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Arrivedérci to Alitalia?

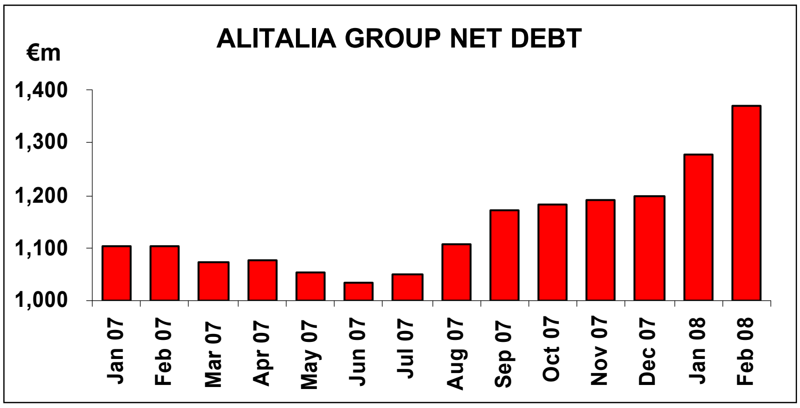
The Italian flag carrier again looks close to collapse given that unions refuse to accept the job cuts demanded by the Franco-Dutch group and the Italian general election has returned Silvio Berlusconi to power - who says he will veto the sale of the Italian flag carrier to Air France/KLM.

In late March Silvio Berlusconi announced that if his right-wing coalition won the election being held on April 13th and 14th then he would veto Air France/KLM's acquisition of Alitalia, which he regarded as "arrogant and unacceptable". He is in favour of an Italian takeover of Alitalia and said that: "I've appealed to the pride of Italian entrepreneurs who think as I do that we shouldn't be colonised."

The impending election meant that some of Berlusconi's statements had to be treated with caution (as they were primarily aimed at attracting votes), and there are analysts who believe that now elected, Berlusconi will back down from blocking Air France/KLM's takeover. At the time of *Aviation Strategy* going to press, it was unclear whether the newly-elected Berlusconi would carry out his threat, although on election night Berlusconi did say he wanted to break the current "impasse".

Berlusconi is likely to be emboldened by the fact that his “Popolo della Libertà” party has won a convincing victory at the polls - so large in fact that he now governs without the need to obtain the support of more moderate centre-right parties. But in any case, Berlusconi may never have to formally veto the deal, since Air France/KLM may pull out of the takeover anyway (and may well have done so by the time *Aviation Strategy* gets to subscribers).

Prior to the election, the immediate problem for Air France/KLM was to get agreement with Alitalia's nine unions,



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who have reacted badly to what they say has been a lack of consultation from the Franco-Dutch group, with what they see as a "take it or leave it" ultimatum from Air France/KLM.

As predicted by *Aviation Strategy* (see March 2008 issue), Air France/KLM's indicative offer of €0.35 for each Alitalia share was unrealistically high, although it went a fair way to persuading the government to nominate the Franco-Dutch group as its preferred bidder, ahead of the rival bid by Air One, which indicated a much more realistic price of €0.01 per share.

When in March (following the end of the exclusive period of negotiations) Air France/KLM unsurprisingly lowered its firm bid to an effective €0.10 per Alitalia share (via offering one of its shares for every 160 Alitalia shares, with Air France/KLM shares trading at €16 as at mid-March), this caused uproar in Italy and gave plenty of room for criticism of the Franco-Dutch group by politicians and unions alike.

Air France/KLM argues that it lowered its bid after finding unexpected surprises in Alitalia's books, such as substantial losses at Alitalia's cargo operation. Air France/KLM now wants to shut down Alitalia's specialist cargo flights over the period to 2010, with a gradual elimination of the five-strong MD-11 freighter fleet. Cargo will then only be carried in the holds of passenger aircraft, but Alitalia's unions argue that all this move will ensure is that Air France/KLM's own specialist cargo aircraft (five 777 freighters are on order) will operate very profitably.

Air France/KLM countered that it still planned to invest €1bn into Alitalia via a rights issue, and that if it took over the flag carrier then it could return to operating profit as early as 2009 under its turnaround plan, with capacity growth at Alitalia recommencing in 2011.

Union anger

But these statements count for little with Alitalia's unions, who have now lost what little trust they had in Air France/KLM and simply do not believe that Air France/KLM will "only" reduce Alitalia's capacity by around 10% in 2010 compared with 2007, with the fleet being cut from the current 186 to 140 by 2010.

Indeed Berlusconi's controversial statements came a week after negotiations between unions and Air France/KLM broke down in mid-March, although they restarted a week later as there had been a March 31st deadline imposed unilaterally by Air France/KLM for unions to approve the Franco-Dutch "framework" for Alitalia.

The talks naturally centred on redundancies. Another reason why Air France/KLM was preferred initially was because it appeared to require fewer redundancies than Air One, but that now doesn't appear to be true. Air France/KLM wants 1,600 job cuts at the current 11,000 workforce and another 500 from the 3,300 employees it says it will transfer across from Servizi, the former Alitalia engineering and ground services division. But although Air France/KLM says the remaining 4,100 at Servizi will be kept for up to four or eight years before Servizi is closed down, unions argue that this effectively means that the true number of job losses will be 6,200.

On/off talks

Predictably, the resumed talks broke down again on the 29th of March, meaning that the 31st deadline imposed by Air France/KLM could not be achieved - although Air France/KLM then extended the deadline to April 2nd. Yet again this was a deadline that was impossible to meet, and later that day Maurizio Prato - Alitalia's chairman and chief executive - resigned, and the shares were suspended. That same evening Air France/KLM then withdrew from the deal, only to then say they would give unions (who are willing to restart talks) a second and "final chance" to reach a deal, with talks starting on April 15th.

Air France/KLM is now believed to be offering to take on an extra 891 from Servizi (meaning that 4,191 will transfer from Servizi to Alitalia, of which 500 will then be made redundant), but that still leaves overall job cuts at 5,309 (1,600 at Alitalia, 500 from the transferred Servizi jobs, and the 3,209 left behind at Servizi, whose positions will all go eventually, over a number of years).

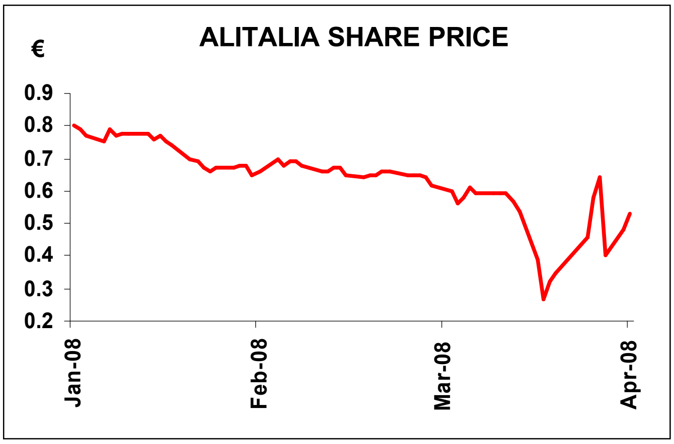
It seems unlikely (although not impossible) that unions will agree to this level of job losses, and Jean-Cyril Spinetta - chief executive of Air France/KLM - has warned unions that his airline has little room for compromise on its offer. Since Spinetta wants all nine of Alitalia's unions to give consent to the takeover - and Air France/KLM maintains it will not go ahead with the deal unless the new government also approves - the prospects for a Franco-Dutch-Italian group look bleak, if not impossible.

A successful Air France/KLM takeover appears even more remote now that Italian airport operator SEA has launched legal action against Alitalia, claiming €1.25bn in damages over the airline's decision to downgrade its operations at Milan Malpensa. While the current government has asked the airport operator to drop its case, Air France/KLM wants the new government to protect Alitalia from the SEA lawsuit. But if the government provides any kind of monetary promise or guarantee to Alitalia or Air France/KLM over the SEA action, then it could break the EC's bar on any more state aid to the Italian flag carrier.

A white knight

This situation leaves the door open for Air One. Berlusconi firmly wants an "Italian option" for Alitalia, and indeed a day after Berlusconi's initial announcement, Carlo Toto, chairman of Air One, said the airline would make a binding offer for Alitalia, to be unveiled in mid-April once (and only if) Air One had a chance to look at Alitalia's full accounts.

The former Italian government said time was running very short for Alitalia and that any rival offer had to be made within days and not weeks, with Tommaso



Padoa-Schioppa - Italy's former finance minister - adding a warning that the government may appoint a special commissioner to run the airline. The net debt at Alitalia continues to grow (see chart, on first page), and in March Alitalia asked the government for a short-term €300m line of credit, even though Alitalia's cash position will be boosted shortly by €148m thanks to a €69m tax refund and €79m from the sale of its Air France/KLM shares. Ominously, after a board meeting on April 8th, Alitalia said it had just €170m in short-term funding left.

Assuming Air France/KLM is no longer a realistic option, there is a brief chance for Air One and a variety of Italian investors to step in and prevent Alitalia from going under. Despite the France-Dutch group's exclusive talks with Alitalia, Air One has continued to work on its bid, and there has been continuing speculation in Italy that Lufthansa may step in and join the Air One bid - although the German flag carrier will not comment.

Of course the most probable outcome is that Air France/KLM pulls out and then an Air One/Italian investor bid fades away, which will effectively mean the end of Alitalia. If that happens, 1,000s will lose their jobs, and accusations and blame will be flung at everyone. But while Italy will be left without a flag carrier, this will give Air One and foreign LCCs and flag carriers alike a huge opportunity to exploit, and the death of Alitalia is likely to ignite a furious scramble to enter the Italian aviation market over the next couple of years.

Iberia back in play in 2008?

Iberia surprised analysts with better-than-expected 2007 results, but it still faces the same fundamental problem of intensifying competition from LCCs in Europe and from Marsans and others on long-haul. The key question remains: can Iberia survive as an independent airline, or will it inevitably be acquired by a larger carrier at some point in the not-too-distant future?

Last year Iberia reported its twelfth consecutive year of profit (see chart, opposite), and while revenue increased by just 2.5%, operating profit rose to €284m (compared with €122m in 2006) while net profit reached €328m (€57m in 2006). The net figure was well ahead of consensus analyst forecasts of €267m, and was due to a better performance on long-haul (and in particular to an increased share in business passengers), tight cost control and a hefty €196m boost from asset sales, of which half came from the sale of part of Iberia's stake in reservations company Amadeus.

The 2007 results show the positive effects of Iberia's latest strategic plan, which runs from 2006-2008 (see *Aviation Strategy*, December 2006). This so-called "Director Plan" is designed with four pillars: network restructuring, revenue improvement, better productivity and cost-cutting, and it's the first part of this that is most crucial to Iberia's future. The airline is furiously cutting back on loss-making point-to-point domestic routes and putting in large capacity rises on its higher margin long-haul routes, and particularly on Madrid-Latin America routes. Until the appearance of a potential diversion at Spanair/ Barcelona (see page 6), Iberia has had a clear focus on building up the Madrid hub, and at Terminal 4 at Barajas airport Iberia's long-haul flights connect in with services to 35 domestic and 40 European destinations.

In 2007 Iberia carried 26.9m passengers - a 3.4% drop compared with 2006, thanks largely to the cuts in Iberia's domestic network, although overall load factor rose 1.8 percentage points, to 81.6%, with RPK growth of 3.3% ahead of the 1% ASK increase. Overall unit revenues rose 1.5% in 2007, but this was affected by dollar depreciation and the increase in Iberia's average stage length. Excluding currency effects, unit revenue would have been 3.1% higher in 2007.

However, these overall figures don't tell the real story, because Iberia has distinct strategies in the three main sectors it competes in - and in each of these markets, the challenges to Iberia will only intensify over the next few years.

Long-haul strength

In 2007 more than 45% of all Iberia's passenger revenues were generated on long-haul routes - a substantial increase on the 35% figure in 2006 - and passengers carried in this sector rose 8.1% in 2007, to 4.2m. A 6.8% rise in long-haul ASKs in 2007 was beaten by an 8.7% rise in RPKs, and load factor rose by 1.6 percentage points, to 87.2%. However, Manolo Lopez Colmenarejo, Iberia's commercial director, says it is "very difficult to maintain and sustain at this level", since Iberia's long-haul traffic in early 2007 was boosted considerably by the collapse of Air Madrid in 2006, after which many passengers switched to the flag carrier. But other competitors have increased capacity out of Madrid since then, with a particular challenge coming from the Marsans group (see *Aviation Strategy*, December 2007).

Iberia's long-haul capacity will rise 2.6% in 2008, and Iberia is increasing frequencies on routes to Boston and Washington Dulles from June (it also operates to Miami, New York and Chicago). Last year Iberia carried 0.8m passengers to the US - 21% up on the figure for 2006 - and posted a load factor of 85%. Last summer Iberia was one of five oneworld partners (excluding BA) that applied jointly for antitrust immunity from US regulators on transatlantic routes from this April, which would enable the airlines to coordinate schedules and fares and compete better with Star and SkyTeam carriers.

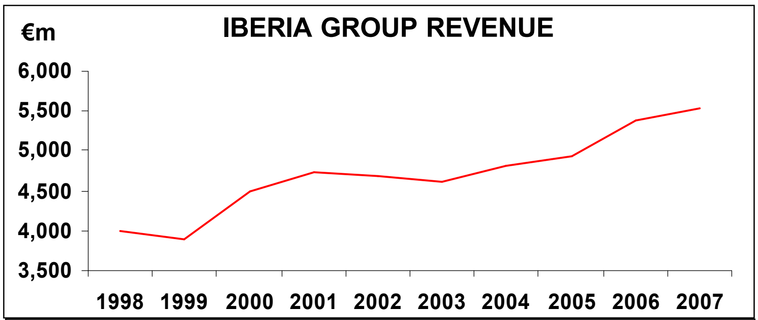
However, it is the Latin America market that remains most crucial to the fortunes of Iberia, and Iberia's share of this sector rose 0.9 percentage points to 19.9% in 2007 (see chart, page 6), with Iberia's share of business class traffic on the Europe-Latin America market rising 3.6 percentage points in 2007, to 22.6%.

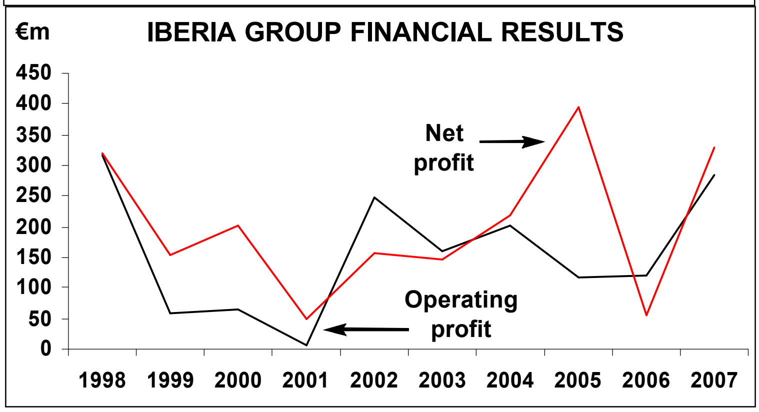
But with rivals such as Air Comet also increasing their ASKs out of Madrid, the key question will be what will happen to unit revenue in 2008? In 2007 long-haul unit revenue rose by 6.4%, thanks to a much better mix of business to leisure passengers, and the progression of unit revenue through this year will be a crucial indicator of how Iberia is faring in general.

European weakness

On European routes, RPKs fell by 1.8% in 2007, ahead of a 1.2% fall in ASK - although capacity on European routes out of Madrid rose by a substantial 17.6% in 2007, reflecting Iberia's shift in strategy towards building up the Madrid hub at the expense of virtually everything else. Last year there was a "softening of demand", according to Fernando Conte, Iberia's chairman, who adds that in 2007 "we faced a very competitive environment in Europe". That competition is at its most threatening from Ryanair and easyJet, the former of which has five operational bases in Spain (Reus, Alicante, Valencia, Girona and Madrid, with 16 routes out of the capital), and the latter of which opened a base at Madrid last year and operates 24 routes out of Barajas.

Overall market capacity (by all airlines) out of Spain to Europe grew 8.4% last year, and by a substantial 21% out of Madrid, so it's not surprising that Iberia's unit revenue on European routes fell 4.1% in 2007 (and is heading only one way in 2008). In 2008





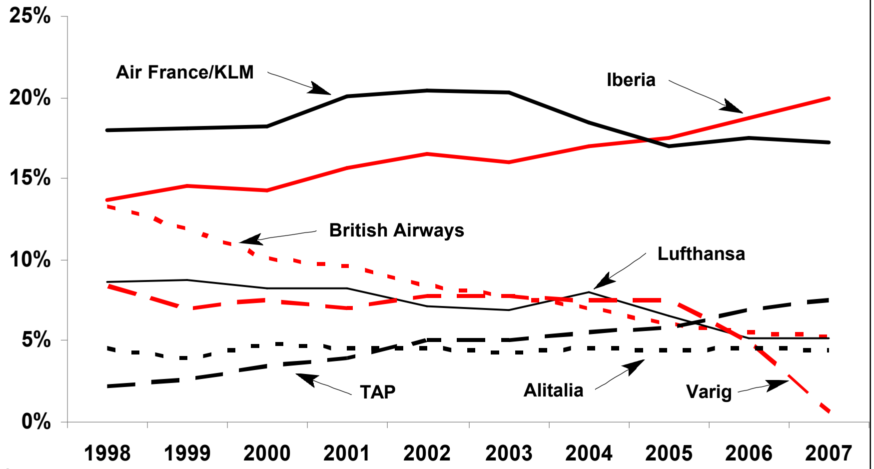
Iberia's European capacity will rise by 4%, again driven out of Madrid, where capacity will rise by 15%. Most of this increase is coming from new routes and capacity into eastern Europe and on extra frequencies into business destinations such as Milan and Brussels, which Iberia hopes will differentiate itself against the LCCs. Whether this strategy will be enough to stave off the threat of Ryanair and easyJet remains to be seen, but in any case Iberia needs to maintain a strong network of European routes to connect in with long-haul routes at Madrid.

Domestic confusion

Iberia's domestic network was previously the weakest part of the Iberia empire, but under the current strategic plan loss-making point-to-point routes have been culled in favour of feeder services into Madrid, and in 2007, while domestic ASKs fell by 13%, load factor rose 3.1 percentage points to 75.9% as RPKs fell by only 9.3%, and - most critically - Iberia's domestic unit revenue rose by a healthy 6% in 2007.

But despite Iberia's reduction in capacity, overall domestic ASKs in Spain (among

MARKET SHARES ON EUROPE - LATIN AMERICA



Source: Iberia

all carriers) rose by almost 10% in 2007, which is the fourth consecutive year of growth of at least 8%. Though there are signs this overall capacity growth is slowing (and Iberia will cull another 15.1% from its domestic capacity this year, which will complete its domestic restructuring) domestic competition is intense.

While Ryanair and easyJet both now offer domestic services and are looking to expand routes further, they each have less than a 1% share of domestic passengers and the main competition to Iberia comes from Air Europa and Spanair. Nevertheless, in shutting down routes that do not connect into Barajas, Iberia appeared to have a sensible and sustainable domestic strategy - until this February that is, when in a surprise move the flag carrier did a strategic U-turn by formally launching a bid for Spanair, in partnership with private aviation group Gestair (which specialises in executive travel and aircraft maintenance).

The Spanair bid

SAS has been trying to offload its loss-making Spanish operation since last year, but Iberia's interest in Spanair shows strategic confusion, as it would simply increase Iberia's exposure to a domestic sector that it had been withdrawing from in favour of a shift of resources to long-haul.

One analyst calls the bid "a strange decision", while reports suggest that British Airways (which now owns 13.2% of Iberia) is unhappy about the move, which came shortly after the Marsans group withdrew its interest in Spanair. Marsans said that it did not want to get involved in a bidding war with Iberia and reportedly felt that it was "a bit betrayed" by SAS's decision not to cut a deal with Marsans, although Marsan's withdrawal may indicate it has bigger targets - such as Iberia itself (see *Aviation Strategy*, December 2007).

The amount of Iberia's bid for Spanair is unknown, but sources suggest it is significantly lower than the €800m figure that some reports initially suggested. Indeed ABN Amro says that SAS would be "fortunate indeed if it can get a positive sum of money for Spanair", because after reporting a profit in 2006, Spanair made an operating loss of €32m in 2007 thanks to the fare wars that have broken out in the domestic market and which show no sign of stopping. Spanair employs 3,600 and operates a fleet of 60 aircraft, although more than half of them are older MD-80s, with Banesto stating that "Spanair needs a major restructuring both on routes and costs".

The only positive rationale that Iberia could have for acquiring Spanair is to secure cost savings between Spanair and Iberia and knock capacity out of the Spanish market. The Iberia group (including Air Nostrum) has an estimated 45% share of the domestic market, and Spanair is in second place with 25%. Much more importantly, however, by acquiring Spanair Iberia would prevent another airline acquiring Spanair's routes and slots, particularly out of Barcelona.

Unsurprisingly, Iberia's bid for Spanair is attracting significant criticism within Spain, and that criticism is led by Catalonia, with everyone from the regional association of travel agencies to the Catalan government voicing concern that Iberia is likely to turn Barcelona's El Prat into a low cost airport, with Iberia transferring passengers to Madrid where they will connect onto long-haul flights. The regional government says it would refer a successful Iberia bid for Spanair to the anti-trust regulator as Iberia/Spanair would dominate El Prat, with an estimated 70% of domestic capacity to/from the airport. And an Iberia/Spanair link-up would make a mockery of the new T-Sur terminal, which will open in 2009, and was planned to be used by both Iberia and Spanair as competitors rather than allies.

Catalonia's businesses and government have long been keen to see El Prat turned into a true international hub, and they have legitimate concerns that Iberia's acquisition of Spanair would prevent this from happening. In order to placate opposition, Iberia now claims that if it acquires Spanair it will turn El Prat into a hub operation, but this claim does not have much credibility as it would be a complete reversal of Iberia's current strategy, which has been to cut international flights from Barcelona and build up the Madrid hub.

Much more likely to happen is for Iberia to take a minority stake in Spanair in order to avoid antitrust scrutiny, with Gestair taking the majority of shares. Iberia is also believed to be willing to sell its 20% stake in LCC Clickair if the regulator requires this as a condition for acquiring Spanair, and at least this gives Iberia an excuse to exit from Clickair. The LCC - in which Iberia owns 20% of equity and 80% of its "economic rights" - was launched in October 2006 and has taken over many of Iberia's routes out of Barcelona, effectively allowing Iberia to abandon Barcelona as a hub. Clickair currently operates a fleet of 25 A320s, but one unconfirmed analyst estimate is that Clickair lost as much as €100m in 2007 - although this is disputed by the airline. The other Clickair shareholders - who each own 20% - are Nefinsa (which owns Air Nostrum), Quercus Equity, Iberostar (which owns tour operator Iberworld) and the engineering group ACS. Clickair is reportedly in merger negotiations with Vueling, the loss-making LCC that operates 23 A320s out of El Prat to a variety of European destinations.

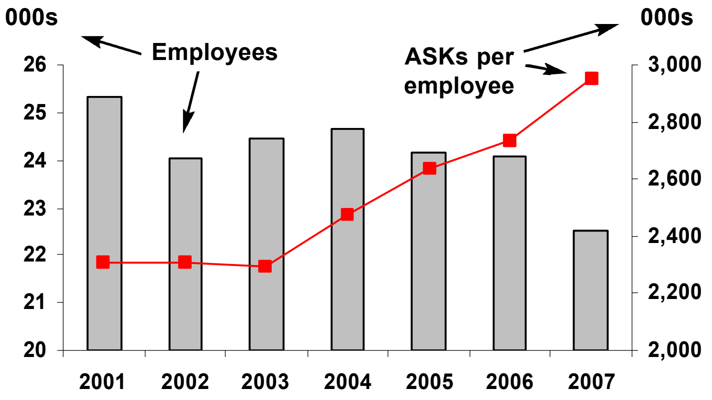
Another factor in Iberia's strategy for Barcelona is the attitude of Iberia's largest shareholder - Caja Madrid. Caja is believed to want to strengthen Iberia's routes out of El Prat, which would prevent a rival such as Marsans building up El Prat as a hub in partnership with Catalonian business and political interests. This may be the underlying reason behind the Spanair bid, though the true rationale may only become apparent in the months and years after Iberia acquires Spanair - if it is successful in doing so. A consortium comprising a Portuguese investment fund and Madrid-based Gadair (which operates a single 757) unveiled a provisional bid for Spanair in late March, and SAS says it expects to complete the sale of Spanair in the second quarter of 2008.

Iberia's bid for Spanair makes a little more sense given the pressure now building on Iberia's most important domestic route: the shuttle service between Barcelona and Madrid. Since February this year Iberia has faced competition from the new high-speed "bullet" train service, which has reduced the journey time between the two cities by a third, to two and a half hours. With rail fares considerably cheaper than going by air, the rail operator expects to double the number of people using the route from 3m to 6m in 2008, which would largely be at the expense of air passengers, who totalled 4.8m between the two cities in 2007, of which Iberia carried 2.7m - and with its main competitor being Spanair. Iberia says it will maintain its schedules (with four flights an hour at peak times), although it will use smaller capacity aircraft, resulting in a 20% reduction in Iberia's capacity. If Iberia acquires Spanair, then more capacity can be taken out relatively painlessly - though again, this will infuriate Catalonian interests.

Cost success

Unit costs fell 1.5% in 2007, thanks to the Director Plan's cost cutting and the depreciation of the dollar. Staff numbers fell by 1,500 in 2007, and as a result productivity is continuing to rise (see graph, page eight). However, labour costs only fell

IBERIA GROUP EMPLOYEES AND PRODUCTIVITY



1% in 2007 thanks to higher salaries, including a pay round agreed with unions representing 18,000 ground workers in July, who secured a salary increase of 2%. However, this deal only lasted until the end of 2007, so the whole process is starting again this year. A similar deal was agreed with 4,200 cabin crew in March last year, and there now appears to be an end in sight to the long-running saga between Iberia and pilot union Sepla. The two sides have been negotiating on and off for an astonishing three years following the end of the previous agreement on pay and conditions in 2004, but there are indications that a deal may be agreed sometime this summer.

Iberia's fuel costs fell 2.7% in 2007, again helped by dollar depreciation against the Euro, as well as a more efficient fleet and Iberia's hedging policy. As of the end of February, Iberia had hedged 47% of its 2008 fuel requirements at around $80 per barrel, but this will still not reduce the need for further and deeper cost cuts at the airline in order to combat fuel prices that are now above $100 per barrel.

Following a fleet overhaul, Iberia currently operates a fleet of 143 aircraft (see table, below), with an average age of under eight years. The airline is moving quickly to a fleet of three aircraft families (A340s, MD-87/88s and A320s), although the A340-300s will start being replaced by A350s or 787s not later than 2011, with an order worth €2bn expected to be placed in the second-half of 2008.

IBERIA'S FLEET

	Fleet	Orders	Options
A319	21	3	
A320	47	13	63
A321	19		
A340-300	20		
A340-600	12	3	4
757-200	1		
MD-87	11		
MD-88	12		
Total	**143**	**19**	**67**

Back in play?

Iberia forecasts that unit costs (excluding fuel) will fall again in 2008, thanks to fleet savings and a full year's impact of a reduction in labour costs due to the redundancies made over last couple of years - but set against this is the statement from Conte that he expects Iberia's revenue growth to slow in 2008, due largely to the slowdown in the Spanish economy.

Some analysts go further and believe that Iberia's earning will peak in 2007, given higher fuel prices and weakening demand. Currently Iberia's financial position is relatively strong - as at the end of 2007 it had long-term debt of €1.8bn and cash and cash equivalents of €2.1bn - but any reduction in 2008 earnings compared with 2007 will surely signal the start of yet another round of merger speculation and substantive bids for Spain's flag carrier.

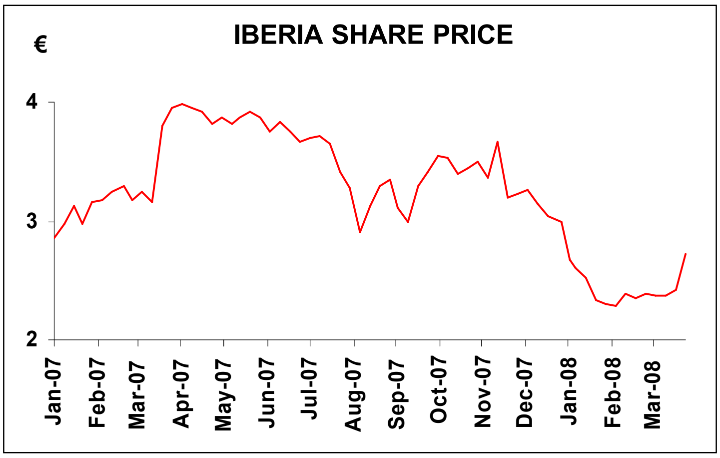
Although Conte says that "we made very good progress in 2007" and that another strategic plan - covering the period 2008-2011 - will be unveiled in the early autumn, this will be immaterial if the market sees financial results heading downhill. Iberia's share price has fallen substantially since April 2007 (see chart, opposite), when last year's bid frenzy was at its peak, although with BA's renewed interest (see below) the shares have started to pick up again, and as of late March 2008 the shares were trading at around €2.76, valuing the airline at €2.6bn. If quarterly results through 2008 are disappointing, then further price weakness may encourage bigger flag carriers to try for Iberia yet again.

At the top of the queue of prospective bidders must surely be British Airways. BA abandoned its joint bid with US buy-out firm the Texas Pacific Group in November 2007, after the consortium had provisionally offered €3.60 per share back in March of that year, which valued Iberia at €3.4bn. A formal bid by the consortium (which also included three Spanish private equity companies: Vista Capital, Inversiones Ibersuizas and Quercus Equity, which owns 20% of Clickair) was supposed to be made by the end of 2007, but a condition of this bid was that it was done on "consensus and friendly terms". But it soon became apparent to BA that this wasn't going to be the case, thanks to another shareholder: Spanish bank Caja Madrid.

In early December Caja Madrid increased its stake in Iberia from 9.58% to 22.99% by spending a total of €470m (at €3.60 per share) to buy a 6.99% stake from Banco Bilbao Vizcaya Argentaria (BBVA) and 6.42% from Logista, a Spanish distribution company for a tobacco group. Once these two Spanish shareholders decided to sell their Iberia stakes, Caja Madrid exercised its pre-emption rights, which effectively sank the BA/TPG bid.

Clearly Caja's aim was to keep Iberia in the hands of Spanish investors and out of the hands of the BA/TPG consortium, and it was clear to the latter that Caja Madrid's purchase of the shares on offer was anything but friendly. But there were deeper reasons for Caja's actions, since the bank is controlled by Madrid's right-wing regional government, which was apparently unimpressed with the plans put forward by BA/TPG for Iberia, as well as the style of its management team, according to one source. There has been some distrust in Spain from unions and politicians about the long-term intentions of BA/TPG, centering on whether those parties are more interested in making a medium-term return on their investment rather than having a true long-term strategic interest in building up the strength of Iberia.

Caja therefore moved quickly to buy out the two major Spanish shareholders once their stakes came into play. Whatever the motivations of Caja at the end of 2007, the outcome was that relations between Caja and BA sank to non-existent levels at the turn of the year, with Caja reportedly meeting with other interested parties through December in order to secure other Spanish investors.



But while Iberia had effectively been on the market since February 2007, no other serious investors surfaced until a consortium of Spanish investors led by private equity company Gala Capital came together in November. The consortium included Juan Jose Hidalgo, chairman of Globalia (which owns Air Europa), as well as regional bank BBK and investment funds Omega Capital and Inver-avante. Its indicative offer was worth between €3.60-€3.90 per share, valuing Iberia at a maximum of €3.8bn, but in December Iberia refused a request from Gala Capital to look at the airline's books, saying that it wanted to maintain "a framework of stability and certainty" in the absence of any definitive offers from potential bidders.

BA back in the frame

Going into 2008, it seemed that BA had abandoned all hope of acquiring Iberia, and some analysts tipped BA to sell its shares, given that BA reportedly was upset at having to follow the rules of an existing shareholder agreement, in which key investors in Iberia are obliged to vote with the majority view on any issue - a situation which means that BA has to vote along with Caja's wishes, which in effect gives the Spanish bank control of the airline.

However, in just a few months the situation has changed completely, and BA now appears to be re-engaging with Caja Madrid. The spur appears to have been a statement from Caja Madrid in January that BA needed to deepen its commercial ties and become an attractive partner for Iberia or else the Spanish flag carrier would seek a strategic partnership elsewhere. Indeed Miguel Blesa, chairman of Caja Madrid, explicitly mentioned Air France/KLM and Lufthansa as potential strategic candidates, saying that: "If BA offers something significant to the future of the company ... it would appear a perfect agreement. If not, we will look for other alliances."

BA's board reacted quickly to this threat and the airline now says it wants to "strengthen its relationship" with Caja Madrid. More concretely, in February BA took advantage of the fall in Iberia's share prices by buying another 2.3m shares (0.2% of the total), thus bringing its stake to 10.1%. But BA didn't stop there, and in March bought another 28.7m shares at €2.34 each, increasing its stake to 13.2% - and also announced it may make further purchases, with Martin Broughton, BA chairman, publicly stating that the airline definately remains interested in acquiring Iberia.

Strategically, Iberia is a good match for BA, with little overlap in the two networks as BA is strong on routes to North America and Iberia is dominant in the Latin America-Europe market. BA and Iberia currently codeshare on more than 40 routes and have a profit share partnership on London-Madrid routes, but there is more potential to exploit, particularly given the challenge that BA now faces from other airlines across the north Atlantic.

From Iberia's point of view, a merger with BA also makes sense, not least because it should secure Iberia's future both strategically and financially. While Iberia appears to be fending off the challenge from LCCs for the time being, a new threat is emerging from Air France/KLM's acquisition of Alitalia. The Rome hub will become a real rival to both Iberia's routes from Madrid to Europe and on long-haul down to Latin America. In 2007, while Iberia had a 19.9% market share on Europe-Latin America routes, Air France/KLM had an estimated 17.3% share, and if Alitalia's 4.4% share is added then Iberia slips into second place.

There had been speculation that Air France/KLM would join the Gala Capital bid in 2007, and although an Air France/KLM bid for Iberia looks impossible once/if Alitalia is acquired because of antitrust concerns, other threatening options remain (from BA's perspective), such as a bid from Lufthansa. At the end of March Blesa cranked up the pressure on BA by saying the UK airline had until the end of June to sign any "commercial agreements" with Iberia, with other reports out of Spain suggesting that Caja Madrid is looking closely at the possibility of a tie-up with Lufthansa.

Although BA is not exactly being bounced into making a play for Iberia, there are as many defensive reasons (i.e. to prevent a rival buying Iberia) for BA to acquire Iberia as positive reasons. When BA may make a formal bid for Iberia remains to be seen, although TPG has stated previously that it might make a new bid for Iberia after the outcome of the Spanish general election, which was held on March 9th and which was won again by Zapatero's socialist party. Unlike in Italy (where a new right-wing Italian government may well interfere with Air France/KLM's takeover of Alitalia), the Spanish government is unlikely to intervene in the future of Iberia, although many politicians would prefer to see Spanish ownership of the flag carrier.

But the biggest challenge to BA may come not from Lufthansa, nor from any Spanish politician, but from the Marsans group, which has ambitious and aggressive plans of its own, and will be Iberia's biggest threat over the next few years. What is certain is that if BA does make a fresh attempt to acquire Iberia this year, then 2008 will be a critical period for Spain's flag carrier.

WestJet: The Canadian overachiever

WestJet, the Canadian LCC, is on a roll: eight consecutive quarters of record earnings, industry-leading financials in 2007 and continued 16%-plus capacity growth in 2008. Why is the Calgary-based carrier outperforming its peers? What strategies is it deploying to ensure future success?

While WestJet has been profitable throughout its 12-year history (except for a small operating loss in 2004), in the past two years it has suddenly emerged as one of the most profitable airlines in the Americas. Just as the other LCC high-flyers in the region - Southwest, JetBlue and the Brazilian LCCs - have seen their profit margins fall due to fuel and other challenges, WestJet has seen the opposite: its operating margin increased from a negative 1% in 2004 to 4.4% in 2005, 11.3% in 2006 and 14% in 2007.

The margin improvement is all the more remarkable in light of WestJet's continued brisk capacity growth. Its ASMs have doubled since 2003, even though in 2003 WestJet was already virtually a "major carrier" (under the US definition of annual revenues exceeding US$1bn). Its revenues have doubled in three years, from C$1.1bn in 2004 to C$2.2bn in 2007, making WestJet only about 20% smaller than JetBlue. (Of course, JetBlue has grown at a much faster rate overall.)

WestJet reported an operating profit of C$300m and a net profit before special items of C$181.3m for 2007, accounting for 14% and 8.4% of revenues. For the fourth quarter, the airline posted operating and ex-item net profits of C$73.4m and C$41.7m, respectively, on revenues of C$553.4m. The 13.3% fourth-quarter operating margin was the highest among large airlines in the Americas.

In the December quarter, WestJet managed to improve its load factor by 2.2 points (to 77.7%), yield by 3.2% and unit revenues (RASM) by 6.2%, despite 15.2% capacity growth. The airline was also able to limit the unit cost (CASM) hike to 2.3%, despite a 17% increase in per-litre fuel cost.

WestJet has been able to turn in such stunning results because of a rare confluence of special internal attributes and favourable external factors. The Calgary-based carrier has a great business model, capable management and some very clever strategies; however, unlike its peers south of the border, it has also benefited from favourable economic and competitive environments.

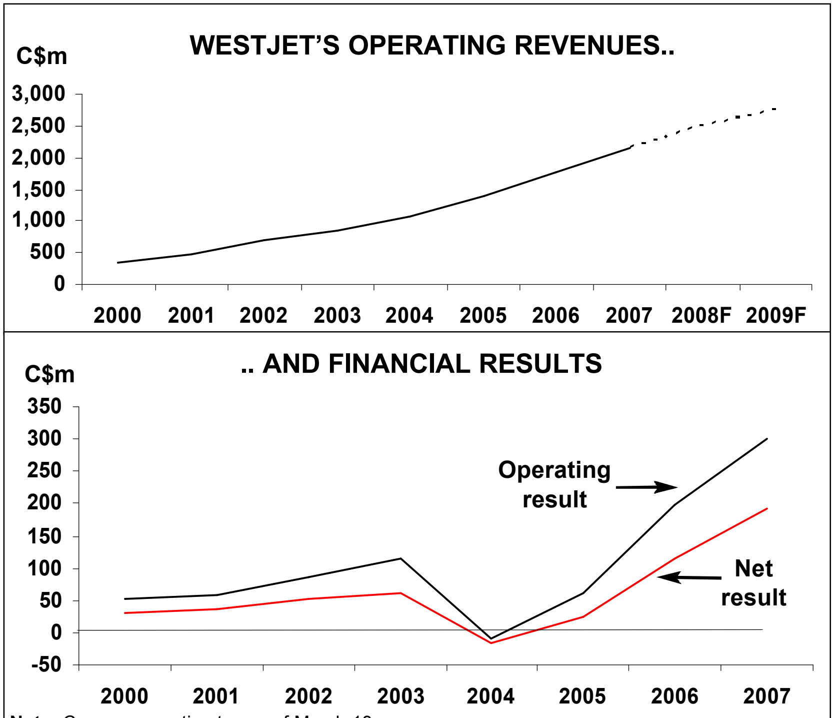
On the revenue side, WestJet has benefited from buoyant demand conditions in Canada, created by a strong domestic economy (with little sign of weakening so far), as well as a stable competitive environment - effectively a duopoly with Air Canada.

But WestJet has also been extremely adept at managing capacity and revenues. It has been able to add significant capacity without adverse effects on the load factor and yield. This has been achieved, among other things, through a seasonal aircraft deployment strategy, under which large chunks of capacity are shifted twice annually between the domestic market and the winter sun routes.

On the cost side, WestJet has benefited from the strengthening of the Canadian dollar particularly in the second half of 2007 (due to the strong economy and high oil prices, as Canada is a net exporter of oil and natural commodities). The C$ appreciated against the US$ by about 15% in 2007. Since about one third of WestJet's total costs are denominated in US dollars or linked to US$ indices, the C$'s appreciation offset about 50% of WestJet's fuel price hike and significantly reduced its aircraft leasing and interest expenses. But WestJet has also succeeded in keeping other costs in check, as indicated by the 2.6% decline in its ex-fuel CASM in the fourth quarter.

Favourable competitive regime

WestJet's good fortunes are intrinsically linked to the major changes that have taken place in the Canadian aviation regime over the past decade. How many other LCCs around the world can boast a 35% share of their country's domestic market? WestJet's CEO Sean Durfy noted in a recent speech:



Note: Consensus estimates as of March 18.

"We are very fortunate that we have a duopoly in Canada and we have rational players in the marketplace today". However, the road leading to this point has been tough at times.

Launched in February 1996 by a team of Calgary entrepreneurs headed by its current chairman Clive Beddoe, WestJet was created essentially to replicate Southwest (with modifications) in Canada's domestic market, which had been deregulated in 1988. Beddoe had the foresight to bring in one of the highest-calibre low-fare airline experts, David Neeleman, to provide the blueprint for a successful operation. Neeleman, who had co-founded Morris Air (which Southwest bought in 1993) and later founded JetBlue in 2000, also helped the WestJet founders raise funds and buy aircraft.

In its initial years, WestJet fought fierce battles with Canadian Airlines in the West but still managed to earn 10%-plus operating margins and go public, with a listing on the Toronto Stock Exchange, in July 1999. WestJet was one of the factors that led to Canadian's downfall.

Air Canada's acquisition of Canadian in January 2000 gave WestJet a major growth opportunity. The airline, which had hitherto focused on the western region, expanded into eastern Canada, developed a new hub in Hamilton (Ontario) and initiated plans to replace its fleet of old 737-200s with new 737NGs.

But the early years of this decade brought new challenges. First, there were the effects of 9/11, even though air travel demand in Canada remained stronger than in the US and the competitive environment was certainly healthier as a result of the 2000 industry restructuring.

Second, there was a surge in competition after the Canadian government stated in 2002 that it wanted Air Canada's domestic market share reduced below 80%. Several new low-fare carriers (CanJet, Jetsgo, etc.) entered the market and Air Canada set up new low-fare and regional subsidiaries. This led to fare wars, which further worsened after Air Canada filed for bankruptcy in early 2003. As a result, WestJet posted small losses for 2004 and the first quarter of 2005.

But the newcomers were too small, poorly funded and lacking in focus to have staying power. Jetsgo ceased operations in March 2005, CanJet withdrew from scheduled service in September 2006 and Harmony ended scheduled flights in April 2007.

Jetsgo's demise led to an immediate substantial improvement in the domestic revenue environment, enabling WestJet to return to decent profitability in the subsequent quarters. Importantly, the demise of the smaller carriers also solidified WestJet's position as Canada's "second-force" airline, part of a domestic duopoly with Air Canada, which had emerged from a successful bankruptcy reorganisation in September 2004.

Air Canada's contraction in bankruptcy had given WestJet added opportunity to build domestic market share. In 2004 WestJet also entered the Canada-US transborder market and in 2006 it added service to the Caribbean and launched WestJet Vacations.

In the past decade WestJet has grown its domestic market share by 2-3 percentage points each year. Because of its prominent position, it has a better business mix than the most up-market US LCCs (passengers travelling for business purposes accounted for 45% of its total traffic last year). Competition with

Air Canada, which is also doing well financially, is totally rational these days.

The only question is: can a duopoly last in a deregulated market? Probably yes - as long as low fares continue to be easily available in most markets - because Canada is not a very large domestic market; at 64m passengers in 2005, it is less than one tenth of the size of the US domestic market.

Maintaining a cost advantage

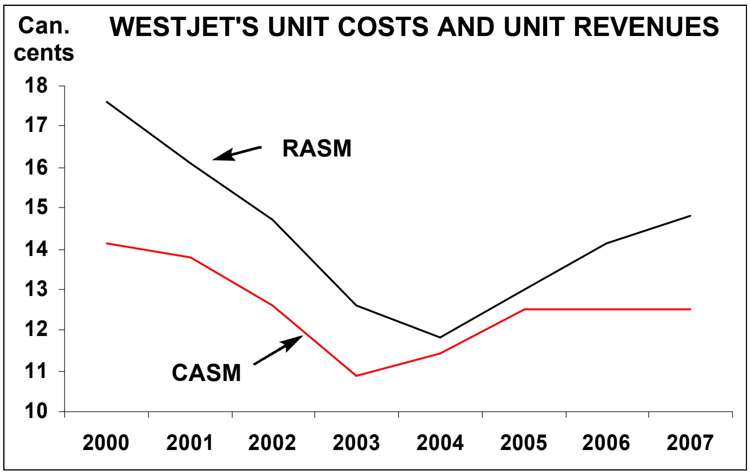
Keeping costs low has been the key factor behind WestJet's financial success. In the past two years, total CASM has remained flat, at 12.5 Canadian cents, while ex-fuel CASM has declined by 1.2%, from 9.16 to 9.05 Canadian cents. These trends are much better than those experienced by US carriers.

However, the bulk of the CASM improvement has come from economies of scale (robust ASM growth) and increased average stage length, rather than ingenuous cost-cutting initiatives. WestJet's average stage length increased by 6.7% in the past two years, from 802 to 856 miles. The stage length has more than doubled since 2000 (when it was only 419 miles) as the airline has expanded transcontinental, Canada-US and Canada-Caribbean flying.

Increased longer-haul flying has also boosted average daily aircraft utilisation, which increased from 11.8 hours in 2006 to 12.1 hours last year. WestJet hopes to achieve 12.5 hours in 2008 through the addition of new Caribbean services, as well as more red-eye and tail-burn flying.

Of course, switching from the 737-200 fleet to 737NGs produced significant cost savings. WestJet uses blended winglet technology on its 737-700s and 737-800s and other fuel conservation measures, including new technology pioneered by Alaska Airlines that helps choose the most fuel-efficient flight paths.

WestJet believes that it enjoys a 30-40% cost advantage over Air Canada and is looking to at least maintain it. CFO Vito Culmone said at a recent conference that the goal is to achieve the "lowest sustainable cost per ASM in North America" but that WestJet is "not there yet", even after adjusting for the excise taxes on fuel and other additional charges that that Canadian airlines have to pay (compared to their US counterparts).



Good revenue management

Airlines in Canada have implemented a steady stream of fare increases in recent years. They have got away with it without adverse impact on demand, in the first place, because of the healthy economy and strong consumer confidence, because people feel that they can afford to fly. But how does that fit in with WestJet's stated Southwest-style strategy of stimulating demand with low fares?

The answer is good revenue management: knowing where and when the market needs to be stimulated with lower fares and when fares can be raised to improve yield. WestJet's management argued at the carrier's fourth-quarter earnings call in February that there was still "great, great, great pricing" available on certain days of the week and on many routes. Also, WestJet continues to stimulate the market - the best examples currently being St. Lucia, Quebec City and Atlantic Canada - as it is still in the process of shifting market share from Air Canada.

WestJet has not abandoned its low-fare strategy; it has simply become very sophisticated in revenue management. Like other LCCs in the Americas, it has experienced severe revenue management problems in the past and has successfully upgraded its systems.

WestJet currently generates ancillary revenues from fees associated with itinerary changes and excess baggage, as well as from the sale of food, pay-per-view movies and headsets on-board aircraft. Revenues from such sources grew by 30% to C$95.7m in 2007 - just 4.4% of total revenues - or C$7.65 per passenger. Like other LCCs in the region, WestJet views ancillary revenues as a promising growth area, because much of it is very high-margin business and can even enhance customer experience. Some of those opportunities will be realised as the stage length increases and at WestJet Vacations, where customers already purchase more than just an air ticket.

The evolving business model

WestJet's business model was originally a close replica of Southwest's: 737s, point-to-point, single-class, no-frills service in niche markets; focus on underserved and overpriced markets; a fun and friendly image and an informal, people-focused culture. The main differences - WestJet's smaller size, lower flight frequencies and supplemental strategy of operating charters - reflected the much smaller size and dispersed nature of the Canadian domestic market.

While much of the original model remains intact, since 2000 WestJet has moved towards the JetBlue model as it has made the rather dramatic transition from a small western-Canada focused regional airline into a nationwide operator with one third of the domestic market and growing international operations.

Today WestJet has a very up-market product, more similar to JetBlue's than Southwest's. It offers LiveTV (and has secured agreement to be the only airline to offer that system within Canada until the end of 2009), four pay-per-view movie channels on its entire fleet, leather seats with a generous seat pitch and lounges at four airports (operated by a third party and available for a fee). Like many other LCCs these days, it now offers the full range of booking channels.

That said, WestJet appears to go a step further than its peers in trying to ensure a "tremendous, world-class guest experience" - or at least its management sounds very scientific about it. CEO Durfy explained recently that guest experience has two components: "functional" attributes (on-time performance, baggage delivery, completion rates) and "care" attributes (how passengers are treated, having empathy when something goes wrong, saying sorry, smiling, etc.). While WestJet certainly continues to deliver in terms of the functional attributes (it ranked among the top five in the North American airline industry in 2007 in terms of the three main DOT operational metrics), the company believes that the more tangible "care" attributes are more important for creating customer loyalty. The numerous initiatives in that area include a "Guest Experience Matters" or GEM Team to facilitate cross-functional planning, decision-making and quality implementation.

WestJet is seeing a positive impact from those and other brand development efforts in its customer surveys, which show that over 90% of its passengers will recommend it to others. The positive effects are especially strong in eastern Canada (except Montreal for some reason), where WestJet is expanding its footprint.

One of WestJet's biggest accomplishments is that it has come closer than any other LCC to emulating the way Southwest treats its people. It recruits service-oriented workers, trains them well and motivates them to outperform through productivity and profit-based incentives. The workforce benefits from generous profit-sharing and stock ownership programmes. Last year the company paid C$48.6m in profit-sharing, with WestJetters (as they are called) receiving on average 16.9% of their base pay as profit sharing. At year-end, 83% of eligible employees participated in the share purchase plan, to which they can contribute up to 20% of their base salaries, with the company matching every dollar contributed (employees must hold the funds in the plan only for a year). Last year the average employee contribution was 14% of base salary and the company's matching expense was C$35.4m.

CEO Sean Durfy noted at a recent investor conference that financial executives' eyes tend to glaze over when one talks about people but that corporate culture really is the key to financial success. "My background is in finance, but the true success of our company is around the culture", he noted, explaining that it is really about "aligning the interests of the people with the interests of the company" and that having a high employee share ownership creates a different dynamic in a company. "When you own something, you treat it differently."

This characteristic of WestJet has received public recognition. The airline recently won Canada's "Most Admired Corporate Culture" award for the third year in a row. The award is presented by Waterstone Human Capital and is based on interviews with chief executives at Canada's top 500 companies.

Route network strategy

Much of WestJet's initial financial success was due to its relatively conservative (by LCC standards) growth strategy of adding only 3-5 aircraft per year. After four years, it operated only 15 aircraft, serving 12 cities primarily in western Canada.

Eight years on, following major expansion first into eastern Canada and then in the US and Caribbean markets, WestJet operates a 73-strong fleet, serving 45 cities (as at the end of March). The scheduled network includes 26 points in Canada, 12 in the US (including Hawaii), two in Mexico and five in the Caribbean. Including the charter business, WestJet flies to 68 destinations in 14 countries.

The stated long-term objective is to achieve 10% annual ASM growth. However, barring a severe recession, growth in the next couple of years is likely to exceed that as WestJet takes advantage of the strong demand conditions and the stable competitive environment in Canada. The airline is confident that it can sustain a higher growth rate because of its good cost controls, revenue management skills and the successful seasonal aircraft deployment strategy. The current plan is to grow ASMs by 16% in 2008 (same as last year), with the first half of the year seeing 18-19% growth, though WestJet is obviously keeping a close eye on the economy.

But where will all that growth take place? The near-term is not likely to see major geographical shifts; each of WestJet's three distinct markets - domestic, US-Canada and Caribbean/Mexico - will see capacity addition. Last year the airline indicated that about half of its future growth would be international (including the US).

• Domestic routes

WestJet still sees good domestic growth opportunities. Markets such as Kitchener-Waterloo (Ontario), which was one of three new domestic cities added in 2007, have quickly become very profitable (eastern Canada markets tend to have more business traffic). WestJet will add Quebec City as its 27th Canadian point in May, initially with service from Toronto. The airline believes that it could serve another 6-7 domestic points. In addition, there are opportunities to increase frequencies; for example, WestJet still has only five daily flights in the important Toronto-Vancouver market in the summer, compared to Air Canada's 20.

The airline believes that its strong brand, additional destinations and frequencies, continued schedule refinements and new interline relationships will help capture another ten points or so of domestic market share, to boost the share from the current 35% to 40-50%.

• Canada-US market

WestJet entered the scheduled transborder market in the autumn of 2004 with six leisure-oriented routes to the West coast and Florida mainly out of Calgary. Within months the Toronto-Los Angeles and Calgary-San Francisco operations were terminated, but since then the airline has added a few more destinations in Florida and the West, as well as three points in Hawaii. The US operations have not been a blazing success because of difficulty in developing US-originating sales. WestJet currently has only 7% of the scheduled transborder market, with Air Canada accounting for 38% and US carriers 55%.

But WestJet believes that it can grow its transborder market share to 15-20% in the next four or five years. It hopes to both stimulate the market and take share from US airlines, once it starts expanding into business markets in the US - something that will be possible when it gets its US point-of-sale developments fully up and running. One major milestone, accomplished in early March, was getting schedules, fares and inventory fully available on Expedia in the US. WestJet is launching its first business-oriented US route, Calgary-Newark, as a seasonal service in June and may add another US business destination this year. It expects to keep adding 1-2 such points each year in the next four or five years.

• Caribbean/Mexico

WestJet ventured into the Caribbean market with scheduled service to Nassau (Bahamas) in 2006. The huge success of that initial foray and the new WestJet Vacations unit encouraged the airline to add six more destinations in 2007, in Jamaica, Dominican Republic, St. Lucia and Mexico.

The airline has only dipped its toe in the Canada-Caribbean/Mexico market (1% market share) but believes that it can capture a 10-20% share. CFO Vito Culmone suggested recently that WestJet could easily add another 10 destinations in that region, as "quite frankly, we can't get there quickly enough to satisfy demand". Many of the US LCCs have also found the Caribbean market very attractive, with JetBlue even reporting year-round demand in some markets.

Caribbean/Mexico operations are ideal for WestJet because the Canadian domestic market is quite seasonal, with demand weakening significantly in the harsh winter months. Flights to the sun destinations (including Florida) have transformed the January quarter from WestJet's weakest to its second most profitable period.

In the past three years, WestJet has deployed a highly successful strategy of moving capacity between the sun destinations and the domestic market, depending on the season. About 25% of its capacity gets shifted around like that. The result is that scheduled international operations account for as much as 25% of WestJet's total ASMs in November-April but only about 5-7% in May-October. If charter services are included, international operations account for as much as 35% of WestJet's total ASMs in February and March.

WestJet has always operated charters to improve aircraft utilisation in off-peak periods. Since 2003 it has also provided aircraft and crews to Transat, Canada's largest tour operator, under a contract that has been renewed twice and is currently valid until February 2010. The contract makes a useful revenue contribution. WestJet's management insists that, despite the airline's own substantial plans for Caribbean expansion and WestJet Vacations, the relationship with Transat remains strong.

International alliances are one particularly promising future growth avenue for WestJet, given its sizeable domestic network. By some estimates, interline or codeshare deals could bring in potentially $400m in incremental revenue annually for WestJet.

Like JetBlue, WestJet has talked about such alliances for years but has been hindered by technological constraints. In the past year, WestJet has had a small interline deal in place with Air China, which has worked well but has mainly been useful in ironing out some of the operational kinks related to an interline agreement.

After spending many frustrating years trying to deploy the aiRES reservation system, which would have facilitated interline and codeshare deals as well as US point-of-sales, last year WestJet extricated itself from that contract (incurring a C$32m impairment loss) and instead focused on upgrading its existing system. The airline says that the current system is now "fully capable of meeting our strategic goals for 2008" and that it continues to review options for a new reservation system for the longer term.

Separately, the management has said that the airline is hoping to add two new interline (though not codeshare) partners in 2008. The new partners could be in Europe or Asia, or in the US. BA is known to be interested (it first approached WestJet in late 2006 when it began London-Calgary operations), but then again WestJet executives have indicated that they would prefer philosophically aligned partners. CFO Culmone noted at a recent investor conference that "there are a few airlines, especially in the US, that we are philosophically aligned with". Is a WestJet/JetBlue alliance a possibility?

Fleet plans

WestJet has spent around $2bn since 2001 on renewing its fleet. The last of the 737-200s departed in early 2006, about two years ahead of schedule. The current fleet of 73 737NGs is among the youngest in North America, with an average age of 3.2 years at the end of 2007.

After originally hoping to standardise the fleet on the 737-700 (the type Southwest has chosen as its workhorse), WestJet realised that the characteristics of the Canadian market (large distances between major cities, some high-density short and medium haul markets) required it to operate more than one aircraft type. The current business plan includes three 737 variants: the 119-seat 737-600, the 136-seat 737-700 and the 166-seat 737-800.

After placing another major 737-600/700 order (20 firm plus 30 options) in 2007, at year-end WestJet had 46 aircraft on firm order. This will take its fleet to a minimum of 116 aircraft by the end of 2013 (91 -700s, 13 -600s and 12 -800s, though there is some flexibility to switch between variants). There are likely to be option conversions. The management indicated recently that the market share targets that they have set for the domestic, Canada-US and Caribbean/Mexico operations would require WestJet to grow its fleet to 116-130 aircraft by 2013.

The fleet will grow at a rate of 6-9 aircraft per year. This year WestJet is taking seven aircraft (five 737-700s and two 737-800s), to bring the fleet to 77 at the end of 2008.

Nearly all of the 2008-2011 deliveries are taken on operating lease - because Boeing's order books have been full in recent years - but all of the 2012-2013 arrivals will be purchased. This means that the total 46 firm deliveries in 2008-2013 will be split evenly between purchases and leases, enabling the company to maintain its desired 65%/35% owned/leased ratio.

Prospects

WestJet's stock plummeted by 24% in the first two weeks of this year in response to sudden (misplaced) worries that the Canadian economy and airline sector were poised for a downturn. Although the share price has somewhat recovered, at the end of March it was still 16-17% below the December level, as fears have persisted that Canada could eventually follow the US into a recession. The stock looks undervalued and therefore remains on the "buy" lists of many analysts, though almost an equal number have a "hold" rating on it.

Most analysts see continued healthy profit growth for WestJet in the foreseeable future. The current consensus estimate is a 14% increase in per-share earnings in 2008, followed by a 13% increase in 2009. Revenues are projected to grow by 16% this year and 11% in 2009.

As of April 3, when WestJet reported its traffic statistics for March, there was no sign of any weakening of the buoyant demand conditions enjoyed by Canada's airline sector. WestJet achieved a stunning 86.6% average load factor in March, despite 19.6% capacity growth. The load factor reflected the successful seasonal aircraft deployment strategy and was up 1.4 points in part because of the early Easter. Unit revenues showed significant year-over-year improvement. Also, advance bookings to the new cities to be added in May and June were strong.

If the Canadian economy remains healthy, WestJet should be able to continue to pass through some of the rise in fuel prices to customers, and the strength of the Canadian dollar will also mitigate some of the impact. But should the going get tough, WestJet has ample cash reserves (C$654m at year-end, about 30% of 2007 revenues) and a strong balance sheet to cushion the impact. Of course, the large cash balance could come in handy if weakening North American airline industry conditions yield some opportunities for the low-fare carrier.

By Heini Nuutinen
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Air Arabia: classic start-up, but facing diversions

Air Arabia is a classic start-up success story. Staring with initial equity of AED50m ($14m) at the end of 2002, it is currently valued at about AED8.3bn ($2.3bn) on the Dubai stockmarket, with a p/e of about 22.

Air Arabia was the first and to date the only flag carrier to be designed on LCC principles. The Emirate of Sharjah, just north of Dubai in the UAE, instigated the airline project in late 2002 by establishing a project team led by Adel Ali, who became the airline's chief executive. From a blank piece of paper Aviation Economics developed the business plan, and the first flight took off in October 2003. (AE hasn't been involved with the airline in recent years and so, alas, can take no credit for its performance, although the principles of the business plan have been very closely adhered to and the original operational and financial projections were pretty accurate.)

2003 was a good time to set up an LCC in the Gulf. Excellent lease rates were available, the fuel price was still low and flying crews were fairly easily available. Air Arabia was sponsored by its own low cost, much underutilised airport at Sharjah, which is physically close to Dubai, although traffic can be horrendous during peak hours. Sharjah Airport Authority originally owned 40% of the airline, and the initial funding of AED50m was provided by the airport and the Department of Civil Aviation. And none of the incumbent airlines took Air Arabia seriously.

Traffic conditions too favoured the airline. Dubai was entering into its phase of super-growth, boosting the migrant worker population (mainly from the Indian subcontinent but also from countries such as Egypt and the Lebanon) that form the core of Air Arabia's market. Air Arabia also benefitted from the increase in tourism within the Gulf region as Dubai advertised its glittering attractions.

* "Air Arabia: Among the most profitable and fastest growing airlines globally", by Andrew Light, Citigroup Global Markets, Feb 2008

Air Arabia has been cash-generative from the first full year of operation. For 2007 its operating profits are estimated at AED260m ($72m) on revenues of AED1.28bn ($350m), a Ryanair-type margin of 20%. Net profits were actually higher because of interest income and because the company accounts for rebates from Sharjah airport as a financial income figure - at AED390m (£108m) net profits represented a remarkable 31% of revenues. No taxes are payable in Sharjah (personal, corporate or other), which of course greatly helps the cost structure (as does Dubai's identical regime for Emirates or Abu Dhabi's for Etihad). Dividend policy is to pay 25% of net earnings to shareholders, which totalled AD97m ($27m) for 2007.

Projections produced by Citigroup Financial Markets in a detailed and insightful review* of the carrier published in February indicate a 38% per annum revenue growth to 2010, with profit margins just easing slightly.

Air Arabia's balance sheet is also extremely strong, with no debt in its AED5.4bn ($1.5bn) capitalisation, following its successful IPO; cash and equivalents at the end of last year amounted to AED3.3bn ($0.9bn).

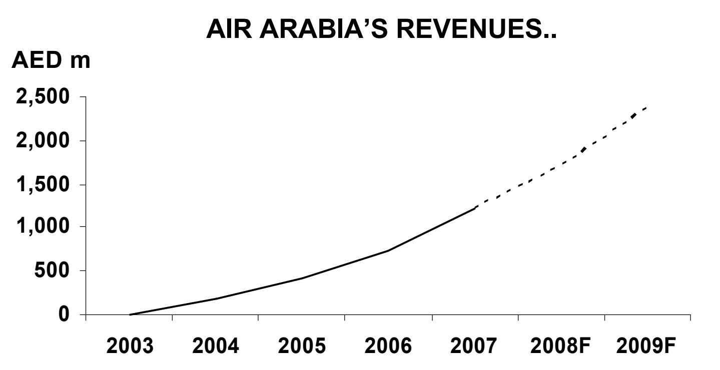
Last year Air Arabia found itself in a position to tap the Middle East financial markets' appetite for airline investment. Through a private placement in March and an IPO in June 2007 on the Dubai Financial Market, AED 3.27bn ($890m) was raised in new equity, which diluted the Sharjah state's stake from 100% to 18%. Other founding investors and staff now have 12%. The remaining 70% is mostly held by Middle Eastern financial institutions, notably Abraaj Capital with about 17% and Al Maha Holding with 9%.

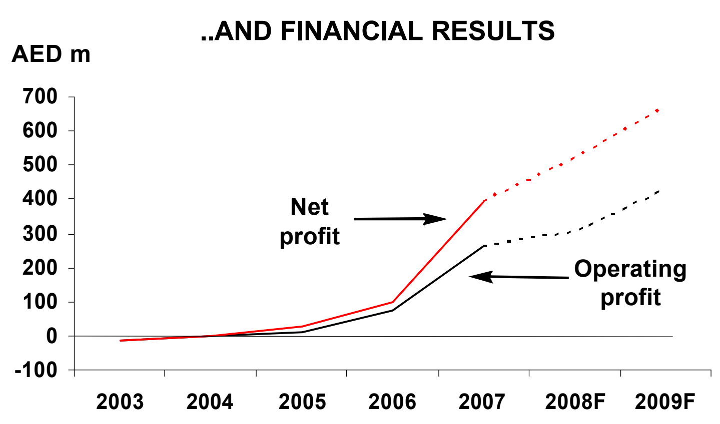
Around AED1.7-2bn of the new funds are earmarked for fleet expansion - specifically deposits and PDPs on the 34 A320s the airline has on order; total aircraft-related expense for the period to the end of 2102 amounts to about AED3.8bn ($1.1bn). AED600-700m will be used for investment in expanding the base, developing maintenance facilities and building a new hotel at Sharjah airport. The remainder - about AED1bn - is linked to "strategic investments" in airline joint ventures and base expansions (see below).

Arabian LCC model

The challenge for Air Arabia has been how to adapt proven LCC tactics - point to points services, internet distribution, high asset utilisation, airport cost minimisation, etc - to Middle East conditions:

• Aircraft utilisation at Air Arabia averages 14.5 hours a day compared to a global average of 8.6 hours for A320s. To achieve this it exploits the fact that Sharjah - like other airports in the region - operates 24 hours a day, so it can schedule an overnight trip to, for example, Colombo in Sri Lanka after operating flights in the Gulf region throughout the day. Dispatch reliability at 99.8% is one of the highest, if not the highest, in the industry, and is the result partly of having a fleet that is under two years old on average as well as the excellence of its line maintenance, for which it has received awards from Airbus. The airline has also set up a joint venture with HAECO, the Hong Kong-based engineering company, to eventually perform C checks at Sharjah.
• Aircraft are configured with 162 economy seats (a bit below the maximum for A320), which allows a 32" pitch, which is slightly better than the average space for economy products in the region. Load factor is around 85%. Meals are sold onboard but there are no alcohol sales as Sharjah is a dry state, which limits ancillary income (about 3% of turnover as against 10% at easyJet).
• All the airports Air Arabia flies to are primary (generally there are no alternatives) and it pays rack rates there. But it has a very important symbiotic relationship with





Note: Forecast by CITI

Sharjah airport, from which it receives a waiver on landing fees and ground handling charges equivalent to about AED30m in 2007. It would be very difficult for a competing airline to set up a base at Sharjah.
• With credit card and computer usage much lower among Air Arabia's clientele than in Europe, internet sales are much lower than for European LCCs, but they are growing rapidly - from about 30% of revenue in 2007 to a budgeted 50% this year. About 60% of sales were made through travel agents in 2007, but with zero commission rates (apart from some override agreements) - the travel agent uses essentially the same online booking process as an individual traveller and charges a fee to the passenger for the service. The other 10% was sold via a call centre, through sales shops in the UAE and through an arrangement with the local post office.
• Air Arabia has had to operate in a regulatory regime that is largely based on bilateral ASAs, although the GCC (Gulf

AIR ARABIA'S FLEET

	Fleet	Orders	Options
A320	11	37	15

Note: 3 to be delivered via ILFC during 2008-09, Airbus order: 6 in 2012, 11 in 2013, 12 in 2014 and 5 in 2015

Source: *ACAS*

Cooperation Council) states do have an open skies regime. But Air Arabia is also a flag-carrier of the UAE (along with Emirates, Etihad and RAK), which greatly facilitates its negotiating position.

Air Arabia currently flies to 37 destinations in the Gulf, the Indian subcontinent, eastern Mediterranean, east Africa, Iran and central Asia, carrying 2.7m passengers in 2007. Its fleet of 11 A320s is expected to grow by about three leased units a year to 2012, when deliveries start of the 34 units (plus 15 options) ordered last year. With the rapid softening in the aircraft lease market, Air Arabia has the possibility of growing much more quickly if it wants to.

There would appear to be plenty of potential for developing business from the Sharjah base, both through increasing frequencies and via adding new points - as Citigroup points out, its existing network of 21 countries contain a population of 1.7bn. However, the competitive environment in the Middle East is changing, which seems to be causing a variation in its strategy.

New competitive threats

A disturbing development for Air Arabia was the announcement last month that Emirates had decided to set up its own low-cost subsidiary in Dubai, with a target market of destinations with 4.5 hours of its base - i.e. identical to Air Arabia's market. Details are not yet available but it will be based at the low-cost terminal at the new Jebel Ali super-airport and will probably start operations in 2009 with narrowbodies. The new carrier will face the usual set of problems - risk of cannibalising traffic from Emirates, employee friction between the two airlines, differentiation of products and so on - but any entity with the backing of the Emirate of Dubai is going to be very powerful. Indeed the Centre for Asia Pacific Aviation believes it is only a matter of time before the A380 is deployed at the airline, with ultra-dense configurations of up to 1,000 seats.

From Saudi Arabia the two newly licensed domestic carriers - nas air and Sama - also have international expansion ambitions, especially to Dubai and Sharjah. They operate under the regulatory regime in Saudi Arabia (including the obligation to serve public service routes and economy fare caps), and are in competition with Saudia, making it very difficult for them to make any money in that market. They could be allowed to start international scheduled services next year or just expand their current international charter flights, which would be a threat to a key growth market for Air Arabia.

Jazeera Airways, based in Kuwait, has had a similarly successful growth to Air Arabia (with a more full service product) and now is encroaching on Air Arabia's territory by establishing a second base at Dubai and using its fifth freedom rights to offer flights to India. When it moves to Jebel Ali it too is expected to expand (it has 30 A320s on order) and it could target the 15% of Air Arabia's passengers who are business travellers, although it will not be able to match Air Arabia's cost structure.

And then there are the Indian start-ups like GoAir, IndiGo and SpiceJet, which are desperate to expand into the international market that has been reserved for Air India/Indian Airlines and Jet Airways. Indian government policy is to liberalise international service but the bureaucracy is - as usual - taking a long time to sort out the details (such as the length of time flying domestically before international service is permitted, the required size of fleet, etc.), and there is a suspicion that protecting Air India's long-planned privatisation has again become a priority. Nevertheless, the threat to Air Arabia is that Indian airline capacity has been artificially restricted on routes to Sharjah and Dubai. Although Air Arabia has benefited from by capturing a major portion of the market (almost 40% of Air Arabia's traffic is now to the subcontinent), this situation could soon change. On the other hand, greater liberalisation would open up new routes for Air Arabia itself.

In response, Air Arabia has decided to add new bases. It is in the process of setting up a base at Rabat, the capital of Morocco, initially with two A320s but with a plan - according to Citigroup - of expanding ultimately to 20 aircraft. It will take over the management of Régional, a mostly domestic turboprop operator, which was for years the only local alternative to the flag-carrier RAM. Rebranding as "Air Arabia Maroc" is likely

The idea is to develop a network into other Arab countries in the Maghreb and the Middle East with which Morocco has open skies agreements. As Morocco - through its liberal bilateral with the EU - is in effect part of the EU in aviation terms, it could also offer services to, for example, France, building on Régional's flights to Spain and Portugal.

Following the signing of an open skies agreement between the UAE and Nepal, Air Arabia entered into a joint venture called FlyYeti with Yeti Airlines, a domestic turboprop operator. Flyyeti is based at Kathmandu and has one wet-leased 737-800 at present, although again Air Arabia is expected to transfer a couple of A320s to Nepal.

The analogy drawn with the European LCCs is that this strategy is the equivalent of easyJet or Ryanair moving to continental European bases as they outgrew the UK/Ireland markets. But this analogy is very strained.

First, there are huge distances between the bases: Rabat is more than 6,000km from Sharjah, further than, say, the distance between Paris and New York. Second, Morocco and the UAE are of course both Arabic countries but their cultures and economies are very different. And Nepal is even more different.

Third, there are few if any network synergies. Flyyeti intends to fly Middle East migrant workers to India, but it seems unlikely that connecting on to the UAE on Air Arabia services from there is a viable strategy. Similarly, there appears to be an expectation that Moroccan traffic will connect to the Air Arabia network at some point in Libya or Egypt. But the dominant Moroccan traffic flows are not west-east but south-north, where Air Arabia Maroc will find itself in uncomfortable competition with Air France/RAM - two airlines that have always been careful to control key French routes - plus local LCCs like Jet4You and potentially with Ryanair, which plans to expand strongly into Morocco from its Marseilles base.

It is difficult to assess whether these new bases really are central to Air Arabia's strategy or are experimental tactics that are low risk for an over-capitalised airline. In Ryanair terminology, however, it doesn't look in this instance that Air Arabia is "sticking to its knitting". On the other hand, Air Arabia may have found a new revenue source from franchising its LCC brand, something that easyJet has considered but never implemented.

There are also other ways that Air Arabia could respond to the changing competitive threat at Sharjah from possible LCC overcapacity. One way might be to consider a merger with one of the new entrants; for example, Abraaj Capital has significant stakes in both nas air and Air Arabia.

		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	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
	Year 2007	**3,506**	**3,294**	**212**	**125**	**6.0%**	**3.6%**	**45,359**	**34,389**	**75.8%**	**25,110**	**13,485**
American	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
	Oct-Dec 07	5,683	5,752	-69	-69	-1.2%	-1.2%	73,408	58,416	79.5%	24,080	85,800
	Year 2007	**22,935**	**21,970**	**965**	**504**	**4.2%**	**2.2%**	**273,307**	**222,719**	**81.5%**	**98,160**	**85,800**
Continental	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	
	Year 2007	**14,232**	**13,545**	**687**	**459**	**4.8%**	**3.2%**	**165,951**	**135,655**	**81.7%**	**50,960**	**45,000**
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%	26,499	55,044
	Year 2007* **	**19,154**	**18,058**	**1,096**	**1,612**	**5.7%**	**8.4%**	**244,187**	**196,403**	**80.4%**	**109,180**	
Northwest	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
	Year 2007******	**12,528**	**11,424**	**1104**	**2,093**	**8.8%**	**16.7%**	**138,603**	**117,335**	**84.7%**	**53,680**	
Southwest	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
	Year 2007	**9,861**	**9,070**	**791**	**645**	**8.0%**	**6.5%**	**160,314**	**116,361**	**72.6%**	**88,710**	
United	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
	Year 2007	**20,143**	**19,106**	**1,037**	**403**	**5.1%**	**2.0%**	**228,200**	**188,857**	**82.8%**	**68,630**	**55,000**
US Airways Grp.	**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	
	Year 2007	**11,700**	**11,167**	**533**	**427**	**4.6%**	**3.6%**	**127,344**	**102,248**	**80.3%**	**66,060**	
JetBlue	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
	Year 2007	**2,842**	**2,673**	**169**	**18**	**5.9%**	**0.6%**	**51,334**	**41,411**	**80.7%**	**21,390**	

Notes: ** = April to May Predecessor Company, June Successor Company, *** = Net Result includes net reorganisation items of $1,215m, **** = Unaudited results Successor Company. Net Result includes net reorganisation items of $1,551m

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 emp.
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
	Year 2007	**9,661**	**8,670**	**991**	**900**	**10.3%**	**9.3%**	**102,462**	**81,101**	**79.8%**	**23,250**	**19,840**
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**
	Year 2006/07	**19,723**	**19,527**	**196**	**-139**	**1.0%**	**-0.7%**	**139,851**	**95,786**	**68.5%**	**57,510**	
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**
	Year 2007	**9,496**	**8,809**	**687**	**12**	**7.2%**	**0.1%**	**76,181**	**55,354**	**72.7%**	**22,830**	
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.

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