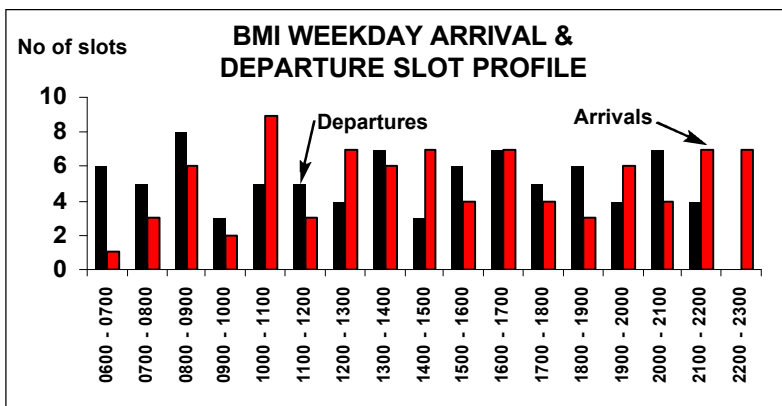


## bmi and LHR slot valuation

bmi's future has become increasingly topical as a host of factors have come to the fore simultaneously: the signing of US-EU Open Skies agreement, the surge in the value of slot trading at Heathrow, the recent statement by Lufthansa that it intends to exercise its call option on the 50.1% of bmi that its chairman Sir Michael Bishop owns and the recent communication from the EU indicating its support for secondary slot trading.

The European Commission launched a consultation process in 2004 to examine the prospect of establishing an EU-wide set of rules for the allocation and trading of slots at EU airports. At the end of April, Jacques Barrot stated that the EU "does not intend to pursue infringement proceedings against Member States where such exchanges (for monetary consideration) take place in a transparent manner". The overall tone of the communication was that slot trading encourages more productive use of slots and helps to highlight the opportunity cost for airlines operating services at slot congested airports. While slot trading has been ongoing in the UK for over a decade, there are probably some airlines that have been reluctant to engage in the process for fear that it may not be lawful. Therefore, the EU Communication could have the effect of adding liquidity to the slot market at LHR (among other airports) and thereby increasing overall activity.

According to EU data, 500 weekly slots (equivalent to 250 weekly slot 'pairs') have changed hands over the period 2001-2006. History has shown that slot exchanges at Heathrow (excluding intra-alliance transfers) typically result in a dramatic increase in the average aircraft size on the transferred/sold slot. Of the 500 slots transferred between 2001 and 2006, the average aircraft size increased 81% from 139 to 250 seats per slot. bmi is in possession of 1,087 weekly slots (543 weekly slot pairs) according to ACL (Airport Co-ordination Limited), over twice the number that have been exchanged since 2001. Below we examine where demand for these slots is likely to originate, from both an airline and a route grouping perspective [continued on page 2].



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### Transatlantic

As mentioned in the March *Aviation Strategy*, there has been a surge in LHR-USA movements for the summer 2008 (S'08) season of over 20% from S'07. There clearly isn't insatiable demand for transatlantic travel and now that the four non-Bermuda II US airlines (CO, DL, NW & US) have established a beach head at LHR, it could be assumed that they will strive to add incremental slots at a lower price than those paid initially. The fact that many of these carriers are either in the process of merging (NW/DL) or are otherwise considering their strategic futures (US/UA/CO/AA) may also serve to dampen their desire to overpay for slots at a time when they are trying to conserve cash as much as possible.

### Middle East

Middle Eastern carriers such as Emirates, Qatar Airways and Etihad are among the most rapidly expanding long haul carriers in the world and their desire to get access to Heathrow at almost any cost has been and will continue to be a contributing factor to the escalating price of slots. Due to their base airports operating on a virtual 24 hour schedule, they can be much more flexible with the timings of their slots but yields are best on the overnight flights that depart London late in the evening. However, as the flight time is relatively short (6-8 hours typically), and a high percentage of their passengers are transferring, frequency will increasingly become an issue for these airlines.

### Slot timing

There are certain times of day when supply exceeds demand for slots at LHR. ACL data indicates that for S'08 departures, there is spare capacity in the 05:00-07:00 hours, 16:00-17:00 and 17:00-18:00. For arrivals, there is spare capacity in the following hours: 08:00-09:00, 11:00-12:00, 12:00-13:00, 13:00-14:00, 15:00-16:00, 16:00-17:00, 20:00-21:00 and 21:00-22:00. However, any apparent spare arrival capacity during, for example, 08:00-09:00 is a function of the fact that demand for the departure block between 09:00-13:00 far exceeds supply. bmi bases most of its aircraft at Heathrow so its slot portfolio is heavily skewed towards a high concentration of morning departures and late night arrivals

(between 05:00-09:00, bmi has 19 departure slots and 10 arrival slots - see chart, page 1).

The \$209m Continental paid for its four daily Heathrow slots generated a substantial amount of publicity but it may be inappropriate to use this as a benchmark to value such a large block of slots. bmi recently announced that the "significant increase" in slot trading at LHR post Open Skies has led its directors to conclude that the conditions now exist to include a value of £770m on the balance sheet in respect of the slots it operates. Deloitte recently pointed out in an article on slot trading that IFRS3 accounting rules contain a requirement for listed airlines to record slot values on their balance sheets.

Slots are notoriously difficult to value as they are dependent on the airline securing an appropriate slot at the airport to which it wants to fly. This issue strikes at the heart of the difficulty in assessing the value of bmi's slot pool as the ability to maximise value will be highly dependent on who is actually the seller of these slots and what the opportunity cost of the slots are to that seller. Unless bmi were to take a major strategic step in advance of Lufthansa gaining control, we'll assume for the purpose of this exercise that the 'seller' is Lufthansa. In some cases, it may make sense to realise a lower price for a single slot pair or a block of slots if the acquirer is a carrier with strategically aligned interests. In the event that price is the main driver of any sale process, it would need to be carefully considered whether to package slots together in such a way that selling one block of slots doesn't make the 'shape' of the remaining potential blocks effectively unsalable.

The table, right, illustrates the split of slots by hour block during a weekday. We have assigned value ranges to the different slots based on several factors:

- 1) Time of day
- 2) Ability of the most interested carriers to finance the purchase of the slots
- 3) Our understanding of the current demand of slots based on the growth plans of airlines in various regions of the world. These values have been assigned to the departure time and doubled on the assumption that for each departure slot there's an operationally viable appropriate arrival slot.

### Conclusion

Our range of £678m - £1.26bn slot value for bmi is highly conditional on the manner in which

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# Aviation Strategy

## Analysis

the sale process is conducted and the intended strategy that ultimately motivates the seller. The higher range of the valuation assumes that there is a very motivated buyer for the particular slot (or group of slots) and an element of competitive tension can be generated in the sale process.

Arguably the best way to maximise the value of the slots would be to sell them to an incumbent Heathrow-based carrier that could add the arrival and departure slots to its own slot pool and thus derive synergies (aircraft utilisation and improved turnaround times) through a more efficient allocation process within a bigger network.

Following the widely expected statement from Lufthansa's CFO that the airline would exercise its call option on Sir Michael Bishop's 50% +1 stake in bmi, the key question centres on what it would do with bmi. One likely option to be considered would centre around Virgin Atlantic as an 'independent' buyer of the slots (Lufthansa could also pool its sizeable LHR slot portfolio - 203 weekly slot pairs - together with bmi's). Another possibility would see Virgin and Lufthansa conduct the process as strategic partners with the intention of creating an LHR-

based Star alliance entity that could compete with BA.

While this second option may seem attractive, the economics of a second LHR hub-and-spoke carrier may not stack up in light of the runway and terminal layout constraints. Heathrow is increasingly being marginalised as a hub in the face of increasing competition from Lufthansa/Star alliance in Frankfurt and Munich (each of which will add one runway within the next five years) and Air France-KLM with Paris CDG and Amsterdam and their combined nine runways.

However, London - and LHR in particular - is unquestionably an excellent source of long-haul point-to-point high yielding traffic and an enlarged Virgin Atlantic may represent the strongest economic case, with the remaining slots sold off in small blocks at the higher end of the value range to other transatlantic carriers, Middle Eastern 'super-connectors' and Asian and Australian airlines. BA would be a likely acquirer of those slots that most logically suit short-haul services operated by a Heathrow-based carrier.

By Robert Cullemore

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### AVIATION ECONOMICS' VALUATION OF BMI'S SLOTS

Departures	# of slots	Suitable route groups	£m price per slot (low)	£m price per slot (high)	£m value of slots (low)	£m value of slots (high)	Arrivals	# of slots	Suitable route groups	
0600 - 0700	6	Short Haul (aircraft must arrive previous evening & overnight)	1	3	12	36	0600 - 0700	1	Transatlantic (East Coast), Asia, S.Africa	
0700 - 0800	5	Short Haul	2	3	20	30	0700 - 0800	3	Transatlantic (East Coast)	
0800 - 0900	8	Short Haul	3	4	48	64	0800 - 0900	6	Transatlantic (East Coast)	
0900 - 1000	3	N.America West/Central	5	7.5	30	45	0900 - 1000	2	Transatlantic	
1000 - 1100	5	N.America West/Central	5	7.5	50	75	1000 - 1100	9	Transatlantic (West Coast)	
1100 - 1200	5	N.America West/Central	5	7.5	50	75	1100 - 1200	3	Transatlantic (West Coast), Transatlantic (West Coast), S. America	
1200 - 1300	4	N.America East/West/Central N.America East/West/Central, East Asia	5	7.5	40	60	1200 - 1300	7	Transatlantic (West Coast), S. America	
1300 - 1400	7	N.America East, East Asia	3	7.5	42	105	1300 - 1400	6	S. America	
1400 - 1500	3	N.America East, East Asia	5	10	30	60	1400 - 1500	7	Far Mid East	
1500 - 1600	6	N.America East, East Asia	5	10	60	120	1500 - 1600	4	Far Mid East, Asia	
1600 - 1700	7	N.America East	5	10	70	140	1600 - 1700	7	Far Mid East, Asia	
1700 - 1800	5	N.America East	5	10	50	100	1700 - 1800	4	Far Mid East, Asia	
1800 - 1900	6	N.America East, Middle East India, Eastern Asia, Far Middle	6	12	72	144	1800 - 1900	3	Far Mid East, Asia	
1900 - 2000	4	East, Australia, S.Africa India, Eastern Asia, Far Middle	5	10	40	80	1900 - 2000	6	Short/Medium Haul	
2000 - 2100	7	East, Australia, S.Africa India, E. Asia, Far Mid East,	4	7	56	98	2000 - 2100	4	Short/Medium Haul	
2100 - 2200	4	Australia, N.America (east) 'day'	1	4	8	32	2100 - 2200	7	Short/Medium Haul Short Haul, N. America	
2200 - 2300	0		-	-	-	-	2200 - 2300	7	(east) 'day' flight, Mid East	
					£678	£1,264				

### Air France/KLM: Challenges in the downturn

Air France/KLM has suffered a series of blows in recent weeks, with its failed bid for Alitalia followed by the posting of its first quarterly loss since 2003 and a warning that operating profits will fall by a third in 2008/09. Yet although it faces challenges, the Franco-Dutch group is in a relatively strong position to weather the aviation downturn, and it may look to acquire other airlines over the next 12 months.

It's been four years since the merger between Air France and KLM, and on an annual basis the group has delivered impressive financial results year-after-year (see charts, right), with results just released for the 2007/08 financial year (ending March 31st) including the group's best ever operating profit - €1.4bn, 13.3% up on 2006/07. The group's airline business (excluding cargo) accounted for €1.3bn of operating income, 21% up on 2007/08.

In the 12 month period to the end of March 2008, the Air France/KLM group carried 74.8m passengers, 0.7% up on 2006/07. Capacity rose by 4.6% in the year, just ahead of a 3.9% increase in traffic, thus leading to a 0.6 percentage fall in load factor to 80.8%.

Air France/KLM posted a 4.5% rise in revenue in 2007/08 to €24.1bn, although net profit was down 16% to €748m, affected by a massive provision of €493m post-tax for the US and European regulatory investigation into potential anti-competitive practices (i.e. alleged price-fixing on surcharges) at

the group's cargo business. Incidentally, Air France and KLM are two of the airlines (which also include Alitalia and Lufthansa) that are being investigated by the European Commission over alleged collusion on passenger flights between Europe and Japan, although no provision has been made for this.

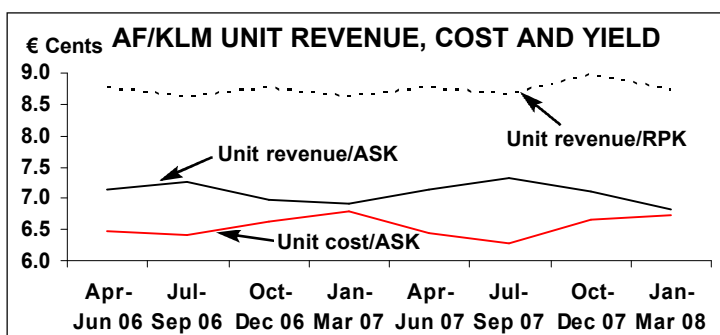
#### Quarterly concern

However, the annual result includes Air France/KLM's first quarterly loss since 2003, as in the January-March 2008 period the group posted an operating loss of €46m and a net loss of €542m (which included the cargo investigation provision), compared with an operating profit of €9m and a net profit of €44m in January-March 2007.

At an operating level the culprit is - of course - the rising cost of fuel. Overall in 2007/08 group fuel costs rose by "just" 7.4% to €4.6bn, but this was due partly to the US dollar's depreciation against the Euro, which made the purchase of oil (as well as the leasing of aircraft) cheaper in Euro terms. On the other hand, the rise in the Euro against the dollar effectively reduced group revenue by 2.3% over the 12 month period, so the currency effect worked both ways.

Passenger unit costs fell during the 2007/08 financial year to € Cents 6.52, while unit revenue per ASK rose by 0.3% to € Cents 7.09. Yield rose by 1% in the year, to € Cents 8.78. However, these figures are distorted by currency effects, and if the €/€ exchange rate had remained constant year-on-year then yield would have risen by 3.2% and unit revenue by 2.5%. But the fourth quarter figures show the gap between unit revenue and cost narrowing significantly (see chart, left).

It's clear that Air France/KLM needs to retain a focus on cost cutting. The group currently employs 104,700 but has already made a substantial effort to reduce costs

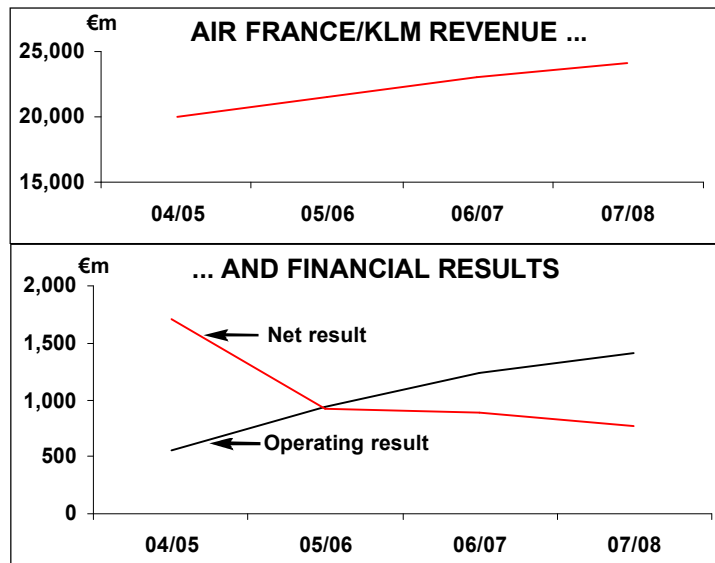


over the last few years; in February Air France/KLM even delisted its shares from the New York stock exchange in order to save €3.5m per year (the group's main listing is on Euronext in Paris, which is now part of NYSE-Euronext).

More significantly, the merger of Air France and KLM has created more than €500m of synergies a year, and the group believes this will grow to €1bn a year over the next two or three years. In relative terms KLM has gained more from the Air France/KLM merger than Air France has, thanks to access to Air France's larger business customer base and FFP. But - crucially - Air France has benefited from KLM's better focus on keeping unit costs down, and many of KLM's practices have - where applicable - been carried over into Air France. So while the "political necessity" to retain the ring-fenced KLM brand and operation is not as crucial now as it was in 2004, the two airlines are likely to remain separate for the foreseeable future, as the focus is still on driving through further synergies.

Air France/KLM's main cost saving programme is called Challenge 10, and has a target of €1.4bn in savings over the three-year period to the end of the 2009/10 financial year, with €536m of the €560m savings targeted for 2007/08 being achieved. Labour is a crucial part of this effort, but the 2007/08 results came despite a five-day strike by cabin crew in October 2007, which was the most serious industrial action faced by Air France for 10 years. The strikes cost the group €60m-€75m of operating profit and were caused by union anger over a new long-term agreement on pay and conditions. This was followed by industrial action in December from ground handlers at CDG, which cost the group another €15m.

Air France/KLM has now reached agreement on 2008 pay and conditions (including an approximate 2.8% increase in salaries) with unions (although only after action by ground crew in January, after initially being offered a 2.3% rise). There was also a strike by air traffic controllers in February, which affected domestic Air France services, although the group says this had a limited impact on its finances.



One area where Air France/KLM should save costs over the next few years is its fleet, as older aircraft are being replaced by newer models and the group is investing around €2bn a year until 2020 on fleet renewal. The mainline group fleet is 365-strong (see table, page 6) and it has more than 50 aircraft on order, almost all of them being replacements for existing aircraft (with the mainline Air France and KLM fleets remaining static over the 2008/09 financial year).

The group is gradually disposing of its 747-400s over the period to 2013, and it will sell six 747-400s in 2009 and 2010 (which are being bought by Deucalion, a German investment company). These will be replaced partly by 17 777-300ERs, while also on order are 12 A380s. Air France/KLM is expected to place an order for A350s or 787s sometime this year, with up to 100 aircraft replacing older 747s, MD-11s and A340s from 2015 onwards. Overall group capacity will grow by around 4.1% in 2008 to 2010, with a 4.7% increase in long-haul ASKs and 2.7% growth in medium-haul.

Domestically, Air France/KLM is coming under increasing pressure not only from LCCs but from high-speed trains, as there are plans to shorten journey times on existing TGV routes to the south and east of the country on a rolling basis from 2013. Earlier this year Air France/KLM said that it might reduce its 4,000 staff on domestic airport stations by as much as a quarter over the next



AIR FRANCE/KLM FLEET			
	Fleet	Orders	Options
<b>Air France</b>			
A318	18		
A319	45		15
A320	64	1	
A321	20		1
A330	16		3
A340	19		
A380		12	2
747	22		
777-200ER	25		1
777-200LRF		5	3
777-300ER	24	13	
<b>Total</b>	<b>253</b>	<b>31</b>	<b>25</b>
<b>KLM</b>			
A330	10	2	18
737-300	13		
737-400	13		
737-700		13	1
737-800	19	2	
737-900	5		
747	25		
777-200ER	15		
777-300ER	2	4	2
MD-11	10		
<b>Total</b>	<b>112</b>	<b>21</b>	<b>21</b>
<b>Group total</b>	<b>365</b>	<b>52</b>	<b>46</b>

Note: Excludes regional subsidiaries.

decade, and the airline's summer schedule includes the closure of routes from CDG to Rennes and Avignon, while frequencies have been reduced on other routes (although a new service between Bordeaux and Montpellier has been added). Interestingly, the airline is analysing the possibility of running its own high-speed trains into CDG - although even if this plan is adopted it will take many years to put into practice.

On medium- and short-haul, in February Air France/KLM bought Belgian regional carrier VLM Airlines for a reported €180m. VLM operates a fleet of 18 F50s and a single BAe 146 and its main base is London City, where it has a quarter of all slots. It will now work closely with Irish-based CityJet (which Air France/KLM acquired 100% of in 2000), which operates 23 BAe 146s and RJ85s and is already expanding routes to/from London City. However, the UK's Office of Fair Trading said in February that it was investigating whether the deal will affect competition in UK markets. Air France/KLM also owns Brit Air and Régional, and last year bought 60% of Transavia France, which operates a fleet of six 737-800s out of CDG to leisure destinations in Europe and North Africa.

Long-haul remains the priority for the group, and long-haul now accounts for 60% of passenger revenue (with domestic rev-

enue at 12% and Europe at 27%). Jean-Cyril Spinetta, group chairman and CEO, says the priority for growth is on routes to the Asia/Pacific region, where Air France/KLM will increase capacity by 8% in each of the next three years. Much of that growth will come from the Chinese market, where frequency has been increased this summer on routes from Shanghai to Schiphol and CDG.

Currently only 17% of Air France/KLM's passenger revenue comes from the transatlantic sector, which is lower than BA or Lufthansa, but SkyTeam's immediate reaction to the UK/US's open skies (with Delta and Northwest gaining access to Heathrow) has been to increase capacity between London Heathrow and the US by 11 flights a day since March, with a new Air France route between LHR and Los Angeles and a Delta service between LHR and Atlanta.

However, BA and BAA's problems at Heathrow T5 (with BA's postponement of the transfer of its long-haul flights from T4 to T5) have led to SkyTeam holding crisis talks with BAA. The SkyTeam partners are developing Terminal 4 as their Heathrow base and the airlines will fully relocate to T4 sometime in early 2009, with Heathrow becoming a major hub for SkyTeam in Europe. SkyTeam will account for around 40% of passenger flows at T4 from next year (around 7m passengers a year).

### Immunity at last

Significantly, in late May Air France, KLM and four fellow SkyTeam members (Delta, Northwest, Alitalia and CSA) received approval from the US regulator for extended antitrust immunity on transatlantic routes. Although the airlines had applied back in June 2007 and wanted immunity granted in time for the summer 2008 schedule (which began at the beginning of April), there is relief at Air France/KLM that a positive decision was made eventually, given that in 2005 the US regulator turned down a similar request. This time around the US DoT said that "a new and highly integrated joint venture will likely provide consumers with additional price and service options, such as lower fares and more non-stop and connecting flights".

The six airlines have up to 18 months to start the partnership, and this approval may lead to a formal transatlantic joint venture between Air France, KLM, Delta and Northwest, which the airlines had planned to start in 2010, leading to expanded services across the Atlantic as well as expanded FFPs. The four (soon to be three) airlines would share revenue and profit on a combined network across the Atlantic, and together their capacity would account for around 30% of all North Atlantic RPKs, with joint revenue of around €12bn a year.

Essentially this would combine the existing partnership between KLM and Northwest with a new partnership just set up between Air France and Delta, which includes an equal profit share on additional revenue generated by the partnership. This mirrors the agreement that KLM has with Northwest, which was launched back in 1991 and currently generates 100s of millions of Euro profit for the two airlines.

Obviously these plans are now overshadowed by the proposed Delta/Northwest merger that - if it gets approval - will mean just one company (with 75,000 employees and a fleet of 800 operating to around 400 destinations in more than 60 countries) for Air France/KLM to partner with. Although Air France/KLM initially said it wanted to invest between €500m and €1bn in the proposed merger between the SkyTeam partners, (assuming that both unions and the US regulator will allow it), in April Air France/KLM quickly backtracked from this position, saying that it could gain the same benefits from a partnership as from an investment.

Nevertheless, the partnership with Delta/Northwest means that a key building block of the Franco-Dutch group's strategy for the next decade or two is in place, which now allows Air France/KLM to return to the question of European consolidation.

There's little doubt that Spinetta needs to keep the group at the centre of the airline consolidation process in Europe, so missing out on the Alitalia opportunity was considered a real blow to the group by its senior management.

In time, however, the failure to acquire Alitalia (blame for which must go partly to Air

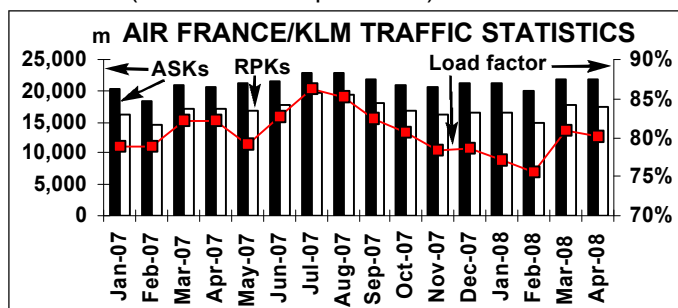
France/KLM, which gave the impression that unions were an afterthought when the group made its initial offer) may be regarded as a lucky escape. The group would have had to spend a substantial amount of resources (both cash and management time) in turning round the Italian flag carrier, even if Air France/KLM believed the effort would have been worth it in order to access the lucrative Italian business market, as well as the cost-savings that could have been made between Alitalia and the group.

However, the bid for Alitalia (in which the group still has a 2% stake) unsettled Air France/KLM shareholders, and some analysts warned against short-term volatility in Air France/KLM's share price if the bid had been successful, even if the long-term strategic impact of Alitalia might have been positive.

But Alitalia is history now, and there may well be better opportunities for Air France/KLM elsewhere in Europe. For example, the group is believed to be interested in acquiring a stake in Austrian Airlines now that the Austrian government is looking to sell its 42.75% stake to a strategic buyer before the end of 2008. If Air France/KLM does make a bid it is likely to face competition from Lufthansa, although unions at Austrian favour a deal with Air France/KLM as they fear Lufthansa has too much of an overlap with Austrian and would subsequently cut routes and jobs.

## The future

In March unconfirmed reports out of Paris said that Spinetta will resign in October - when he reaches 65 - even though the group has approved him to stay on as chairman and CEO (roles he took up in 1997) until his



70th birthday. Those same reports said that Pierre-Henri Gourgeon - the group COO - would replace Spinetta, but all Air France/KLM says on the matter is that it does not comment on rumours (which is a less-than-robust denial).

Whether or not Spinetta stays, it's likely that Air France/KLM will continue to look for merger and acquisition opportunities in Europe. In the longer term - following the completion of strategic moves in North America and Europe - Air France/KLM is likely to look for equity tie-ups with Asian airlines.

One possibility is SkyTeam partner China Southern, with whom Air France/KLM is launching a cargo joint venture later this year. The Guangzhou-based cargo airline will be owned 51% by China Southern and 49% by Air France/KLM, and is likely to include a fleet of 777Fs, 747-400Fs and A300-600Fs, which will be supplied by China Southern (either taken from its current fleet or from future orders). The venture will operate not only on Europe-Asia routes, but on the rapidly growing intra-Asian and transpacific routes.

### Short-term versus long-term

However, although Air France/KLM appears to have a sound strategic path mapped out, it's inevitable that both investors and analysts will concentrate more on the group's short-term prospects.

In late May the group said it expected operating profits to fall by a third in 2008/09, to somewhere "in the region of €1bn" and, although that is likely to compare very well

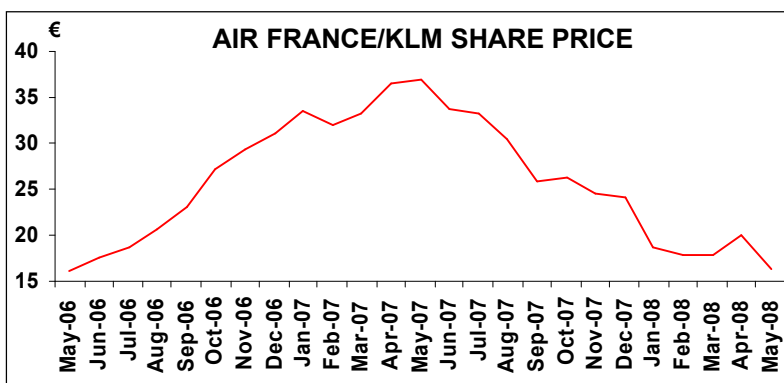
with results of its main competitors, this news is not going down well with investors, with shares in the group falling by 10% on the day this announcement was made; as of early June shares were trading at under €17 - see chart, below.

Some investor unease is undoubtedly valid because the group's 2008/09 forecasts are made on the basis of some crucial assumptions, including "new sources of synergies" between Air France and KLM, a €/€ 1.56 exchange rate and a \$120/bbl oil price - the last of which already looks unlikely.

On the other hand, of all the European majors Air France/KLM is perhaps the most able to withstand rising fuel prices. The group has a track record in carrying out successful hedging policies, and Philippe Calavia - group CFO - says that as of late May the group has hedged 78% of its 2008/09 fuel requirements at around \$80 a barrel. Air France/KLM also increased its fuel surcharge on all flights again in May, although interestingly it gave specific promises on reducing half the increase when the price of oil is "stabilised over time" below \$110/bbl and the other half when the price falls below \$105/bbl.

So although Air France/KLM is now unlikely to reach its previous target of an 8.5% return on capital employed by 2009/10, thanks to the rising cost of fuel (it achieved a 7.1% ROCE in 2007/08), the profit dip over the next few years will not be as severe as its European rivals. Spinetta says that "the current year is set to be challenging, but given our strategic advantages, the efficiency of fuel hedging and a tough stance on costs ....we will remain comfortably in profit".

Indeed financially the group is relatively strong. Long-term debt and other liabilities rose from €10.1bn at March 31st 2007 to €10.9bn a year later, but cash and cash equivalents rose by €0.9bn over the same period to €4.4bn as at the end of March 2008, partly thanks to the exercise of a warrant. With plenty of cash available, the Air France/KLM group will be looking hard for opportunities in Europe over the next 12 months.





## Alaska Air Group: It's better in the West

Alaska Airlines, the smallest of the US major network carriers, is well positioned to make it through the current industry crisis because of its good fuel hedges and strong liquidity. But is there a place for a niche airline like Alaska in the longer term?

In the past couple of months, as fuel prices have continued their relentless climb, Alaska has been frequently portrayed alongside Southwest as a survivor at \$150-per-barrel oil. Analysts have come to that conclusion after carrying out detailed financial and liquidity analyses. And, not surprisingly, Alaska's chairman/CEO Bill Ayer has made the company's special survival attributes his main theme at recent conference calls and at the May 21 AGM.

Alaska Air Group (AAG), the parent of Alaska Airlines and regional carrier Horizon, will easily make it through 2008, first of all, because it has the industry's second-best fuel hedge position (after Southwest). The group has hedged half of its 2008 fuel needs at the crude oil equivalent price of \$76 per barrel.

Second, AAG has a conservative balance sheet, with strong liquidity. Cash reserves amount to more than \$1bn, (29% of last year's revenues) and there is an unused \$185m credit facility. Debt leverage is low by network carrier standards, as indicated by an adjusted debt-to-capital ratio of 73%.

Third, AAG's liquidity raising prospects seem better than average. There are some unencumbered aircraft in the fleet, including 737-800s. There are assets that could be monetised, including the FFP and regional carrier Horizon.

Fourth, Alaska has a good track record on controlling non-fuel costs. Its ex-fuel CASM has declined steadily in the past six years, from 8.73 cents in 2001 to 7.50 cents in 2007 (see chart, page 10).

Fifth, Alaska benefits from a young, fuel-efficient, single-type fleet. Horizon, in turn, has just embarked on a similar quest - one that has involved the very interesting deci-

sion to shed its 70-seat RJs in favour of focusing entirely on the Q400 turboprop.

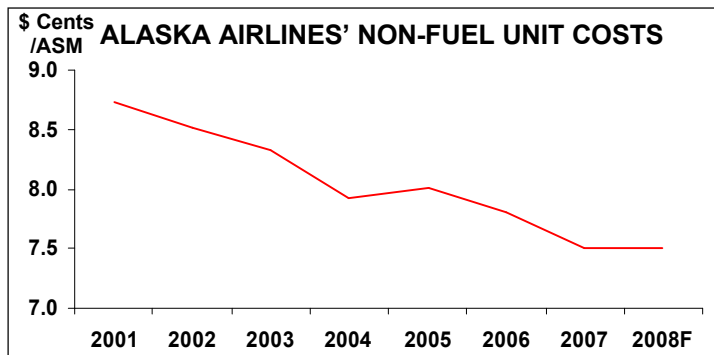
Finally, the Seattle-based carrier has various network advantages that will help it weather the current industry crisis. Its core regions, the Pacific Northwest and the state of Alaska, are expected to fare better economically than other US regions. There are promising new markets, such as Hawaii and transcon out of Portland (Oregon), where Alaska has been able to profitably redeploy capacity withdrawn from underperforming markets. And Alaska has a strong network of codeshare partners and is poised to benefit from transpacific growth.

What makes Alaska uniquely interesting is that it would make a perfect "low-risk" partner for just about any of the large network carriers. Its route system will look increasingly attractive to the larger carriers if and when industry consolidation gets under way and as airlines grow internationally.

In the short term, however, the most interesting thing to watch for will be the battle with Virgin America. The San Francisco-based start-up entered the Seattle to Los Angeles and San Francisco nonstop markets this spring, creating the first head-to-head clashes with Alaska. Alaska has responded by increasing capacity and creating a shuttle-type hourly service on the Seattle-Los Angeles route. One of its top executives explained the move as follows: "We're in this fight to win. We know how history has played out elsewhere in the country (LCCs winning market share) and we don't intend to let it happen here."

### Financial performance

Alaska emerged from the post-September 11 industry crisis in relatively good shape. The group lost money for four consecutive years (2000-2003), but the losses were relatively modest, reflecting the resilience of the West Coast and Alaskan markets (the isolation factor) and



Alaska's successful positioning as a high-quality, leisure-oriented point-to-point airline with unit costs "a notch above the LCCs".

AAG returned to modest profitability in 2004, two years ahead of the industry. Profits peaked in 2006, when the group reported adjusted net income of \$138m (4.1% of revenues), but last year saw profits decline to \$92m due to higher costs.

In contrast with its peers, AAG has seen a steady positive revenue trend since 2001. This is because Alaska continued to grow at a 7-8% annual rate in 2002-2004 (capacity growth has since slowed to the 4% range). The airline never parked aircraft or furloughed workers; instead, it redeployed its fleet in new markets, including transcontinental routes.

### CASM success

Alaska has done some impressive cost cutting. Under a 2002 plan, the airline sought to reduce ex-fuel CASM from 8.73 cents in 2001 to 7.25 cents by 2005. Although CASM was still at the 8-cent mark in 2005, the 7.50 cents achieved last year was not that far off the original target.

The 7.25-cent CASM target was part of a broader seven-year vision to transform Alaska into a profitable, larger airline with a greatly expanded network. The so-called "Alaska 2010" plan included employee and customer elements and growth and financial targets. The employee aims included providing "excellent job security" and making Alaska "one of the best places to work for in America". With service and brand, the aim was to provide "the best value" (a combina-

tion of product and price), build on an already strong brand and "maintain differentiation". The plan set 10% annual pre-tax profit margin and ROI targets, which would permit annual capacity growth in the 8-10% range.

Alaska has made great strides towards many of those goals, except of course the financial targets. The best ROI achieved was 7.9% in 2006, followed by 6.1% in 2007. The financial goals are now obviously totally out of reach in the current fuel environment.

AAG incurred a \$36m net loss before special items in the March quarter, reflecting an \$89m or 45% increase in fuel costs. On a pre-tax basis, Alaska lost \$38m and Horizon \$18m. Alaska saw an impressive 3.4% reduction in ex-fuel CASM, but its 3% RASM improvement lagged the industry - both evidently reflecting an increased average stage length and brisk 6.8% capacity growth.

Like its peers, AAG is now taking action on multiple fronts to try to offset the sharply higher fuel costs. The company recently unveiled a new package of cost and revenue initiatives that are aimed at improving annual pre-tax income by \$150m.

First, Alaska has modestly reduced its planned 2008 capacity growth from 3% to 2% (down from 6% envisaged last year), while Horizon's capacity is now expected to decline by 4-5%. The reason Alaska is still growing ASMs is that there continue to be opportunities to redeploy capacity in profitable markets.

The company has also decided to eliminate all of Horizon's 20 CRJ-700s and transition the regional carrier to a single-type fleet of Q400s.

AAG has also put in place measures to boost ancillary revenues by \$30-40m annually. The main focus is on increasing fees on items such as booking through reservations or airport sales agents, overweight baggage and pets. Like many other US carriers (with the notable exception of Southwest), Alaska has also started charging \$25 for a second checked bag. The airline is determined to maintain its "simple, customer-friendly fare structure". Many of the changes went into effect in May or June, so there should be an immediate revenue boost.

Alaska has been raising fares where it can, holding more seats open for its premium customers closer to flight departures and evaluating changes to its mileage plan. The strategy of focusing more on premium customers has helped: in the March quarter, first class revenues were up by \$17m and the bucket mix in the main cabin also improved.

Before oil prices surged to the \$130-plus range, the fare increases needed by many of the airlines seemed surprisingly small. In late April, when oil hovered at around \$118 (equivalent to \$3.60 per gallon, assuming refining costs of 70 cents per gallon and no fuel hedges), Alaska's executives calculated that the airline needed an average fare increase of just \$10 per passenger to break even, or \$25 per passenger to "achieve the kind of margins investors expect".

But Alaska is much better positioned than its peers this year simply because of its fuel hedges, which are mainly crude oil call options. AAG has hedged 50% of its 2008 needs at \$76 and 20% of its 2009 needs at \$92. This is nowhere near Southwest's position (70% of 2008 needs and 55% of 2009 needs hedged at \$51) but significantly ahead of the rest of the industry.

Like its peers, Alaska is implementing numerous fuel conservation measures. Recently announced initiatives include a new flight planning system to select more direct routings, single-engine taxi procedures and using more ground power for taxi procedures. Ongoing measures include transitioning to more fuel-efficient aircraft, installing winglets on the 737NGs, eliminating unnecessary weight on board and working with the FAA to pursue more direct routings and fuel-saving approaches and departures. The winglets alone will reduce the annual fuel bill by \$20m at \$118 oil price.

Alaska expects to maintain its mainline ex-fuel CASM flat at 7.50 cents in 2008. The primary goal is to continue to improve operational reliability.

The company faces some labour cost pressures, especially because pilot contracts at both Alaska and Horizon have been open for more than a year. Somewhat unusually, Alaska's pilots had to take a 26%

wage cut in 2005 as a result of a binding arbitration ruling, and that contract became amendable in May 2007. The pilots understandably want a wage increase, but the management believes that Alaska's current pilot unit costs are the second-highest in the industry for the size of aircraft operated and is therefore insisting on a strict trade-off for improved productivity. Negotiations continue, with the management presenting its latest counter-offer on May 20.

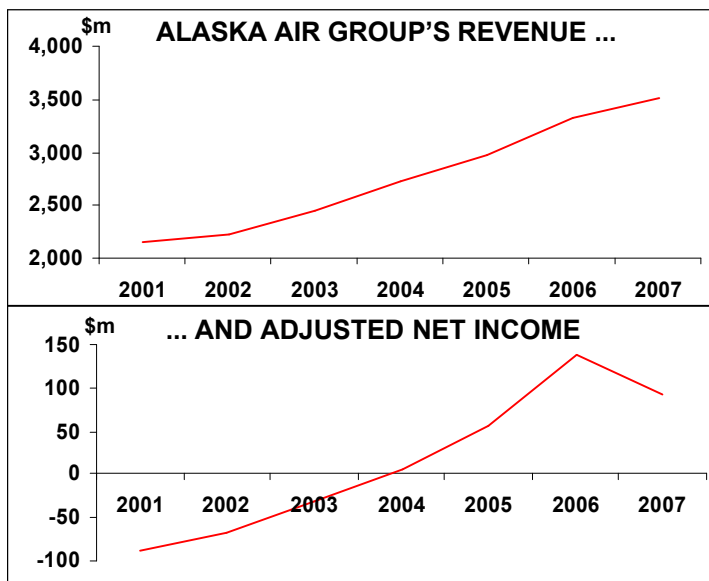
Alaska is likely to escape the worst brunt of the recession because the Pacific Northwest and the state of Alaska are expected to fare better economically than other regions. For example, real personal income growth is forecast to be at least one percentage point higher in Washington state than in the US overall in 2008-2009, while housing prices are stable in cities such as Seattle and Portland. In addition, Washington state exports are booming thanks to the weak dollar.

Consequently, AAG may see only minimal cash burn this year. The current consensus estimate is a loss before special items of around \$40m in 2008 - only 1-2% of revenues. But much will obviously depend on fuel price developments. According to a May 12 earnings sensitivity analysis by Calyon Securities, AAG could break even this year if the fuel price averaged \$100, but at \$150 oil the loss could be as high as \$127m (4% of projected revenues, so still manageable).

The Calyon Securities analysis suggested that Alaska would be fine even at \$150 oil, because at year-end 2008 it would still have about \$682m in cash or 18.6% of revenues. However, at \$150 oil, by the end of 2009 cash reserves would have dwindled to \$402m, only 10.7% of revenues.

JP Morgan's May 19 liquidity analysis ranked Alaska as the second-lowest Chapter 11 risk in the US industry (after Southwest).

Next year's outlook for Alaska is much less certain, as the 2009 fuel hedges are not that good. But, as Southwest's management has noted in the past, good fuel hedges in the near-term give an airline valuable extra time to adjust to a new environment of pos-



sibly permanently high (\$130-plus?) fuel prices.

### Horizon's fleet transition

In late April AAG's board approved a plan to transition Horizon to a single-type fleet within 24 months. This will mean shedding the 20-strong CRJ-700 fleet, in addition to the previously announced phase-out of Horizon's 12 remaining 37-seat Q200s by June 2009, in favour of concentrating on the Q400 turboprops. In other words, Horizon will simplify its fleet from three types to one, while also reducing the size of the fleet from 70 to about 50 aircraft by December 2009. The latter is based on the Q400 firm order total of 48, but there are also 20 options that could be exercised.

The decision is interesting in that it confirms a new trend of turboprops gaining popularity at the expense of RJs in the new fuel environment, as turboprops are much more fuel-efficient than jets. At a recent conference, a representative from ATR noted a surge of interest in turboprops from airlines. Could the prop-to-jet trend that began in the early 1990s soon be reversed?

Horizon is already a leading operator of the Q400 and has come to know it as an "extremely flexible and capable aircraft" and a great match for the majority of its current and planned markets. The airline describes

the type as "one of the most technologically advanced turboprop aircraft in the world" and one that offers "jet-like speed and cabin environment". The type burns 30% less fuel and produces 30% less emissions than a 70-seat jet.

The Q400 apparently offers the best economics of any regional aircraft in Horizon's network. At the system average stage length of 365 miles, the Q400 has 10% lower CASM than the CRJ-700; on a 129-mile route such as Seattle-Portland, the Q400 offers 16% lower CASM, and even on a 600-mile route the differential is 7%. Of course, RASM will be lower, but the revenue differential should be much less, so profits will improve.

The 70-seat jets served a great purpose at AAG by improving the performance of markets previously served by larger Alaska jets. However, the management noted that the markets continued to underperform, with no end in sight to the yield pressures and cost increases, particularly fuel.

One problem that Horizon will face is that the 74-76 seat Q400 will be too large for the smaller markets and could preclude the carrier from developing new markets. This means that Horizon may well eventually contract some services out to a smaller third-party operator, not unlike what Alaska currently does on particularly thin routes in the state of Alaska. At the same time, Horizon itself could do some third-party work as there is apparently potential demand from the legacy carriers for Q400 feed.

In addition to leveraging the favourable economics of the Q400, the new fleet plan will allow Horizon to reduce its annual operating costs through the reduced fleet size and achieve the favourable economics and efficiency of a single fleet type.

The beauty of the plan is that it should involve no additional capital spending. Horizon already had 15 Q400s on firm order (to bring the fleet to 48), and as those come in, the Q200s and CRJ-700s will leave, bringing in sales proceeds or lease income. The airline has already subleased out or is in the process of arranging such deals on the Q200s, but it will need to find a market for the 20 CRJ-700s, of which two are owned

and 18 are leased. All the indications are that worldwide interest in 70-90 seat RJs remains strong.

### Alaska's fleet plan

Alaska is nearing the completion of its transition to an all-737 fleet, with the return of its last MD-80 on September 30 - three months ahead of the original plan, which was announced in March 2006.

The MD-80 fleet has been whittled down to 10 aircraft (March 31) from 26 aircraft two years ago. Last year the airline sold all 20 of its owned MD-80s and leased most of them back under short-term leases. Of the 10 still in the fleet at the end of March, six were under short-term operating leases that expire this year; the other four, on long-term operating leases, will simply be grounded and stored (or subleased) by October.

At the end of 2008, Alaska will have an all-737 fleet of 116 aircraft, consisting of 46 737-800s, 20 737-700s, 12 737-900s and 38 737-400s. The average fleet age will be 7.6 years - among the youngest in the US.

The airline is receiving as many as 17 737-800s this year (including one on operating lease), which means a relatively heavy \$390m aircraft capital spending. However, after this year capex will start to fall quite dramatically, as 737-800 deliveries moderate to six in 2009, six in 2010 and three thereafter. As of March 31, Alaska had another 41 737 options. Currently, the expectation is that the mainline fleet will grow by one aircraft or not at all in 2009.

### Promising new markets

Like its peers, Alaska is in the middle of a thorough route re-evaluation. So far, the airline has pulled out of two markets (San Diego-San Francisco and Orange County-Oakland) and reduced service in certain other West Coast markets. The aircraft have been moved to three markets: Transcon out of Portland (Oregon), Hawaii and Seattle-California. This autumn, Alaska intends to reallocate another 3-5% of its capacity. So far, the airline has disclosed that it will terminate Portland-Orlando and San Francisco-Vancouver, will not return

to three seasonal Mexico routes out of San Francisco and will launch a new Seattle-Minneapolis route in October.

Transcon and Hawaii have received additional service because they are performing well. Alaska is particularly pleased with the response it is seeing on its new Hawaii routes from Seattle to Honolulu and Lihue and from Anchorage to Honolulu, which were launched in October 2007. Reduced industry capacity since ATA's demise has helped and advance bookings are strong. The services appear to be profitable, though Alaska says that the fares could be higher to facilitate satisfactory returns. This summer will see Alaska adding service to its third Hawaiian island, Maui, to be followed by Kona in November.

Alaska's greatly expanded Seattle-California schedule, in turn, is a direct response to Virgin America. The "West Most" schedule features 78 daily flights, with hourly service from Seattle to Los Angeles and flights every other hour to five other airports (Orange County, San Francisco, San Diego, San Jose and Oakland).

Alaska's 15 and eight daily flights on the Seattle-Los Angeles and Seattle-San Francisco routes, respectively, this summer vastly outnumber Virgin America's four and three daily flights. Those services represent only 4.6% of Alaska's total daily flights. But, as Alaska's management put it, "those markets are extremely important to us and we'll defend them to the end".

Alaska's strong portfolio of airline partnerships positions it well to capitalise particularly on transpacific growth. Its major domestic partners are American, Delta, Continental and Northwest, while international partners include Air France/KLM, LAN, Qantas and, on an FFP basis, BA and Cathay Pacific.

In the event of industry consolidation, Alaska believes that it will have a significant role to play almost regardless of what happens. The management is enthusiastic about Seattle's potential to act as a gateway to Asia; in a recent presentation, the executives noted Northwest's possible growth to Asia and Europe out of Seattle with the 787, as well as Delta's possible Asian expansion out of Los Angeles.

By Heini Nuutinen



### Singapore Airlines: The push into China

Although Singapore Airlines is consistently one of the most profitable airlines in the world, it is devoting large amounts of management time to securing an expansion into the huge Chinese market via an equity acquisition at China Eastern, one of the country's "Big Three" carriers. While completing this investment has been far harder than the SIA group has anticipated, Singapore's flag carrier is determined to push through a deal that will be the cornerstone of SIA's strategic plans over the next few decades.

The SIA group is already substantial, employing 30,100 and currently operating to more than 75 destinations in the Asia/Pacific region and around the globe. In results just released, during the 2007/08 financial year (ending 31st March 2008), the group reported revenue of S\$16bn (US\$10.8bn) - 10% up on the 2006/07 financial year. But group operating profit rose even faster, up by a substantial 62% to S\$2.1bn (US\$1.4bn), of which S\$1.6bn came from the SIA airline operation (61% up year-on-year).

Net profit for 2007/08 reached S\$2.1bn (US\$1.4bn), slightly down on the S\$2.2bn net profit in 2006/07, but this was due to a large amount of exceptional items in 2006/07, including S\$421m from the sale of assets, as well as S\$247m from tax write-backs following a reduction in the Singaporean corporate tax rate. Excluding these items from 2006/07, SIA's 2007/08 underlying net profit rose by a substantial 40%.

The SIA group includes the mainline SIA, SilkAir, SIA Cargo, engineering and airport ser-

vices, but in 2007/08 airline operations (pre inter-segment eliminations) accounted for 87.6% of revenue, 85.9% of operating profit and 80.3% of net profit, and it is the airline business that dominates the SIA group.

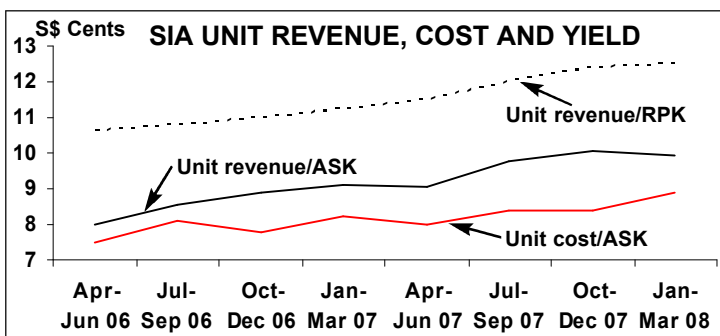
In the 12 month period to the end of March 2008 the mainline operation carried 19.1m passengers, 4.2% up on the previous financial year, and a 2.6% rise in traffic was greater than a modest 1.2% capacity increase, resulting in a 1.1 percentage point rise in load factor, to 80.3%. As can be seen in the chart below, although the difference between SIA's unit revenue and costs was reduced in January-March 2008 compared with October-December 2007, the gap is still healthy, and yield is still heading upwards.

#### What recession?

Indeed 2007/08 results were better than most analysts expected, and despite an increase in capacity this year and what SIA says is some softening in leisure demand out of North America (but not business travel), the airline expects yields to hold up for the foreseeable future. SIA says that while "the combination of a global economic slowdown and record high fuel prices will make this a more challenging year for airlines", SIA is "well positioned to weather the storm".

Others are not so sure, and in early May Citigroup put a "sell" recommendation on SIA's shares, saying that "even a quality, cash-rich SIA cannot fight slower global traffic, cargo overcapacity, record fuel prices and intense competition", adding that although the January-March quarter may show weakness, "the real pain would be in the 2008/09 financial year".

It's true that SIA is particularly vulnerable to an economic downturn as the airline obtains at least 50% of revenue from first- and business-classes, although SIA executives contend that their premium passengers tend to be more resilient and loyal to SIA than premium traffic at competitors due to SIA's innovative first- and business-class products.

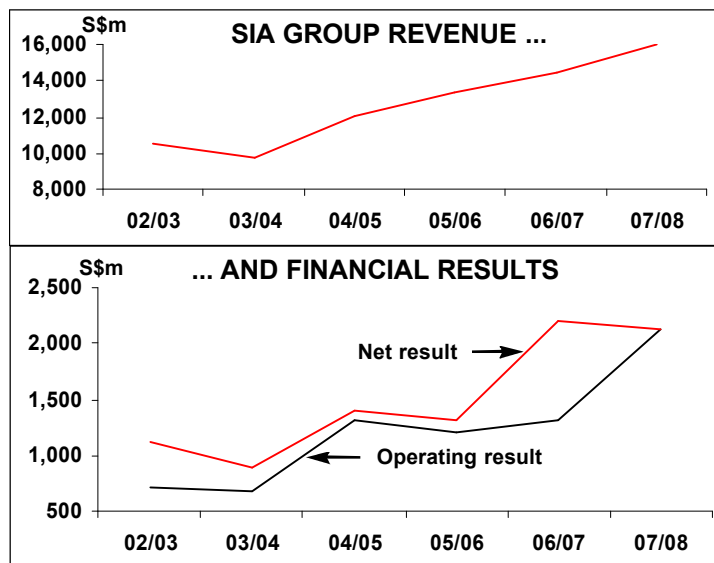


Indeed from this May SIA has been converting its five A340-500s used on routes between Singapore and New York Newark and Los Angeles from a 181-seat two-class configuration (business and premium economy) to a 100-seat all-business class product (all of which are convertible into flat beds). The two-class non-stop Singapore to Newark and Los Angeles services were launched in 2004 and have been well received by customers, claims SIA, even though SIA's business fares on the route have gradually increased over the last four years into a 15% gap between the non-stop and one-stop services.

The first all-business class aircraft was introduced onto the Newark route in May, to be followed by the Los Angeles service in September and these all-business class transpacific flights will force economy passengers on SIA to use the airline's stopping services to the US. SIA currently operates more than 50 flights a week between Singapore and the US, to San Francisco, Los Angeles, New York and Houston (the last route - via Moscow - being launched this March).

On long-haul, the group now has four A380s, with 15 more on firm order. The first was put onto the Singapore-Sydney route in October 2007, with the next two used on London-Singapore from this March and the fourth being used on Tokyo-Singapore from May. The aircraft are configured with 471 seats - 12 premium class (what SIA terms the so-called "beyond first-class"), 60 business class (with lie-flat seats) and 399 in economy. Further A380s will be used on Asia-European routes, and although SIA will face stiff competition against capacity from Middle Eastern airlines on this sector, the SIA group may order up to 15 more of the model, according to Airbus.

Altogether the mainline SIA currently operates a fleet of 99 aircraft (see table, page 16), with an average age of six and a half years, and as well as the A380s, SIA received five 777-300ERs in 2007/08, and decommissioned five 747-400s. While there is now renewed uncertainty over A380 delivery dates, four more will arrive in 2008/09 (to add to the current four), although the delivery dates on the others may yet be put back by Airbus. Four A330-300s and five 777-300ERs will also



arrive in 2008/09, and with six 747-400s being sold, the airline's capacity is forecast to grow by just over 7% in this financial year.

An order for around 20 A330s or A350s is also possible. SIA is to lease six A330-300s from AWAS from 2009 onwards, all of which are short-term stopgaps before the first of 20 A350-900s on order are delivered.

Elsewhere on long-haul, SIA wants to operate transpacific services between Australia and the US, but is excluded from doing so even under the new "open skies" deal that came into force between Australia and the US this year. However, the unexpectedly liberal air services agreement between Singapore and the UK (called a virtual "open skies" deal) that was agreed late last year allows SIA to operate domestic UK routes and beyond services from the UK to other markets, such as the US. SIA has long wanted to launch transatlantic services, although even after this ASA several hurdles remain, including the acquisition of sufficient slots at Heathrow.

On the other hand, SIA has benefited significantly from more than 30 years of protection given to it and Malaysia Airlines on the lucrative Singapore-Kuala Lumpur route, where the two airlines operated a shuttle service in partnership, with co-ordinated flight schedules and split revenue from their joint 90+ flights a week. However, LCCs were allowed onto the route in February 2008, and the route will be fully opened up in December this year, which led to SIA and MAS ending their partnership on June 1st.

<b>SIA GROUP FLEET</b>			
	<b>Fleet</b>	<b>Orders</b>	<b>Options</b>
<b>SIA</b>			
A330		19	
A340	5		
A350		20	20
A380	4	15	21
747-400	18		
777-200ER	46		28
777-300	12		
777-300ER	14	5	13
787		20	
<b>Total</b>	<b>99</b>	<b>79</b>	<b>82</b>
<b>SIA Cargo</b>			
747-400F	14		
<b>SilkAir</b>			
A319	6	4	
A320	8	8	12
<b>Total</b>	<b>14</b>	<b>12</b>	<b>12</b>
<b>Group total</b>	<b>127</b>	<b>91</b>	<b>94</b>

The SIA group also includes regional subsidiary SilkAir, which operates to more than 25 destinations in nine Asian countries with a fleet of 14 A320 family aircraft, with four A319s and eight A320s on outstanding order. The group's cargo operation is Singapore Airlines Cargo, which operates 14 747-400s, and in turn this subsidiary owns 25% of Great Wall Airlines, a Shanghai-based joint venture cargo operator that operates three 747-400Fs.

Though not part of the SIA group, LCC Tiger Airways was launched in September 2004 by SIA (which now owns 49%), Temasek (11%) and two investment companies - Irelandia (16%, and owned by Tony Ryan and family) and US-based Indigo Partners (24%). The Tiger group operates 12 A320s to around 30 destinations in nine countries - Singapore, China, Australia, Malaysia, Indonesia, the Philippines, Thailand, Vietnam, and India. Tiger also launched a subsidiary operation called Tiger Airways Australia in November last year, which is based at Melbourne, although Tiger is looking to open a second base in Australia. Tiger plans to open other subsidiaries around the Asia/Pacific region, though the only firm plans appear to be for Incheon Tiger in South Korea in 2009 (and this was originally planned to launch in 2008).

In October last year Tiger ordered another 30 A320s and took options on a further 20 aircraft, and these options were converted to firm orders in December, bringing the total order book to 58 aircraft. These aircraft will bring the Tiger group fleet (including the

Australian and Korean operations) to more than 70 aircraft by 2016.

Although a full set of results have yet to be released, in the financial year ending March 31st Tiger recorded a net profit of S\$10m - its first profit since it launched. The Tiger group saw passengers carried rise by more than 50% in the 12 month period, with revenue up 82%. Capacity rose by 39.6% in the financial year, but traffic increased at a higher rate, resulting in an 8% rise in load factor.

The SIA group maintains that Changi-based Tiger operates completely independently from SIA, although in May Chin Sak Hin - a longstanding SIA group executive and previously CFO of SIA Engineering - became CFO of Tiger. The new CFO is a close associate of Chew Choon Seng, the SIA group CEO, and there are unconfirmed rumours that Hin has been parachuted in to keep close control on the LCC (which has also seen two previous CFOs leave in the previous 12 months).

Looking at the group as a whole, although SIA has capex commitments of S\$8.3bn (US\$5.6bn) over the next three financial years (largely for aircraft purchases) this is easily affordable for the group. As of March 31st this year, the SIA group had long-term debt of S\$1.6bn (US\$1.1bn) - S\$200m lower than a year earlier - which was considerably less than the group's cash and cash equivalents, which stood at a hefty S\$5.1bn (US\$3.5bn) as at the end of the 2007/08 financial year (the same level as 12 months earlier).

Indeed the only real downside for SIA going forward is oil prices. SIA increased its fuel surcharge on all types of flights in May (coming on top of an increase in the surcharge in March this year, and October and December of 2007), and in 2007/08 fuel costs rose by S\$453m (US\$307m), although SIA's hedging policy reduced the cost rise by another S\$232m. As of May, the group had hedged 36% of its 2008/09 fuel needs, at an average price of US\$106, which is well below the current spot rate.

### The China push

Fuel concerns aside, Chew Choon Seng - who has been CEO of SIA group since 2003 (and who has recently had his contract extended until the end of 2010) - has driven record

# Aviation Strategy

## Briefing

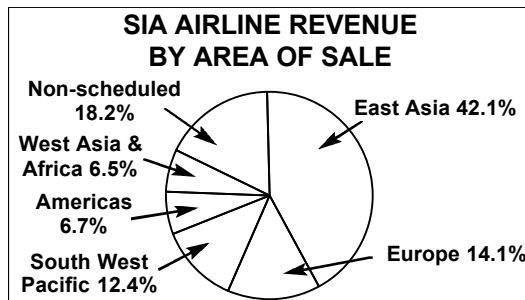
profit levels at the group, and substantial profits are expected to come in year-after-year for the foreseeable future.

Nevertheless, Seng has aggressive expansion plans for SIA, and these centre largely around the massive potential of the nearby Chinese market. In September last year the SIA group and Temasek Holdings, the investment vehicle of the Singaporean government (and which owns 54.5% of SIA), announced a proposed deal to buy 24% of Shanghai-based China Eastern for HK\$7.15bn (US\$920m), with SIA owning 15.7% and Temasek 8.3%.

However, in early January their proposal was rejected by China Eastern's minority shareholders, who said SIA's bid of HK\$3.80 was too low. Those shareholders included China National Aviation Holding (CNAH), the parent company of Air China, which has been building up a stake in China Eastern and now owns 4%, but which also wants to buy China Eastern. CNAH is keen for Air China to expand into Shanghai, the hub of China Eastern, and if it can't acquire China Eastern itself then the last thing it wants is for China Eastern to be revitalised by someone else - even if SIA and Air China are both members of the Star alliance. SIA has undoubtedly suffered from China Eastern's relative lack of support within the Chinese government compared with Air China, and the close ties between Air China and the government were made even closer in January when Li Jiaxiang, chairman of Air China, was made the acting head of the Civil Aviation Administration of China.

The SIA/Temasek bid needed approval from two-thirds of shareholders, but - encouraged by CNAH's strident opposition - 78% of shareholders voted against the Singaporean bid. However, while this was an unexpected blow to SIA, the Singaporean group is determined to press forward with its bid, and this is reciprocated on China Eastern's side, as the airline has a heavy debt level (see *Aviation Strategy*, May 2008) and needs both foreign management experience and financial support urgently.

In essence China Eastern is desperate for a strategic investor, and the airline says publicly that a partnership with SIA would be "superior" to one with CNAH, thanks largely to SIA's global strength and expertise, whereas

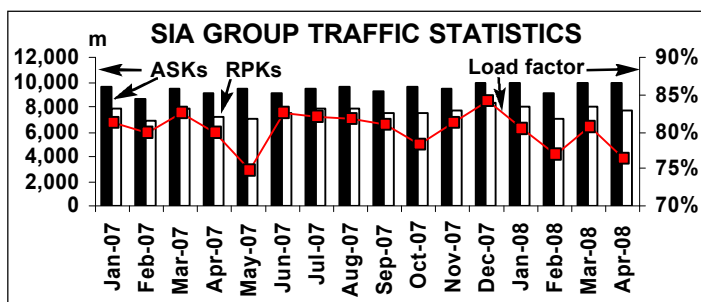


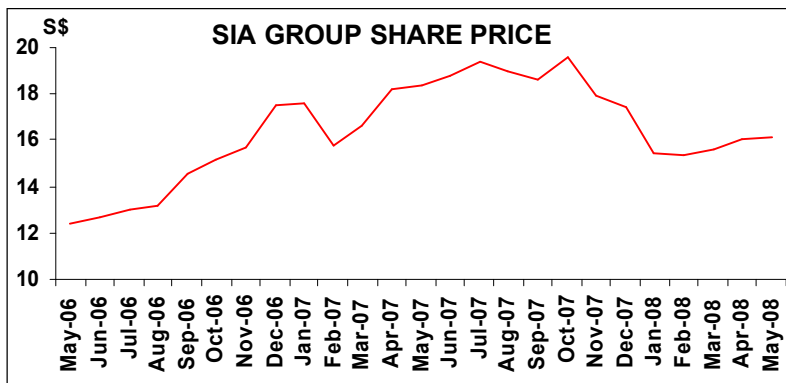
CNAH's bid would face regulatory hurdles, and in any case there would be few synergies between Air China and China Eastern.

SIA's earlier bid was rejected partly because of the anticipation of a higher bid from CNAH, even though it had support from the China Eastern board and from parts of the Chinese government, but a few weeks later China Eastern's shareholders also rejected a higher CNAH bid (of HK\$5 a share). Although in January SIA said that it would not raise its bid, it also said that it wanted to continue building a relationship with China Eastern. That's not surprising given that SIA and Temasek had negotiated the terms of a stake in China Eastern ever since 2006, and in March SIA confirmed what everyone else suspected: that negotiations had restarted between the Singaporeans and China Eastern.

While a SIA shareholding would give China Eastern protection against a takeover bid from China Southern or Air China (as China Eastern is perceived to be the most vulnerable airline of China's "Big Three"), from SIA's perspective a China Eastern stake is not only a sensible long-term financial investment but would open up the huge domestic market in China to the SIA Group - and, most importantly, business feed to/from China, particularly at Shanghai, the Chinese airline's main hub.

Additionally, there is little overlap between the international routes of China Eastern and





SIA, and the two airlines could develop a formidable international route network that would be a major challenge to Air China. A SIA/China Eastern equity link could even secure the Chinese carrier's entry into Star, which would be a huge blow to oneworld as China Southern joined SkyTeam in November 2007 and Air China joined Star the following month.

Only the practicalities of the level of SIA and Temasek's bid for China Eastern remain to be resolved. There has been concern that the Singaporeans would have to put together a significantly higher offer for China Eastern than previously in order to secure the support of the minority shareholders, with a danger that the price they have to pay would be as high as CNAH could force it, in order to reduce the value of the "strategic gain" to SIA of securing a major stake in one of China's Big Three.

However, as of early June China Eastern's share price was less than HK\$3.50 - compared with the HK\$7 share price when minority shareholders rejected SIA's offer of HK\$3.80, so - ironically - the CNAH-inspired blocking of SIA's earlier bid may well have saved the Singaporeans a considerable sum of money.

Talks between SIA and China Eastern are continuing through the summer, and it's possible that a revised bid will be put to China Eastern's AGM, which is due to be held on June 30th. However, one senior executive at China Eastern indicated that a more likely timeframe for a renewed bid will be in the autumn, since top management at China Eastern was focussing on operations around the Olympic Games, which are being held in August. But it's more a case of when the deal gets done, rather than if, and in May Li Fenghua, chairman of China Eastern, con-

firmed that a deal is very likely to be completed between the two.

### Other deals...

While SIA group's main strategic focus is on mainland China, it is also looking at other potential deals. There were rumours in March that SIA was interested in buying 25% of Taiwanese airline China Airlines. However, while SIA has previously been interested in acquiring a stake in this carrier, it's highly unlikely to be considering such a move at the moment as this would undoubtedly lead to its renewed bid for China Eastern being vetoed by the Chinese government on political grounds.

In December 2007 SIA was also reported as being involved in a consortium interested in bidding for Alitalia, though this was swiftly denied by SIA. Again, with China Eastern the priority it is highly unlikely that the SIA group would be interested in taking a stake in a European carrier - at least in the short- and medium-term.

Meanwhile SIA's 49% stake in Virgin Atlantic Airways (bought in 2000 for US\$960m) is the source of much speculation, although in May Chew Choon Song confirmed that: "It's not a secret that we regard it as an underperforming investment. We are still reviewing our plans and are open to all offers ... but we are not desperate." Virgin has a right of first refusal, and last year Richard Branson said Virgin might buy back SIA's stake before going for an IPO.

The focus for the SIA group in the next few months will be completing the China Eastern deal, to be followed by the huge task of setting up deep-rooted co-operation between the two giant carriers. And there is one more pressing reason for SIA to conclude a China Eastern deal as soon as possible - SIA's growing cash pile. If SIA does not seal a deal very soon then the group will come under pressure from shareholders to pay out another special dividend. The group paid a S\$2bn special dividend as recently as 2007, but with S\$5.1bn in cash and cash equivalents sitting in SIA's coffers as at March 31st this year, the motivation for management to go out and gain kudos through the acquisition of a stake in a Big Three carrier rather than pay a dividend (and thereby allowing shareholders to make their own minds up on where to invest this cash) must be huge.



### Jet values and lease rates

The following tables reflect the current values (not "fair market") and lease rates for narrowbody and widebody jets. Figures are provided by the The Aircraft Value Analysis Company (contact details on page 20) and are not based exclusively on recent market transactions but more reflect AVAC's opinion of the worth of the aircraft. These figures are not solely based on market averages. In assessing current values AVAC bases its calculations on many factors such as number of

type in service, number on order and backlog, projected life span, build standard, specification etc. Lease rates are calculated independently of values and are all market based.

These values and lease rates indicate a stable market compared with 2007; however, the impact of deteriorating economies and inflated fuel prices is already apparent in the aircraft market, and, in *Aviation Economics'* opinion, substantial downward adjustments are inevitable.

#### NARROWBODY VALUES (US\$m)

	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A318	29.2	19.6			717-200		13.2		
A319 (IGW)	39.8	30.9	25.4		737-300 (LGW)			10.5	6.0
A320-200 (IGW)	47.4	38.3	29.1		737-400 (LGW)			11.4	6.4
A321-200 (LGW)	52.5	42.0	31.5		737-500 (LGW)			9.5	
					737-600		22.0	14.5	
					737-700 (LGW)	40.2	33.4	26.4	
					737-800 (LGW)	50	41.2	32.3	
					737-900ER	54.8			
					757-200			23.0	12.9
					757-200ER			24.3	13.5
					757-300		36.4		
					MD-82			4.8	3.1
					MD-83			5.8	3.7
					MD-88			5.8	3.5
					MD-90			7.3	

#### WIDEBODY VALUES (US\$m)

	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
					747-200B				2.6
A300B4-600				5.6	747-400		95.2	74.0	
A300B4-600R (HGW)			26	10.1	767-200				6.4
A310-300 (IGW)			16.4	7	767-300			28.7	12.4
A330-200E	99.5	83.9			767-300ER (LGW)			41.2	20.1
A330-300 (IGW)		72.4	50.3		767-400		55.4		
A340-200			41.5		777-200		71	54.5	
A340-300 (LGW)		72.3	54.6		777-200ER	130.6	107.6	84.7	
A340-300ER		82.5	61.7		777-300		100.5	69.3	
A340-500 (HGW)		122.9			787-800	105.1			
A340-600 (HGW)		127.2							
A380-800	193.6				MD-11P			38.6	

Note: As assessed at end-April 2008. Mid-range values for all types.  
Source: AVAC.

# Aviation Strategy

## Databases

### NARROWBODY LEASE RATES (US\$000s per month)

	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A318	250				717-200	173			
A319 (IGW)	369	316	270		737-300 (LGW)			155	111
A320-200 (IGW)	371	342	293		737-400 (LGW)			156	119
A321-200 (LGW)	445	379	324		737-500 (LGW)			136	
					737-600		180	148	
					737-700 (LGW)	375	320	274	
					737-800 (LGW)	405	353	320	
					737-900ER	458			
					757-200			224	186
					757-200ER			251	191
					757-300		292		
					MD-82			103	78
					MD-83			116	82
					MD-88			115	79
					MD-90			108	

### WIDEBOY LEASE RATES (US\$000s per month)

	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
					747-200B				126
A300B4-600				131	747-400	779		682	
A300B4-600R (HGW)			262	156	767-200				126
A310-300 (IGW)			205	145	767-300			281	203
A330-200E	892	774			767-300ER (LGW)			441	372
A330-300 (IGW)		718	555		767-400		533		
A340-200			544		777-200		617	535	
A340-300 (LGW)		800	655		777-200ER	1,098	954	838	
A340-300ER		838	674		777-300		928	734	
A340-500 (HGW)		1153			787-800	900			
A340-600 (HGW)		1094							
A380-800	1,641				MD-11P			392	

Note: As assessed at end-April 2008. Mid-range values for all types.  
Source: AVAC.

## AIRCRAFT AND ASSET VALUATIONS

Contact Paul Leighton at AVAC (Aircraft Value Analysis Company)

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# Aviation Strategy

## Databases

		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
<b>Air France/ KLM Group</b>	<b>Year 2006/07</b>	<b>30,773</b>	<b>29,129</b>	<b>1,644</b>	<b>1183</b>	<b>5.3%</b>	<b>3.8%</b>	<b>245,066</b>	<b>199,510</b>	<b>81.4%</b>	<b>73,484</b>	<b>103,050</b>
	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	
	Jan-Mar 08	8,543	8,612	-69	-810	-0.8%	-9.5%	62,948	49,060	77.9%	17,154	
	<b>Year 2007/08</b>	<b>34,173</b>	<b>32,182</b>	<b>1,991</b>	<b>1,087</b>	<b>5.8%</b>	<b>3.2%</b>	<b>256,314</b>	<b>207,227</b>	<b>80.8%</b>	<b>74,795</b>	<b>104,659</b>
<b>BA</b>	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
	<b>Year 2006/07</b>	<b>16,149</b>	<b>15,004</b>	<b>1,145</b>	<b>578</b>	<b>7.1%</b>	<b>3.6%</b>	<b>148,321</b>	<b>112,851</b>	<b>76.1%</b>	<b>33,068</b>	<b>43,501</b>
	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
	Oct-Dec 07	4,142	3,774	368	247	8.9%	6.0%	37,122	27,531	74.2%	7,913	
	Jan-Mar 08	4,049	3,824	225	133	5.6%	3.3%	36,745	26,149	71.2%	7,394	
<b>Year 2007/08</b>	<b>17,315</b>	<b>15,584</b>	<b>1,731</b>	<b>1,377</b>	<b>10.0%</b>	<b>8.0%</b>	<b>149,572</b>	<b>113,016</b>	<b>75.6%</b>	<b>33,161</b>	<b>41,745</b>	
<b>Iberia</b>	Apr-Jun 06	1,816	1,753	63	44	3.5%	2.4%	16,809	13,420	79.8%	7,461	24,109
	Jul-Sep 06	1,825	1,700	125	96	6.8%	5.3%	16,846	14,065	83.5%	7,354	22,721
	Oct-Dec 06	1,811	1,750	61	-12	3.4%	-0.7%	16,458	13,132	79.8%	6,682	
	<b>Year 2006</b>	<b>6,545</b>	<b>6,391</b>	<b>154</b>	<b>72</b>	<b>2.4%</b>	<b>1.1%</b>	<b>65,802</b>	<b>52,493</b>	<b>79.8%</b>	<b>27,799</b>	<b>23,901</b>
	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
	Oct-Dec 07	1,963	1,681	279	140	14.2%	7.1%	16,773	13,471	80.3%	6,463	22,168
	<b>Year 2007</b>	<b>7,617</b>	<b>7,049</b>	<b>568</b>	<b>450</b>	<b>7.5%</b>	<b>5.9%</b>	<b>66,454</b>	<b>54,229</b>	<b>81.6%</b>	<b>26,860</b>	<b>22,515</b>
	Jan-Mar 08	1,948	1,990	-42	-661	-2.2%	-33.9%	16,360	12,990	79.4%		21,574
<b>Lufthansa</b>	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	
	Oct-Dec 06	6,316	6,062	254	529	4.0%	8.4%	36,204	27,056	74.7%	13,103	
	<b>Year 2006</b>	<b>24,979</b>	<b>23,913</b>	<b>1,066</b>	<b>1,014</b>	<b>4.3%</b>	<b>4.1%</b>	<b>146,720</b>	<b>110,330</b>	<b>75.2%</b>	<b>53,432</b>	<b>93,541</b>
	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	
	Oct-Dec 07*	8,197	8,103	94	165	1.1%	2.0%	45,845	35,128	76.6%	17,106	
	<b>Year 2007</b>	<b>30,682</b>	<b>28,797</b>	<b>1,885</b>	<b>2,264</b>	<b>6.1%</b>	<b>7.4%</b>	<b>169,108</b>	<b>130,893</b>	<b>77.4%</b>	<b>62,900</b>	<b>100,779</b>
	Jan-Mar 08*	8,368	8,086	282	85	3.4%	1.0%	45,131	34,828	77.2%	15,992	106,307
	<b>SAS</b>	Apr-Jun 06	2,439	2,319	120	75	4.9%	3.1%	14,279	10,551	73.9%	10,436
<b>YE 31/12</b>	Jul-Sep 06	2,476	2,318	158	83	6.4%	3.4%	14,468	11,059	76.4%	10,319	32,772
	Oct-Dec 06	2,215	2,121	94	679	4.2%	30.7%	13,672	9,343	68.3%	9,705	25,534
	<b>Year 2006</b>	<b>5,270</b>	<b>5,010</b>	<b>260</b>	<b>169</b>	<b>4.9%</b>	<b>3.2%</b>	<b>54,907</b>	<b>39,247</b>	<b>71.5%</b>	<b>39,059</b>	<b>31,965</b>
	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
	<b>Year 2007</b>	<b>5,969</b>	<b>5,676</b>	<b>293</b>	<b>259</b>	<b>4.9%</b>	<b>4.3%</b>	<b>57,551</b>	<b>41,048</b>	<b>71.3%</b>	<b>41,087</b>	<b>26,538</b>
	Jan-Mar 08	2,046	2,185	-139	-181	-6.8%	-8.8%	10,669	7,235	67.8%	7,277	25,477
	<b>Ryanair</b>	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
Jan-Mar 07		661	611	48	41	7.3%	6.2%				10,019	
<b>Year 2006/07</b>		<b>2,887</b>	<b>2,278</b>	<b>609</b>	<b>518</b>	<b>21.1%</b>	<b>17.9%</b>	<b>48,924</b>	<b>40,118</b>	<b>82.0%</b>	<b>42,500</b>	
Apr-Jun 07		934	722	212	187	22.7%	20.0%				12,600	
Jul-Sep 07		1,229	795	434	384	35.3%	31.2%				13,952	
Oct-Dec 07		824	760	64	68	7.7%	8.3%					
Jan-Mar 08		859	808	51	-85	6.0%	-9.9%					
<b>Year 2007/08</b>		<b>3,846</b>	<b>3,085</b>	<b>761</b>	<b>554</b>	<b>19.8%</b>	<b>14.4%</b>			<b>82.0%</b>	<b>50,900</b>	
<b>easyJet</b>	Oct 04-Mar 05	1,039	1,116	-77	-41	-7.4%	-3.9%	14,526	12,150	83.8%	13,500	
	<b>Year 2004/05</b>	<b>2,478</b>	<b>2,356</b>	<b>122</b>	<b>109</b>	<b>4.9%</b>	<b>4.4%</b>	<b>32,141</b>	<b>27,448</b>	<b>85.2%</b>	<b>29,600</b>	<b>4,152</b>
	Oct 05-Mar 06	1,095	1,177	-82	-50	-7.5%	-4.6%	16,672	13,642	81.8%	14,900	
	<b>Year 2005/06</b>	<b>2,917</b>	<b>2,705</b>	<b>212</b>	<b>170</b>	<b>7.3%</b>	<b>5.8%</b>	<b>37,088</b>	<b>31,621</b>	<b>84.8%</b>	<b>33,000</b>	<b>4,859</b>
	Oct 06-Mar 07	1,411	1,333	-47	-25	-3.3%	-1.8%	19,108	15,790	81.2%	16,400	
	<b>Year 2006/07</b>	<b>3,679</b>	<b>3,069</b>	<b>610</b>	<b>311</b>	<b>16.6%</b>	<b>8.5%</b>	<b>43,501</b>	<b>36,976</b>	<b>83.7%</b>	<b>37,200</b>	
Oct 07-Mar 08	1,795	1,772	22	-87	1.2%	-4.8%	23,442	19,300	82.3%	18,900		

Note: \*Lufthansa group including SWISS. Annual figures may not add up to sum of interim results due to adjustments and consolidation.

# Aviation Strategy

## Databases

		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.
<b>ANA</b>	Year 2003/04	11,529	11,204	325	234	2.8%	2.0%	87,772	55,807	63.6%	44,800	28,870
<b>YE 31/03</b>	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
	Year 2007/08	13,063	12,322	740	563	5.7%	4.3%	90,936	61,219	67.3%	50,384	
<b>Cathay Pacific</b>	Year 2004	5,024	4,350	674	581	13.4%	11.6%	74,062	57,283	77.3%	13,664	15,054
<b>YE 31/12</b>	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
<b>JAL</b>	Year 2003/04	18,398	19,042	-644	-844	-3.5%	-4.6%	145,900	93,847	64.3%	58,241	21,197
<b>YE 31/03</b>	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	
	Year 2007/08	19,583	18,793	790	148	4.0%	0.8%	134,214	92,173	68.7%	55,273	
<b>Korean Air</b>	Year 2003	5,172	4,911	261	-202	5.0%	-3.9%	59,074	40,507	68.6%	21,811	15,352
<b>YE 31/12</b>	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	
<b>Malaysian</b>	Year 2003/04	3,061	3,012	49	86	1.6%	2.8%	55,692	37,659	67.6%		20,789
<b>YE 31/03</b>	Year 2004/05	3,141	3,555	-414	-421	-13.2%	-13.4%	64,115	44,226	69.0%		22,513
	2005	2,428	2,760	-332	-331	-13.7%	-13.6%	49,786	35,597	71.5%		22,835
<b>Apr-Dec 05</b>	2006	3,696	3,751	-55	-37	-1.5%	-1.0%	58,924	41,129	69.8%	15,466	19,596
<b>YE 31/12</b>	2007	4,464	4,208	256	248	5.7%	5.6%	56,104	40,096	71.5%	13,962	
<b>Qantas</b>	Year 2003/04	7,838	7,079	759	448	9.7%	5.7%	104,200	81,276	78.0%	30,076	33,862
<b>YE 30/06</b>	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
	Jul-Dec 07	7,061	6,323	738	537	10.5%	7.6%	63,627	52,261	82.1%	19,783	33,342
<b>Singapore</b>	Year 2003/04	5,732	5,332	400	525	7.0%	9.2%	88,253	64,685	73.3%	13,278	14,010
<b>YE 31/03</b>	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
	Year 2007/08	10,831	9,390	1,441	1,449	13.3%	13.4%	113,919	91,485	80.3%	19,120	14,071
<b>Air China</b>	Year 2004	4,050	3,508	542	288	13.4%	7.1%	64,894	46,644	71.9%	24,500	29,133
<b>YE 31/12</b>	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
	Year 2007	6,770	6,264	506	558	7.5%	8.2%	85,257	66,986	78.6%	34,830	
<b>China Southern</b>	Year 2004	2,897	2,787	110	19	3.8%	0.7%	53,769	37,196	69.2%	28,210	18,221
<b>YE 31/12</b>	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	45,575
	Year 2007	7,188	6,974	214	272	3.0%	3.8%	109,733	81,172	74.0%	56,910	
<b>China Eastern</b>	Year 2004	2,584	2,524	60	39	2.3%	1.5%	41,599	27,581	66.3%	17,710	20,817
<b>YE 31/12</b>	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
	Year 2007	5,608	5,603	5	32	0.1%	0.6%	77,713	57,180	73.6%	39,160	
<b>Air Asia</b>	Year 2004/05	152	122	30	25	19.7%	16.4%	6,525	4,881	74.8%	4,410	2,016
<b>YE 30/06</b>	Year 2005/06	230	172	57	34	25.0%	14.8%	8,646	6,702	77.5%	5,720	2,224
	Year 2006/07	453	325	128	141	28.3%	31.1%	12,391	9,863	79.6%	8,738	2,924
	Jul-Sep 07	134	91	42	52	31.6%	39.0%	3,645	2,707	74.3%	2,440	
	Oct-Dec 07	189	122	67	73	35.4%	38.9%	4,274	3,223	75.4%	2,758	
	Jan-Mar 08											

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

# Aviation Strategy

## Databases

### 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
Mar-08	28.4	19.4	68.5	18.6	15.3	82.3	16.2	13.3	82.0	52.2	42.5	81.4	78.2	60.6	77.5
Ann. change	2.0%	4.2%	1.4	1.4%	1.8%	0.3	2.0%	-0.3%	-1.9	3.9%	2.1%	-1.4	4.4%	3.7%	-0.5
Jan-Mar 08	81.5	51.7	63.4	53.4	40.4	75.7	47.1	38.1	80.8	151.8	119.7	78.8	226.3	167.5	74.0
Ann. change	4.3%	5.1%	0.5	3.9%	2.9%	-0.7	3.0%	1.3%	-1.3	5.4%	3.0%	-1.8	6.0%	4.4%	-1.1

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 %
2005	225.1	172.2	77.8	41.9	33.2	82.1	27.4	22.3	82.7	24.2	17.2	72.7	93.5	72.7	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
Q3	229.9	191.8	83.4	59.6	49.9	83.8	28.9	24.7	85.2	26.2	21.1	80.8	114.7	95.7	83.4
Q4															
2007															

Note: Legacy airlines plus Alaska and Southwest.

### JET ORDERS

	Date	Buyer	Order	Delivery	Other information/engines
Boeing	12 May	EI Al	4 x 777-200ERs		Plus two options Can be exchanged for 777-300ER model
	8 May	Asiana Airlines	2 x 777-200ERs		
Airbus	29 May	KD Avia	25 x A319s		
	28 May	Gulf Air	15 x A320s, 20 x A330-300s		
	27 May	British Airways	2 x A318s		

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

Source: Manufacturers



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