only six months of operation and went on to achieve spectacular 17% operating margins in 2002 and 2003.

With its new A320 fleet, state-of-the-art technology and superior in-flight product, JetBlue also set new standards in airline service quality in the US. Like Southwest, it quickly built a "cult following", which has enabled it to attract price premiums and considerable customer loyalty.

JetBlue also grew extremely rapidly, achieving "major carrier" status, with $1bn-plus annual revenues, in 2004 - its fifth year of operation, which is by far the fastest-track to a major ever seen in the US. Last year JetBlue had $2.8bn of revenues, making it the eighth largest US passenger carrier.

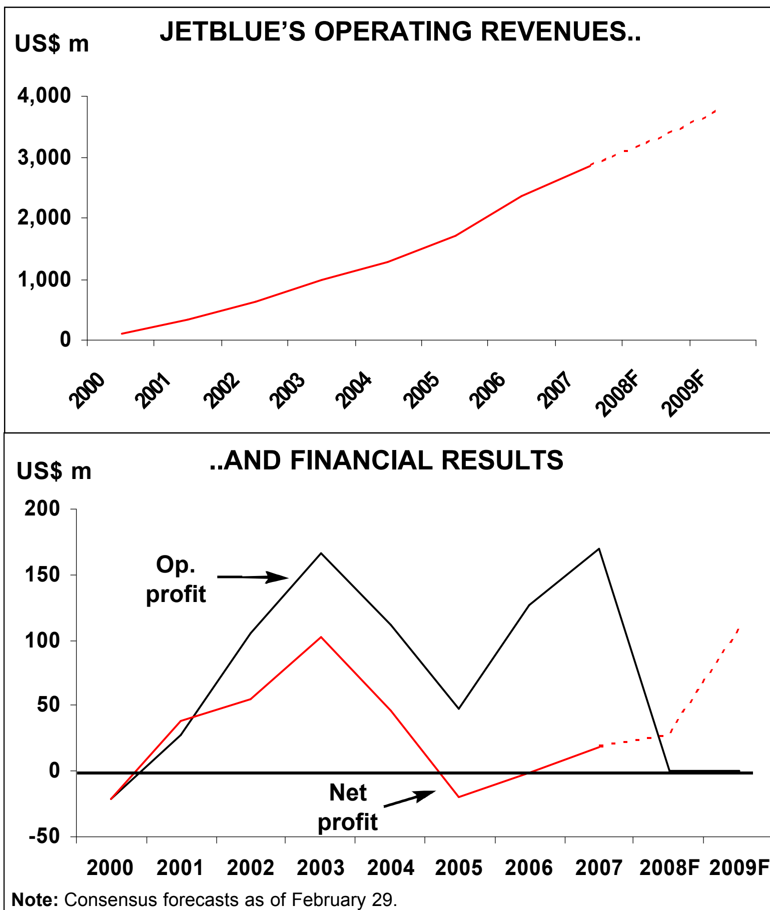
However, after the spectacular start, JetBlue stumbled financially just as the rest of the US airline industry began to see light at the end of the tunnel. In two years, JetBlue literally went from the industry's best to worst in terms of financial results. Its operating margin plummeted from 17% in 2003 to 8.8% in 2004 and 2.8% in 2005. 2005 and 2006 saw net losses of $20m and $1m, respectively.

The main reason for the losses, of course, was the hike in fuel prices. Like most US airlines, JetBlue did not have significant fuel hedges in place. Like other LCCs, JetBlue also found it harder than the legacies to deal with the weak domestic pricing environment. It had no lucrative international operations. Its simple pricing model meant that it had few fare buckets to play with. And its aggressive growth plan required it to focus on filling aircraft rather than pricing for profitability.

JetBlue was the fastest-growing US LCC in the first half of this decade. It continued to grow ASMs by 21-25% annually in 2005 and 2006, despite the financial losses, because there was no demand problem and because it did not want to forego good growth opportunities.

Although JetBlue began to tackle its problems in the spring of 2006 with a "return to profitability" plan, the most visible actions came following an operational meltdown on Valentine’s Day in February 2007 that highlighted serious shortcomings in the airline's ability to deal with operational issues. An ice storm in the Northeast grounded 1,000-plus flights, and because JetBlue had a policy of not cancelling flights ahead of bad weather, thousands of people were trapped in aircraft for hours or stranded in terminals for days. JetBlue did not fly a full schedule for days. There was a massive outcry from air travellers and calls from Congress for legislation to protect passengers' rights.

JetBlue averted the crisis - and fortunately suffered no lasting negative impact on image or customer loyalty - by taking decisive action. The airline made important changes in the way it responds to weather and other operational irregularities, drafted its own "customer bill of rights" and strengthened its operations team.



Note: Consensus forecasts as of February 29.

The February 2007 crisis also led to a leadership change three months later. JetBlue's board ousted CEO David Neeleman and named President Dave Barger to succeed him. Neeleman had been criticised for spending too much time apologising rather than fixing problems; however, the changeover was seen more as a natural progression in the leadership structure as JetBlue matures. It was hoped that Barger's appointment would bring more stability internally and help facilitate more orderly growth. Neeleman remains JetBlue's chairman, and holds about 4% of the carrier's stock.

Since introducing the financial recovery plan in April 2006, JetBlue has tackled many of the issues with great success. Most significantly, it has drastically slowed growth through fleet reductions. Second, JetBlue has improved revenue generation (in a very difficult domestic pricing environment) through a multitude of initiatives and strategy changes, and it continues to enjoy robust RASM trends in 2008.

Third, JetBlue has enhanced profitability through network changes. Among other things, there has been major Caribbean expansion and a shift to higher-yield short and medium haul markets utilising the E190 - strategies that have helped reduce overdependence on the transcontinental market.

Fourth, like many other US LCCs, JetBlue is moving decisively to develop ancillary revenues. It is now going all out to market its subsidiary LiveTV, which should be a good revenue generator in the short term and a spin-off candidate in the longer term.

As a result, JetBlue returned to profitability in 2007, posting operating, pretax and net earnings of $169m, $41m and $18m, respectively (6%, 1.4% and 0.6% of revenues). This was a real achievement in light of the fuel price hike, the February ice storm (which meant a $40m revenue hit) and last summer's terrible flight delays in the New York area.

JetBlue has basically returned to industry "mainstream" financial performance. Its 6% operating margin was slightly higher than the legacies' typical 5-5.5% margins, the same as AirTran's 6%, but well below the 12.2% and 8.7 margins achieved by Allegiant and Southwest in 2007.

More disciplined growth

Slower growth has been the key factor behind JetBlue's financial recovery. The airline reduced its ASM growth from an annual average of 25% in 2003-2006 to 12% last year. For a while it looked like around 10% would become the norm, but growing economic uncertainty prompted JetBlue to twice scale back its growth plans in January. The current plan calls for 5-8% ASM growth in 2008, but further revisions are possible if the economic picture worsens.

The ASM growth reduction has been achieved through a combination of older aircraft sales, lease terminations and order deferrals with Airbus and Embraer. In 2006 JetBlue sold five A320s in the used aircraft market. In 2007 it sold another three A320s,

returned one leased A320, deferred four A320 deliveries from 2009 to 2012 and deferred 16 E190 deliveries from 2007-2012 to 2013 and beyond. In January JetBlue disclosed that it had deferred the delivery of 16 A320s from 2010-2011 to 2012-2013. It also currently has commitments to sell six A320s in 2008 and is open to selling more, if necessary.

The airline also intends to manage capacity through aircraft gauge reductions (substituting E190s for the A320s) and by reducing utilisation in off-peak periods. JetBlue is lucky to have one of the highest aircraft utilisation rates in the industry - still averaging 12.8 hours daily on the A320s - which gives it flexibility in the current fuel environment.

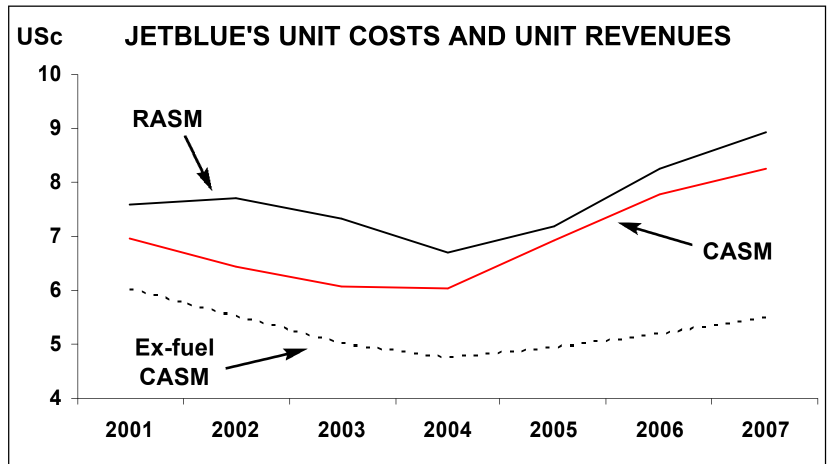
The A320 and E190 options help JetBlue maintain flexibility to accelerate fleet growth and respond to market opportunities. For example, in December the airline exercised three E190 options for 2009 delivery.

JetBlue is scheduled to take delivery of 12 A320s and six E190s this year. Assuming six A320s are sold, the year-end 2008 fleet would be 110 A320s and 36 E190s. Including the effects of the January Airbus order amendments, at the end of 2007 JetBlue had 70 A320s and 74 E190s on firm order for delivery through 2015, plus 32 A320 options and 91 E190 options for 2009-2015 delivery. The firm order deliveries amount to 18-25 annually in the next six years.

Improved revenue generation

The April 2006 recovery plan instigated fundamental changes to JetBlue's revenue strategy. In David Neeleman's words at that time, fuel simply changed the way the airline looked at the world. The premise of the previous model, which worked well when crude oil was at $20-30 a barrel, was to keep costs and prices low and make substantial profits on volume and growth. Now the time had come to sacrifice some load factor to the yield.

The aim was to get the system average fare of $105 up by "a few more dollars" to



cover the increase in fuel prices. JetBlue did not want to change its low fare structure; rather, it wanted to improve the fare mix.

This meant a move towards conventional yield management and more complexity in the pricing model - strategies that European LCCs like Ryanair have used successfully since their inception. JetBlue upgraded its yield management systems and revamped its revenue management team. The spring and summer of 2006 saw a multitude of revenue initiatives, including selective capacity cuts, scheduling adjustments, adjustments to fare buckets, elimination of some of the cheapest fares and new corporate booking tools.

Add to that the slower growth rate, fewer new city additions (which has meant that a large number of markets are maturing) and the increased use of E190s in higher-yield short and medium haul markets (the type was introduced in November 2005), and the results have been quite stunning. Between 2005 and 2007, JetBlue's average fare rose by $13 or 12%, while the yield surged by 28% and RASM by 24%.

The revenue momentum remains strong going forward also because of competitors' capacity cuts in JetBlue markets, new product offerings targeting the higher-yield segment and a new focus on developing ancillary revenues.

Many of JetBlue's latest revenue moves are aimed at capturing more business traffic. Last year JetBlue listed its fares in all four major GDSs, which resulted in higher average fares, offsetting the increased dis-

tribution costs. In January the airline launched refundable fares - a fare class with a $50-100 premium for passengers needing extra flexibility.

In the second quarter JetBlue will unveil a new "front cabin" product, aimed at monetising the increased pitch on its A320s especially against competitors such as Virgin America. About a year ago, JetBlue removed a row of seats from its A320s, reducing the seating from 156 to 150, which enabled it to operate the aircraft with two (rather than three) flight attendants. The reconfiguration also meant that seats in the first 11 rows (44% of total seats) have an industry-leading 36-inch pitch, while the remaining seats have at least 34-inch pitch. JetBlue planned to reserve some of the front seats for last-minute or first-class type customers and said that it would later roll out "exciting programmes" to boost revenues. The product to be unveiled in the coming months is the result of those efforts. It will not involve removing more seats from the A320s.

JetBlue's management has indicated that developing ancillary revenues will be a major focus in 2008. Last year the airline increased its change fees, began collecting a $10 fee for reservations over the phone and launched a "cashless cabin", which will provide a platform for further developing sales onboard aircraft. The result was an encouraging 50% increase in "other" revenues in 2007. Like Southwest, JetBlue needs to invest in some technological enhancements to be able to fully meet its ancillary revenue goal.

Selling LiveTV products to other airlines is a highly promising "other" revenue source. A wholly owned subsidiary that JetBlue acquired in 2002, LiveTV had $40m revenues in 2007. At year-end contracts were in place with seven airlines, involving 372 aircraft.

Until recently, JetBlue was careful not to give direct competitors access to the product; however, Continental, JetBlue's primary competitor in New York, is now the latest LiveTV customer, having signed a long-term contract for its 737s and 757-300s. This represents an interesting shift of strategy on JetBlue's part. CEO Dave Barger explained recently that JetBlue believed that domestic passengers in the US would soon expect some form of in-flight entertainment and connectivity on flights, so having a LiveTV-type product would be necessary just to keep up with competition. Since the product no longer offers a distinct competitive advantage, JetBlue has decided to begin aggressively pursuing sales opportunities with any airlines.

Unique business model

In the past couple of years, it has often been suggested that JetBlue is moving towards a conventional business model, "toward something decidedly traditional", as one analyst put it. Multiple fleet types, modest growth, GDS participation, international partners, emphasis on high-yield passengers and refundable tickets all point in that direction.

However, JetBlue has always been upscale and it remains one of the lowest-cost US carriers and committed to low fares, so nothing has fundamentally changed.

JetBlue's key value proposition and marketing message, as stated in its 2007 annual report, is the same it has always been: "Low fares and quality air travel need not be mutually exclusive". And as CEO Dave Barger put it recently, "our ability to deliver exceptional service at a low cost differentiates us from the rest of the industry".

Back in October, Barger stressed that JetBlue remained a "discretionary airline, a leisure airline by and large" but that there were opportunities to "mine the corporate customer" and that JetBlue needed to go after those opportunities.

JetBlue is merely doing what it needs to do to remain viable in the current fuel environment. Southwest is moving in the same direction, one difference being that it needs to move cautiously because of its egalitarian image. AirTran, in turn, has had a business class product for about a decade.

That said, JetBlue does seem to have a brisker attitude to doing business than the other LCCs - its CEO has used the term "can do" airline. It is less averse to doing

unusual deals, such as accepting an investment from Lufthansa.

JetBlue has not departed from its Southwest-style growth strategy of focusing on markets that have high average fares and then stimulating demand with low fares.

Most significantly, JetBlue has retained its low cost structure, despite the increasing mix of the shorter-haul E190s in the fleet and rising A320 maintenance costs, in addition to the fuel price pressures. Asset and labour productivity are high and the latter continues to improve. The management believes that the cost initiatives launched in 2006 have "helped institutionalise JetBlue's low-cost culture". That said, AirTran has about 10% lower CASM on a stage length and density adjusted basis.

Route network strategy

JetBlue is primarily a point-to-point carrier, earning 90% of its revenues from such operations in 2007. Most of the flights are to or from New York JFK or the other focus cities of Boston, Fort Lauderdale, Long Beach and Washington DC. The carrier serves about 53 cities in 21 states, Puerto Rico, Mexico and the Caribbean. International services accounted for 4% of total revenues last year.

Route expansion in the past couple of years has had three main themes. First, there has been significant Caribbean expansion. Second, there has been a modest shift away from transcontinental to short and medium haul routes, associated with the introduction and growth of the E190 fleet (though just last month JetBlue announced significant new transcon and West Coast expansion). Third, JetBlue is increasingly overflying JFK due to congestion issues; for example, operating upstate NY to Florida point-to-point services with the E190s.

However, JetBlue is also determined to maintain its leading position in New York. In addition to growing JFK outside the daily peak periods, it has added service from LaGuardia and Newark, as well as the two satellite airports of Stewart Field and Westchester County. About 66% of its daily flights have one of those airports as either origin or destination.

As a result of the new strategies, in the past two years East-West services' share of JetBlue's total capacity has fallen from 55.1% to 47.4%, while Caribbean's share has increased from 6.4% to 10.6%. Northeast-Florida has declined slightly from 33.5% to 31.8%.

Reflecting its more disciplined approach to route profitability, JetBlue is, first of all, adding fewer new cities. After launching 16 new destinations in 2006, last year saw just five and 2008 will also see only five. The focus will be on connecting the dots and boosting frequencies. Second, as a result of a network profitability review, JetBlue recently exited two cities (Nashville and Columbus) and discontinued Fort Lauderdale-Oakland service.

The Caribbean expansion has been from JFK, Boston, Fort Lauderdale and Orlando and has taken JetBlue to places such as Cancun in Mexico, Bermuda, San Juan, Santo Domingo and Aruba. JetBlue calls the Caribbean "a natural out of New York". The markets are strong, have year-round demand, have matured quickly, generally require minimal up-front capital and, in spite of limited daily frequencies, are relatively low-cost.

Encouraged by the Caribbean experience, JetBlue has applied to serve Bogota (Colombia) from both Fort Lauderdale and Orlando (pending approval). It would be the first US LCC in that competitive market. JetBlue is not planning major expansion into South America but believes that there are opportunities for an LCC to serve the region from the Northeast or Florida.

Both the A320 and the E190 are over-water-equipped, long range aircraft. JetBlue believes that the E190, with its near-2,000-mile range, is "perfectly situated as a pathfinder in many of those markets, say Florida-Caribbean". The airline is also considering utilising the E190 in off-peak periods in the Caribbean.

Not everyone is convinced that the E190 will be a good choice for the Caribbean.

Raymond James analyst Jim Parker observed in a recent research note that "it remains to be seen if this higher unit cost aircraft is appropriate for leisure destinations that are typically characterised by lower fares".

But the 150-seat A320 and the 100-seat E190, because they offer sufficiently different sizes, seem to be a nice combination for JetBlue's diverse East Coast operations. The E190 JFK overfly Northeast-Florida services have apparently performed very well and continue to be expanded. The E190 is ideal for developing thinner markets and maintaining frequencies in seasonal trough periods in markets.

The E190's technical dispatch reliability is now close to the A320's and average daily utilisation has improved to 10.6 hours. After hitherto utilising it only in the East, JetBlue will be introducing the E190 on the West Coast in May. Despite the current fuel price environment, the management believes that the economics and operating flexibility of the E190 give JetBlue a significant competitive advantage.

Last month JetBlue announced a major expansion of transcontinental flying and significant new service on the West Coast from May. The airline will start serving Los Angeles from JFK and Boston to complement its existing transcon operations to Long Beach, Burbank, Ontario and San Diego in Southern California. It will also introduce a first-ever Washington/Dulles-Burbank nonstop service and extensive West Coast operations from Los Angeles and other Southern California airports to cities such as Austin, San Jose, San Diego, Las Vegas and Seattle. The E190 will debut in Long Beach, though most of the intra-West Coast services will utilise A320s.

This move seems to be a response to Virgin America, which began operations out of San Francisco in August, and is aimed at maintaining JetBlue's position as the leading LCC in the transcontinental market (where it offers more nonstop flights than any other LCC). JetBlue will then face VA head-on in the JFK-Los Angeles market (along with American, Delta and others). It will also compete directly with Alaska and Southwest in some of the intra-West markets.

JetBlue is more exposed to VA than any other US airline. JPMorgan analyst Jamie Baker calculated last summer that in the Northeast-Northern California market alone, $220m or 9.5% of JetBlue's total passenger revenue was at risk.

While JetBlue is concerned about the additional competition, it has been dealing with fierce competition in its markets since its inception. Also, JetBlue truly believes that it is well positioned to compete against VA because of its extremely strong position in New York, the multiple airports it serves in Southern California and the Bay Area, its high frequencies and its very competitive product (including its 34-36 inch seat pitch throughout the aircraft, plus the soon-to-be-unveiled new front cabin product).

JetBlue is the largest domestic airline at JFK, accounting for about half of the domestic passengers there. Maintaining such a dominant position at JFK is obviously highly desirable, and to that end JetBlue is being helped by two developments. First, JetBlue emerged as one of the winners under the new government-imposed rules to limit flights at peak times at JFK that go into effect this month. The outcome preserves JetBlue's dominant position, will reduce congestion-related costs, will improve the passenger experience and will limit new competition in the future (improving RASM, etc).

Second, JetBlue will be moving to a new home at JFK, Terminal 5, later this year. The airline expects the state-of-the-art facility to significantly enhance its service and help differentiate it from competitors, as well as facilitate continued growth of operations at JFK.

International alliances

JetBlue has been talking for years about pursuing international alliances, which would help leverage its presence at JFK. About a year ago it finally had a tentative deal with Aer Lingus, but that was only finalised last month. The deal will go into

effect on April 3.

It is essentially an internet booking partnership, apparently the first of its kind between low-fare carriers. Customers will be able to make a single low-fare reservation between Ireland and 40-plus US points via JFK through a booking process available live on Aer Lingus' web site. Passengers will be able to drop their bags at transfer desks at JFK but will have to change terminals.

JetBlue's CEO Dave Barger reportedly said that the airline chose Aer Lingus from "dozens" of potential partners because of its low-fare philosophy and because it was the only European discount carrier currently offering scheduled flights to the US.

JetBlue still seems interested in forging partnerships with a large number of foreign carriers, but it appears that, like Southwest, it has more work to do to develop the technology to handle multiple international partnerships and possible codeshares.

In the meantime, JetBlue is in discussions with Lufthansa about a commercial agreement, following the completion, in January, of Lufthansa's $300m investment in JetBlue, which gave it a 19% ownership stake and a board seat. JetBlue made it clear initially that it saw it simply as a financial transaction, designed to strengthen its liquidity position and give it more financial flexibility in light of economic uncertainty and a possible convertible put option in July. However, in recent statements and conference calls JetBlue executives have mustered more enthusiasm about future cooperation with Lufthansa. In the first place, the two are exploring potential supply-chain opportunities which could yield significant cost savings for JetBlue. Of course, Lufthansa is believed to be mainly interested in longer-term strategic benefits, such as the sharing of slots and gates at JFK and getting US feed to its transatlantic flights.

Outlook

JetBlue is enjoying a turnaround, driven by a strong revenue momentum. The management is predicting an operating margin of 6-8% in 2008, which assumes extremely healthy 9-11% PRASM growth. According to analysts, the margin forecast implies EPS of 20 cents a share, which would be double the 10 cents JetBlue earned last year.

Wall Street has not accepted that forecast, because of economic and fuel price uncertainty, high execution risk and because JetBlue's management does not have a good forecasting track record. The current consensus estimate is a profit of 12 cents a share, though the individual estimates range from a loss of 23 cents to a profit of 30 cents. The consensus forecast for 2009 is 48 cents per share. The stock is mainly rated "hold", though some analysts recommend "buy" based on the post-2008 growth and earnings potential.

On the positive side, JetBlue is following sound strategies, its low cost structure remains intact, its culture, image and brand are strong and its financial position is solid enough to withstand a recession.

While JetBlue is highly leveraged, it has modest near-term debt maturities, an excellent cash position of over $1bn, readily monetisable A320s and deep-pocketed investors.

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		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Alaska	Jul-Sep 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
	Jul-Sep 07	995	852	143	86	14.4%	8.6%	10,225	8,154	79.7%	4,878	9,753
	Oct-Dec 07	747	730	17	7	2.3%	0.9%	9,688	7,239	74.7%	4,191	9,672
American	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%	25,301	85,500
	Jul-Sep 07	5,946	5,627	319	175	5.4%	2.9%	69,636	58,401	83.9%	25,448	85,800
Continental	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
	Jul-Sep 07	3,820	3,540	280	241	7.3%	6.3%	48,836	40,912	83.8%	17,901	
	Oct-Dec 07	3,523	3,443	80	71	2.3%	2.0%	45,947	36,483	79.4%	16,732	
Delta	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
	Jul-Sep 07	5,227	4,774	453	220	8.7%	4.2%	65,889	54,774	83.1%	28,987	55,022
	Oct-Dec 07	4,683	4,685	-2	-70	0.0%	-1.5%	60,210	47,052	78.1%		55,044
Northwest	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**	3,181	2,824	357	2,149	nm	nm	38,070	32,495	85.9%	17,400	29,589
	Jul-Sep 07	3,378	2,919	459	244	13.6%	7.2%	38,445	33,222	86.4%	17,300	29,579
	Oct-Dec 07	3,096	3,009	87	-8	2.8%	-0.3%	36,836	30,361	82.4%	16,100	30,306
Southwest	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
	Jul-Sep 07	2,588	2,337	251	162	9.7%	6.3%	41,385	31,680	76.5%	23,533	33,787
	Oct-Dec 07	2,492	2,366	126	111	5.1%	4.5%	40,649	28,171	69.3%	24,876	34,378
United	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
	Jul-Sep 07	5,527	4,871	656	334	11.9%	6.0%	65,547	55,089	84.0%	17,804	51,800
	Oct-Dec 07	5,030	5,094	-64	-53	-1.3%	-1.1%	62,679	49,732	79.3%	16,042	51,700
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
	Jul-Sep 07	3,036	2,834	202	177	6.7%	5.8%	31,653	26,385	83.4%	14,965	34,321
	Oct-Dec 07	2,776	2,850	-74	-79	-2.7%	-2.8%	34,859	26,812	76.9%	19,828	
JetBlue	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
	Jul-Sep 07	765	686	79	23	10.3%	3.0%	13,446	11,020	82.0%	5,528	9,301
	Oct-Dec 07	739	709	30	-4	4.1%	-0.5%	13,056	9,995	76.6%	5,181	9,909

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/	**Year 2005/06**	**25,901**	**24,771**	**1,136**	**1108**	**4.4%**	**4.3%**	**234,669**	**189,253**	**80.6%**	**70,020**	**102,422**
KLM Group	Apr-Jun 06	7,282	6,766	516	306	7.1%	4.2%	60,839	49,596	81.5%	19,049	
YE 31/03	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
	Jul-Sep 07	9,183	7,855	1,328	1041	14.5%	11.3%	67,375	57,009	84.6%	20,448	
	Oct-Dec 07	8,678	8,202	476	207	5.5%	2.4%	62,615	49,591	79.2%	17,868	
BA	Jan-Mar 06	3,692	3,530	162	144	4.4%	3.9%	36,657	26,780	73.1%	8,160	45,171
YE 31/03	**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**
	Apr-Jun 07	4,395	3,868	527	539	12.0%	12.3%	37,514	28,836	76.9%	8,648	
	Jul-Sep 07	4,729	4,118	611	458	12.9%	9.7%	38,191	30,500	79.9%	9,206	42,024
Iberia	Apr-Jun 06	1,816	1,753	63	44	3.5%	2.4%	16,809	13,420	79.8%	7,461	24,109
YE 31/12	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
	Jul-Sep 07	2,080	1,882	198	211	9.5%	10.1%	17,119	14,653	85.6%	7,216	22,803
Lufthansa	**Year 2005**	**22,371**	**21,656**	**715**	**561**	**3.2%**	**2.5%**	**144,182**	**108,185**	**75.0%**	**51,260**	**90,811**
YE 31/12	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
	Jul-Sep 07 *	8,960	8,004	956	843	10.7%	9.4%	48,662	39,112	80.4%	18,836	
SAS	Apr-Jun 06	2,439	2,319	120	75	4.9%	3.1%	14,005	10,325	74.0%	10,325	32,622
YE 31/12	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
	Jul-Sep 07	2,612	2,518	94	109	3.6%	4.2%	15,352	11,890	77.4%	11,031	27,447
	Oct-Dec 07	2,041	2,039	2	-96	0.1%	-4.7%	14,263	9,701	68.0%	9,923	25,651
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	
	Jul-Sep 07	1,229	795	434	384	35.3%	31.2%			86.0%	13,952	
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	
	Year 2006/07	**3,679**	**3,069**	**610**	**311**	**16.6%**	**8.5%**	**43,501**	**36,976**	**83.7%**	**37,200**	

Note: * Lufthansa Group including SWISS

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

Airline	Period	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
2007	346.6	239.9	69.2	241.4	196.1	81.2	184.2	152.1	82.6	610.6	500.4	81.9	915.2	713.9	78.0
Jan-08	26.9	15.9	59.2	17.9	13.3	74.2	15.9	12.8	80.4	61.4	40.4	78.6	76.0	55.2	72.5
Ann. change	4.0%	3.5%	-0.3	2.9%	1.7%	-0.8	1.5%	0.9%	-0.5	4.1%	2.4%	-1.4	5.0%	3.2%	-1.2

Source: AEA

EIGHT 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 %
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	**464.2**	**364.6**	**77.8**	**91.4**	**75.4**	**82.1**	**56.3**	**46.5**	**82.7**	**49.2**	**36.0**	**72.7**	**196.9**	**157.9**	**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**
2007 Q1	217.4	169.6	77.5	42.9	32.5	75.5	27.0	22.5	83.4	29.5	22.7	76.8	99.4	77.7	78.2
Q2	226.6	189.9	83.8	53.7	44.9	83.6	28.1	23.5	83.8	27.1	20.8	76.8	108.9	89.2	81.9

Note: Legacy airlines plus Alaska and Southwest.

JET ORDERS

	Date	Buyer	Order	Delivery	Other information/engines
Boeing	19 Feb	Garuda Indonesia	4 x 777-300ER		
	19 Feb	Lion Air	56 zx 737-900ER		plus 50 purchase rights
Airbus	!9 Feb	Korean Airlines	23 xA389x 737-800s		
	18 Feb	Korean A/L	3 x A380	2012/13	
Embraer					
Bombardier					

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

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