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Lufthansa's bmi buyout: what does it add?

At the Lufthansa Q3 results meeting the management appeared to mention as an aside (and as if it were no surprise) that Michael Bishop had exercised his put option to them for his majority shareholding in British Midland - the second largest operator at London's Heathrow - only a few months before they would have had to decide whether to exercise their own call option. The exercise price of €400m, albeit slightly less than the value of the company's Heathrow slots that bmi capitalised this year for the first time, at least gives Sir Michael a reasonable pension fund. It is also recompense for his developing a serious competitor to British Airways at its own hub. It also creates a benchmark for SAS's remaining 20% stake in bmi - and SAS has indicated its wish to divest for some time. However, as bmi is a private company, there should be no legal pressure for Lufthansa to have to make a bid for the rest of the company (even though the management stated they were in discussions with the UK Takeover Panel on the subject) and with a firm majority stake they may see no absolute need to spend more of their valuable cash than need be. The management admitted that they like Heathrow - "we make money on those routes" - but must be in a bit of a dither as to what to do with the legacy they have acquired. Depending on regulatory approval (Michael O'Leary may complain, but Brussels is unlikely to) the deal should be finalised by January 2009.

What it does provide is an extra 11% of the scarce Heathrow slots. They should be able to add that to their existing 4% slot holding, and SAS's 3% and United's 2% (both partners) to generate a brand position for the Star alliance at Europe's prime transatlantic gateway similar to that enjoyed by American at United's stronghold in Chicago, and may undermine British Airways' hub at the constrained airport.

The difference is , however, that this is a numerical agglomeration of slots rather than an integrated hub/spoke system. They are probably considering trying to bring on board the virtually non-aligned Virgin Atlantic (with its 3.5% share of the slots) - reputed to have had various discussions for co-operation with British Midland in the past - which will be facing significantly increased competitive pressures once the BA/AA/IB ATI and joint venture are given the green light next year. With hope seemingly receding that there will be a third runway at LHR - at least within a reasonable time frame - this would also help to make sure that Lufthansa's long-time trans-Maginot line rivals at Air France are kept out of the prize airport in Europe in any serious way; although more capacity would become available when dual usage is finally allowed (which will have to happen with or without a third runway), developing a similar 20% share

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of the slots will be exceedingly difficult.

In any case the Star alliance is due to move to single terminal operations in Heathrow - albeit an area due for substantial construction upheaval as BAA develops Heathrow East out of the ashes of Terminals 1 and 2 over the next five years in time to miss the London Olympics (while SkyTeam will be moving into the almost inaccessible Terminal 4). They will also acquire a questionable regional business, a loss-making European operation (and having covered many of those losses in the ECA in recent years they should be well aware of the problems). It also gives them a low cost wannabe in bmibaby, which may make little sense in the Lufthansa portfolio. Having said all that, there should be substantial upside from full integration of British Midland within the Lufthansa portfolio of hubs and networks - its own Frankfurt and Munich, Swiss's Zurich, SN Brussel's Zaventem and - who knows - maybe Vienna or Milan. This time, however, the management may have its work cut out to develop a real restructuring programme for bmi to avoid damaging losses in this cyclical downturn.

Also intriguing is (almost a footnote to the quarterly accounts) the announcement that Lufthansa will buy out the majority 50.9% of Eurowings - which runs the (slightly) lower cost regional output and the low fares operator germanwings - with effect from the end of December. This signals a complete breakdown in the hoped-for deal to merge Eurowings/germanwings with TUIFly, designed to provide some rational consolidation of the domestic German market. Lufthansa also has the option to pass this stake onto someone else - if the airline can find another buyer in the current environment.

Curate’s egg of results

Meanwhile, the results the company announced at the same time were a bit of a curate's egg. The headline figures were not that bad all things considered, but for cultural reasons Lufthansa does insist on publishing cumulative numbers through the year, hiding as best it can the individual quarterly performance. Nevertheless, for the three months to end September group revenues were up by just under 4% year-on-year and 14% for the nine months (this quarter is the first to show a relatively real like-for-like comparison, SWISS having been fully consolidated from July 2007). Operating profits reflecting the extraordinary increase in fuel costs in the period fell by 62% (if you include all the usual “unusual” items) to €222m, or by 52% (if you don't) to €279m. The total fuel bill jumped by 48% to €1.65bn in the period (and would have climbed by 78% to nearly €2bn were it not for the Euro strength and the hedging programme). The principal decline was felt in the passenger division where operating profits fell by 76% to €112m following a 7% increase in capacity, a 5% growth in demand and a slight decline in unit revenues (mostly because of Euro strength). This was partly impacted by the strikes it suffered in the quarter (which probably cost it some €100m in foregone profitability) and the knock-on effects for the network from maintenance disruption.

The Logistics division (aka Cargo) did somewhat better - it has been somewhat easier to get fuel surcharges to stick - with a 10% growth in revenues and a 28% jump in operating profits to €46m for the quarter. Maintenance also didn't do that badly given the strength of the Euro in the period with a modest 1.5% decline in revenues and only a 5% fall in operating profits to €69m. The catering operations also saw an earnings decline in the period - again not helped by the Euro strength and also the increase in food and commodity prices - while the IT Services division actually saw profits more than double from an almost insignificant €11m, mainly because of the absence of a prior year impairment charge. For the nine months, helped by the consolidation of the first half, operating profits fell by only 9% to a little short of €1bn on revenues up by 14% to €18.5bn.

Given the current economic environment all these numbers may be somewhat irrelevant. Having been a little reticent earlier in the year, the group has finally decided that it is unrealistic to expect that it would be able to reach its target of matching last year's record profits. It has at last adjusted its capacity plans: it is now looking for a modest cut in winter 2008/09 capacity (down from an earlier plan for a 2.5% growth) and planning virtually flat 1% growth in capacity for 2009 (except for Air Dolomiti's establishing a handful of aircraft at Malpensa). These cuts may not go far enough, and although it is always difficult for an airline to shrink, LH may find it necessary to trim next year's capacity further. However, like Air France, it does have a well balanced portfolio of routes and should be able to switch capacity to those areas that still display some strength. Moreover, it has over the past few years put in place a substantially higher level of operational flexibility than it has ever had - with almost unique union contracts negotiated, with the anticipation of the risks of a downturn, to include the possibility of furloughs and short-term working.

The group, however - at least for the moment - will not be changing its capital spending plans. It has 53 aircraft due for delivery next year (including the first two of the long-awaited A380s, and it would hardly be politically acceptable to cancel those, would it?) - but the management did state that it will use these now purely for replacement and effectively accelerate the disposal of older, less fuel-efficient tin cans.

As with its great rival Air France, Lufthansa's balance sheet appears strong. At the end of September it had some €3.3bn in cash in hand against debt of €3.4bn, pension provisions of €2.3bn and equity of €7bn (if you are willing to credit intangibles of €1bn). This cash balance is well into the management's comfort zone of wishing to maintain a minimum liquidity of €2bn in ready money - and supplemented by credit lines (with some 50 separate banks) of a further €2bn.

At the results presentation it was a little surprising to find that the erstwhile strong fuel hedging position had unwound a little - all because of the collapse of Lehman Brothers - although LH could credit the P&L with some €70m from the default of its counter-party. It appears from the material presented that the failed New York investment bank had been the other side of the hedge for 8% of the Lufthansa group fuel uplift requirements for 2008 and 2009. As a result the group is only 72% hedged for the

LUFTHANSA GROUP 2008 QUARTERLY RESULTS

€m	Q1	%ch	Q2	%ch	Q3	%ch	9 mos	%ch
Revenues	5,587	19%	6,469	20%	6,540	4%	18,596	14%
Fuel costs	1,202	60%	1,638	85%	1,870	67%	4,710	71%
Hedging gains	-131		-255		-219		-605	
Net fuel bill	1,071	42%	1,383	56%	1,651	48%	4,105	49%
Operating results								
Passenger division	38	nm	311	-3%	112	-76%	461	-38%
Logistics	46	667%	68	196%	46	28%	160	146%
MRO	71	18%	87	36%	69	-5%	227	15%
Catering	5	400%	26	-13%	25	-52%	56	-33%
IT Services	11	175%	7	-30%	11	nm	29	nm
Group operating profits	**188**	**422%**	**517**	**15%**	**279**	**-53%**	**984**	**-9%**

rest of the year (which in one sense may be a blessing in disguise) and 57% for 2009 - well below its normal corporate targets. As a result it looks as if Lufthansa's effective fuel hedge collar has widened significantly to \$55-\$103/bbl equivalent (between which the group gains no benefit against spot prices, below or above which it suffers or benefits respectively). At current contango forward rates it looks as if the group's fuel bill (excluding bmi, or any other new acquisition) would increase by a further 5% next year to some €5.6bn (up from €3.4bn in 2006).

This downturn presents difficulties for many but opportunities for the few to accelerate consolidation among the legacy network carriers in Europe. The British Airways/Iberia merger will no doubt eventually go ahead; Lufthansa, BA and Air France are all skirting around the new improved Alitalia - which through the effective merger with AirOne provides some consolidation of the Italian market; Lufthansa appears the only contender for long-time partner Austrian (and its symbolic €1 bid for the government's shares, less the debt, may even be accepted); Lufthansa has recently taken a 45% in Brussels Airlines, with an option for the remainder, giving it some greater access particularly into francophone markets; and now it finally gets bmi giving it a base at Heathrow. With luck the group should be able to manage all this without getting indigestion.

Air France/KLM: Thinking about competitiveness through the cycle

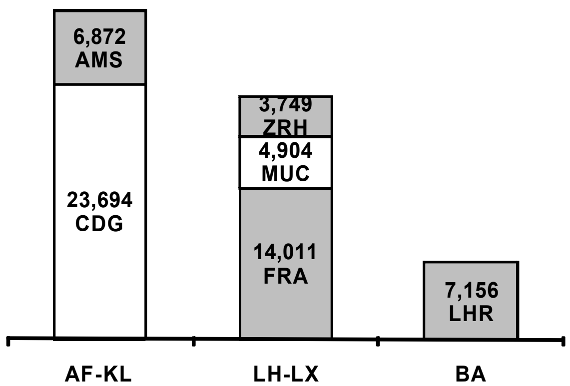
Back in 1993 the state-owned Air France had just suffered a crippling strike, was losing out to start-ups and the TGV in the domestic market, had a very poor perceived product quality, a balance sheet in tatters and was heading for annual losses of some FRF7.5bn. It seemed very ill-prepared for the full force of European deregulation and was viewed as the basket-case of the industry. In short, its very survival appeared in doubt.

Fifteen years on and how things have changed. The Air France/KLM group is now by some measures the largest airline grouping in Europe, firmly in a pole position among the three network legacy carriers. It has been at the forefront of industry consolidation, is profitable and - as we enter this current downturn - has a healthy balance sheet. Notwithstanding the current financial crisis, weakening economic environment, damaged consumer confidence and slowing air traffic demand, the group held its annual investor day in Paris in October: the last such meeting to be chaired as CEO by Jean-Cyril Spinetta, the prime architect of this remarkable turnaround.

Naturally these events are used to present and reiterate some of the group's strategic thinking; and since it holds its investor day during a closed period (the September quarter results are due for publication later in November), few meaningful details can be disclosed about current profitability. The presentation from deputy CEO (and CEO designate) Pierre-Henri Gourgeon indeed continued in much the same vein as since privatisation nearly a decade ago; the numbers just get bigger and more impressive. There were nevertheless some important messages to be gleaned. The Air France/KLM management has obviously been thinking for some time of the group's competitive positioning through this next cycle; it has concentrated on increasing flexibility in its medium-term planning; it is willing to react decisively and proactively in changing market conditions; and it has built a prudent and risk-aware financial strategy.

Air France/KLM has some pre-eminent competitive advantages. It has the largest international network of the three major European network carriers. The combined group operates to 114 long haul destinations, some 63% of the long haul points served by the AEA carriers, compared with BA serving 71 and Lufthansa (plus SWISS) operating to 85. Of these routes 42 (or 37%) are not served by the other two network majors - what the AF management refers to as "unique" routes - whereas both BA and LH/LX enjoy a greater overlap on the same measure - only 25% and 13% of their respective route portfolios offer "unique" destinations. Second, the twin hub system of Roissy CDG and Schiphol - each with their multiple parallel runways - provide the capacity to allow the group to run effective multi-wave network systems at their base airports, with little in the way of the capacity constraints and slot scarcity suffered by BA at Heathrow or LH at Frankfurt. This provides them with by far the largest number of connection opportunities through their hubs (short-haul to long-haul) of any of the network carriers. This last summer AF could market some 24,000 weekly transfer con-

HUB CONNECTIONS SUMMER 2008

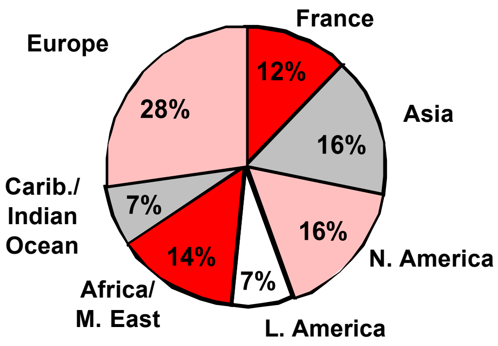


nections through CDG compared with 14,000 for Lufthansa at FRA and 7,000 for BA at LHR. On a group wide basis, KLM added some 6,900 to provide a total approaching 31,000, far outstripping provision by LH and LX at FRA, MUC and ZRH of 21,000 and dwarfing BA's offering (see chart, left). The mere potential is not enough of course, but CDG is the only other airport destination after Heathrow that provides a good level of point-to-point demand to underpin a successful hub operation. This competitive position has been producing rewards - helped to no small extent by increased marketing of multi-hub routings - in that premium connecting traffic revenues grew by some 4% in the first half of this year, more than twice the rate of growth in point-to-point revenues.

Third, the group has a relatively well-balanced network in terms of markets, traffic and revenues. Admittedly 12% of revenues arise from the domestic French operations (see chart, right) and a further 27% from intra-European routes (with 20% being point-to-point and subject to LCC incursion) but Asia and North America each account for 16% of revenues while the Middle East and Africa (with great help from francophone Africa since the demise of the Swissair empire) account for 14%.The Caribbean and Indian Ocean (albeit mostly leisure routes, these provide strong unique benefits, specifically the DomTom routes for AF and the Dutch Antilles for KLM) and Latin America supply a modest 7% each.

The fourth major benefit it sees is the (currently) unique four-way joint venture on the Atlantic between AF, Delta, Northwest and KLM. With Delta and Northwest likely to finalise their merger before the year end, the four have received full anti-trust immunity and originally planned to introduce a full cost, revenue, capacity and margin-sharing joint venture on the Atlantic in April 2010. This target they have now brought forward and aim to introduce the joint venture in time for the 2009 summer season. This will generate a business pooling of all the respective carriers' transatlantic operations (and some beyond routes) significantly widening the scope of the successful and long-standing

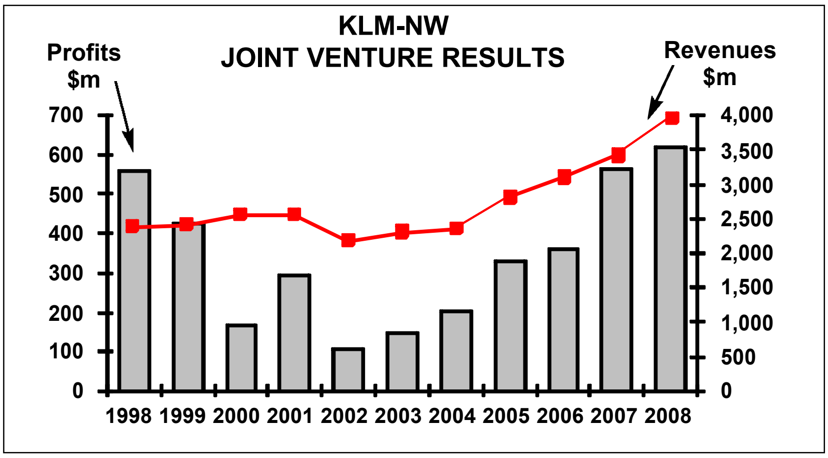
AF-KL REVENUE DISTRIBUTION



KLM-Northwest joint venture to generate a business area with annual revenues of over $25bn. This will give them a pre-eminent market presence on one half of the Atlantic market - the bit that bypasses Heathrow - while they may no doubt be suffering a feeling of envy (or should it be schadenfreude) at Lufthansa's success at gaining entry to Europe's main transatlantic gateway.

The KLM Joint Venture

One of the more interesting presentations at the meeting was one from Leo van Wijk, former CEO of KLM, on the subject of joint ventures. KLM was the pioneer. Having taken a stake in Northwest in 1992 (and later forced to divest - at a profit though, which is unusual for an airline's investment in a US carrier) it created a transatlantic joint venture with the Minneapolis-based carrier in 1997. It has naturally gone through various changes over time as they have ironed out the best ways of managing the structure, and has evolved into an almost irreversible linkage - the initial 10 year agreement was extended last year. Following the Delta/Northwest merger it will no doubt form the basis of the new AF-DL-KL-NW joint operation. The deal is effectively a margin-sharing agreement, with a pooling of capacity, joint pricing (thanks to ATI) and joint revenue management system. In one sense this type of JV on the Atlantic is a surrogate for that full merger forbidden by the ownership restrictions implicit under the Chicago Convention - and almost goes as far as a full



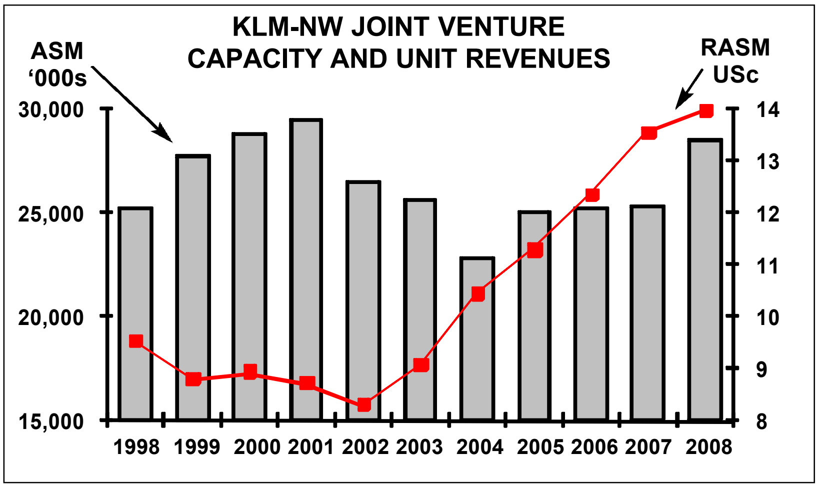
merger would go to create the operational and capital advantages that would otherwise be available. The JV is based on the assumption that both carriers have fully aligned their interests so that neither worried nor cared which operated what route - save that naturally there is a clause in union negotiations to specify that there is a "fair" distribution of flying between the two. Given that both carriers operate from equally weak intercontinental hubs the benefits have been enormous. With a fully co-ordinated flying schedule, the JV created an exponential expansion in city pairs that they can (jointly) market through their respective hubs far beyond the conventional codeshare agreement, giving many more markets and frequencies and improved asset utilisation.

Each has been able to cut out the waste of resources in the other's home market - cutting out the individual sales organisations (always expensive at the other end of a route) and using the most efficient handling operations at delegated hubs and spokes per continent. Equally they have been able to achieve an efficient use of capacity for marginal network expansion: using a NW 757 for a route from Hartfield, CT to Amsterdam (a route KLM would never be able to operate on its own) or utilising NW's route rights to India, via Amsterdam, (which also NW would never have been to operate profitably on its own) to provide KLM access to the sub-continent where it was restricted by the bilateral.

The returns appear to have been very strong: in the eleven years of joint operations (albeit with the downturn post September 11 and SARS providing a disruption) joint capacity has grown by 13%, revenues by 65% to $4bn and operating margins are exceedingly strong. Apparently Air France management was somewhat surprised to find, after the merger with KLM, that unit revenues being achieved by the JV on the Atlantic were several points higher than its own (and CDG with its natural O&D demand should be a far less revenue-dilutive hub operation than AMS) and the margins were impressively better (although in the past two years no doubt helped by the post Chapter 11 restructuring at NW): for the year ended March 2008 they appear to have achieved returns of $620m (a 16% margin) on $4bn of revenues. The group's hope is no doubt that these returns will be achievable on the expanded agreement including Delta and Air France.

Strong finances

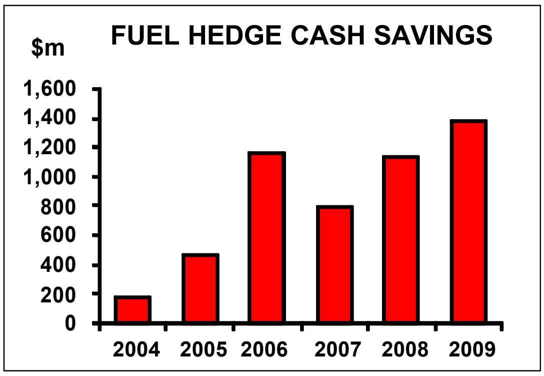
On the finance side meanwhile, the group is in one the best positions it has ever been in during the approach to a cyclical downturn. This is partly due to what appears to be an excellent management of risk; throughout the increase in fuel prices in the past few years the group has operated one of the best fuel hedging strategies on this side of the Atlantic. Since 2003 it has achieved cash savings through its hedging programme of some $5bn from what it would have paid at spot prices - including a possi-



ble cash saving in this current year alone of $1.4bn. After the recent slump in the crude price of oil it still has reasonably effective hedges in place with a near 70% cover for FY2010 at an average $78/bbl equivalent, which would still provide it with cash savings at current forward rates of some €100m - and it will no doubt continue to build its cover at advantageous rates. Of course the hedging advantage will unwind and the group's total fuel bill is still likely to continue to rise into a period where it may be increasingly difficult to get the passenger to pay - but these savings have significantly bolstered the balance sheet. It is certainly a sign of the times that the CFO felt it necessary to include a slide in his presentation showing details of how the group manages counterparty risk - through a "Proactive Risk Management Committee" - with strict group-wide limits on exposure to individual counterparties and daily monitoring of exposure. It is fortunate that, unlike Lufthansa, it had no exposure to Lehmans.

The balance sheet is in good health. Capital spending has been restrained in the past few years - ironically helped in part by the delays in the A380 delivery programme - while cash flow has remained strong. Net debt has fallen from €3.8bn at the end of March 2007 to €2.17bn at the end of June 2008 (representing a modest 24% of shareholders' funds down from 48% two years ago). The group currently has cash balance of €5.15bn (having drawn down €500m from a revolving credit facility in October as a "precautionary measure") and has a further €2bn available credit lines carefully spread through a plethora of banks. It is comfortable in maintaining (and exceeding) a cash/liquidity objective of 10-15% of revenues. Debt repayments over the next few years meanwhile are well spread with no real peaks: averaging €670m-700m a year. At the same time the underlying group debt is conservatively financed: of the €7.6bn total long term debt, 80% is secured on aircraft assets and 75% on fixed or swapped rates - and the advantage of secured debt is that it is still (just about) available and at reasonable rates.

Air France/KLM has one additional major



competitive advantage - hardly really noticed by the markets or regulators - in that it has no pension funding problems (at least at the moment). For Air France, its French employees are all fully covered by the French national scheme; whereas at KLM its employees' pension funds are still (possibly even after the recent market slump) in surplus - and this is also after the group was able to recognise the negative goodwill that these funds provided on the acquisition of KLM in 2004.

The changing operating environment

Earlier in the year AF/KLM was one of the first to adjust medium-term capacity plans to the changing environment. At the time of course the main threat was seen to come from the significant strength in the fuel price - which generated the requirement to raise prices and unit revenues to such an extent that it could destabilise demand. Since then events have changed and with the intensification of the financial crisis the world's economies are palpably weakening towards a full-blown recession and business and consumer demand appears to be evaporating. The winter season for northern hemisphere carriers is naturally the weakest and the group has taken further snips out of its capacity plans - even after the start of the season. Originally targeting a 4% growth this season, AF/KLM has cut this to a 1.7% increase in seat kilometres - including a 1.5% reduction in short-medium haul operations and on routes to the Middle East. It has halved its plans for routes to North America

(now +4.6%), Latin America (+2.8%) and Asia (+3%) while switching more capacity onto its routes in Africa. In reducing its capacity in the medium term it is helped by its relatively conservative fleet financing strategy - maintaining a third of its fleet on operating lease gives it the option to return equipment to lessors on a rolling basis. The group's current plans see a 17% increase in the number of seats on long haul operations and a 6% growth on short haul by summer 2013. In a worst case scenario, the group could cut capacity by 12% and 17% respectively over the same period.

At the same time AF/KLM is in the process of reviewing its capital spending programme - helped in part by the delays in the A380 deliveries, but also apparently in negotiation with the manufacturers to delay or postpone some deliveries. The company presented its initial review projecting capex of €1.2bn and €1.6bn in FY09 and FY10 respectively down from €1.4bn and €2.1bn. In the absence of Armageddon these should still sit comfortably within cash flow generation. As this action will defer the spend into following years, it looks as if there would still be a jump in capex in FY11 to €2.1bn.

Meanwhile the group has one final, additional advantage - the extraction of further synergies from the 2004 merger with KLM. Initially it appeared that most of the benefits of the acquisition were merely coming from incremental revenue gains - but then, cynics would say, in a sense revenue gains are simpler to achieve when you cut out a competitor. Last year the group introduced a "Challenge 10" cost reduction programme to target an additional €1.6bn of profit enhancement by March 2010; of this they had targeted a run rate of €430m by the end of the current financial year. It recently expanded its expectation for the current year savings to €620m (some 20% of which comes from early retirement of older equipment) - and in light of the current economic environment, the management announced that it has started to develop a "Challenge 12" programme to prolong and deepen the integration of the two companies. The initial idea seems to be to try to double the savings and generate an additional €1.2bn of operating synergies by 2014.

Although the management was unable to comment too much on current profitability, it did accept that it was unlikely to reach earlier targets for €1bn in operating profits this year - which the markets interpreted as a profits warning. Given the dire economic background there will no doubt be great difficulty in achieving reasonable levels of returns for some time. In the interim, Air France/KLM, with the levels of operational flexibility it has introduced and with the strength of its balance sheet, appears far better placed to survive and emerge far stronger from this downturn than many competitors.

By James Halstead

easyJet - the best placed LCC to weather the downturn?

EasyJet has just reported operating profit of £91m and net profit of £83m for the year ending September 30, and although these figures are 47% and 45% down respectively on 2006/07, the results confirm that Europe's second-largest LCC is weathering the recession relatively well.

After two profit warnings earlier this year, for the 2007/08 financial year easyJet recorded a 32% rise in revenue (compared with 2006/07) to £2.4bn, of which £2bn came from passenger revenue (up 22.7%) and £367m was ancillary revenue (including checked-in baggage), which more than doubled. Total revenue per seat rose 12.6% in 2007/08 to £45.51, while passengers carried rose 17.3% to 43.7m. Load factor improved by 0.4 percentage points during the 12 month period, to 84.1%

These figures are a major achievement given the macro background and the fact that fuel costs have obviously killed easyJet's ambition of 12 months ago to increase profits by 20% this financial year. While Ryanair is struggling though the current tough period (see *Aviation Strategy*, July/August 2008), easyJet appears to be benefiting relatively from the key strategic differences between the two LCCs (such as easyJet's focus on primary airports; its targeting of both business and leisure passengers; and its more positive attitude to travel agents).

Short-term focus

In the short-term though, easyJet's relative financial strength is being underpinned by a further culling of costs, what it calls a "tactical reduction" in overall growth (while continuing to expand in core markets) and improvements to ancillary revenue wherever possible.

easyJet's cost per seat (excluding fuel) fell by 7.5% in 2006/07 compared with 2004/05 (see table, page 10), and earlier this year the airline announced a new cost saving programme aimed at mitigating the current increase in fuel costs, with a target of a £90m reduction in annual costs over the next three years.

Fleet rationalisation is an important part of this programme, and the airline wants to cut £40m from annual costs by 2011 by increasing the pace of 737-700 withdrawal, selling a number of older A319s and disposing of seven A321s acquired as a result of the GB Airways acquisition in January.

The remaining 28 737-700s will be phased out earlier than planned, and with further disposals over the next three years this means that the fleet will increase from the current total of 154 (see table, page 11) to approximately 200 by September 2011, despite around 80 deliveries in this period. In 2011 the fleet will consist of 175 A319s and 25 A320s.

This summer easyJet switched 25 of its existing orders for A319s into larger A320s (its first such order for the model), reducing its outstanding orders for A319s to 80 (with options for another 88 aircraft). The A320s will be used on the longer range routes operated by GB Airways such as to the Canary Islands and Sharm el-Sheikh, and the larger capacity will reduce unit costs on these routes. But this also hints at the long-term problem that easyJet (and Ryanair) faces - finding enough short-haul routes in Europe that are profitable, on which to place all its aircraft that are on order. Of course both airlines insist there is a substantial number of routes in Europe that they have yet to enter, but almost inevitably the search for profitable routes will encourage both airlines to look at longer sectors, even if that reduces the number of daily rotations.

Fleet rationalisation comes on top of the efficiencies that the current fleet already provides. Its average age is just over 3.5 years, and average utilisation per aircraft is

EASYJET'S COST AND REVENUE BREAKDOWN

£ per seat	04/05	05/06	06/07	07/08
Maintenance	3.44	2.82	2.21	2.84
Ownership	3.56	3.84	2.40	2.67
Navigation	3.13	3.12	3.19	3.77
Overheads	4.26	4.11	3.77	3.40
Crew	3.92	4.12	4.59	5.07
Airports/handling	10.39	10.35	10.39	11.74
Costs per seat ex. Fuel	**28.70**	**28.36**	**26.55**	**29.49**
Fuel	7.50	9.98	9.57	13.65
Total costs per seat	**36.20**	**38.34**	**36.12**	**43.14**
Pax revenue	36.15	38.28	36.57	38.44
Ancillary revenue	2.51	3.38	3.85	7.07
Total revenue per seat	**38.66**	**41.66**	**40.42**	**45.51**

just under 12 hours per day (although this reduces to nine hours per day in the current winter season), based on turnaround times of 30 minutes.

The integration of GB Airways into easyJet in March should also deliver £20m of cost savings per year, while in other areas some £20m in annual cost savings will come from better fuel consumption through improved route planning and reducing takeoff weights (including the reduction of the amount of onboard drinking water).

Around £30m will be saved from improved crew productivity and rostering, while in September easyJet announced that it was cutting up to 10% of all its positions (655 in total) at its head office in Luton airport. Salaries of senior management have also been frozen. easyJet's current workforce stands at around 6,600 (including 1,700 pilots and 4,000 cabin crew); as can be seen in the graph, page 12, after stalling over the period 2005-07, productivity improved again in 2007/08.

But it's not all good news on the cost front. easyJet says costs (excluding fuel) in the second half of the FY were "been under pressure from increased airport charges, not least at Gatwick". The UK CAA is allowing BAA to increase charges at Gatwick by more than 20% in 2008 and by 31% plus the RPI by 2013, and this infuriates easyJet given that no major infrastructure improvements are planned at the airport. In May easyJet applied for a judicial review on what it describes as "an obscene increase in passenger fees", which has now been approved by the UK High Court.

easyJet's view on the impending sale of Gatwick by BAA is that this in itself will not necessarily be beneficial, as the airport is still a "local monopoly", and so what it wants is effective regulation at Gatwick (and other UK airports).

In general, easyJet appears to be becoming more aggressive in its ongoing battle to keep costs down at the primary airports it operates into, and it is edging closer to Ryanair's more combative stance. For example, the 88% rise in charges at Stansted from April 2007 (to £12.57 per passenger) has led directly to easyJet withdrawing capacity from the airport. And in August easyJet complained to the Dutch competition authority about the increase in charges at Amsterdam Schiphol, which the airline claims now make it the most expensive airport in Europe.

And, of course, keeping all other costs down will only partly offset the rising costs of fuel that easyJet has experienced in most of the 2007/08 FY. Every $10 increase per tonne of oil is estimated to hit easyJet's bottom line by £2.5m over a year, and although easyJet has offset around half the cost of the fuel price rise in 2007/08 (the airline's fuel costs rose by £283m in the FY) through various measures such as cost savings and better revenue performance, the airline still took a hefty hit to the bottom line thanks to fuel. As of mid-November, 66% of easyJet's fuel needs for the 2008/09 financial year had been hedged at £1,146 per tonne, while 66% of anticipated 2008/09 US$ requirements had been hedged at $1.96/£.

And despite all this cost-saving effort, it should be realised that easyJet's costs on a per ASK basis are approximately 60-70% higher than those of Ryanair - half of which easyJet attributes solely to its tactic of operating into mostly primary airports. But this is an inherent part of easyJet's strategy, and the higher costs are acceptable to easyJet given the benefits these primary airports give in attracting business passengers, which provide stronger yields.

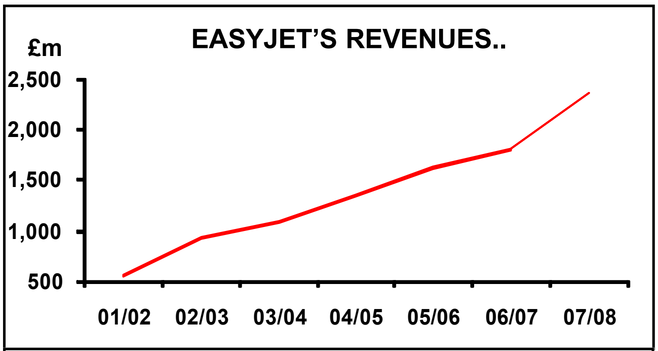
Network focus

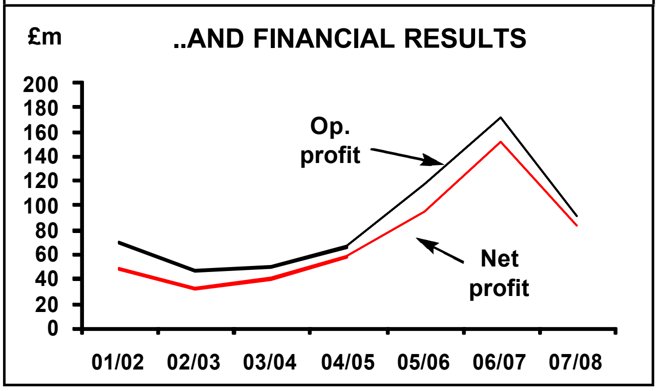
While Ryanair has criticised easyJet's focus on primary rather than secondary airports, this strategy may be more recession-proof, with underlying demand to/from these primary airports holding up better than to some of the more exotic secondary airports that Ryanair operates to. Indeed, in the short-term margin protection on the key "business routes" appears to be more of a priority for easyJet than revenue expansion over the winter season. This winter easyJet is broadly keeping capacity flat year-on-year, but within this there is a substantial shift of services and routes to more profitable winter sectors, such as France, Italy and routes to/from Gatwick.

Over the winter season growth will focus on Paris CDG (with capacity up 28%), Milan Malpensa (+91%) and Madrid (+17%). Overall, mainland Europe will see capacity rise by 19% over the winter season. In the UK, while capacity to/from Gatwick will increase by 19% in the winter, in Stansted it is falling by 23% and in the rest of the UK it will reduce by 14%.

But this is not just a trend for this winter, but rather part of a longer-term strategy to lessen dependence on the UK market in favour of continental Europe. While easyJet operates approximately 400 routes to more than 100 airports in 26 countries, just under 50% of its passengers originate outside of the UK, and approximately one-third of all passengers "do not touch the UK", according to easyJet. easyJet is keen to build on its estimated market share of 2% on mainland Europe, and in the third quarter of the 2007/08 FY, for example, while passengers carried rose 16% to 11.5m, UK originating passengers increased by 9% and non-UK originating passengers by 25%.

According to Andy Harrison, easyJet's chief executive: "European short-haul is fundamentally a growth industry, albeit with occasional short-term corrections." And this growth comes not just from increasing numbers of people flying cheap short-haul routes for the first time, but - crucially - also from easyJet stealing demand from passengers that previously flew with Europe's legacy airlines.

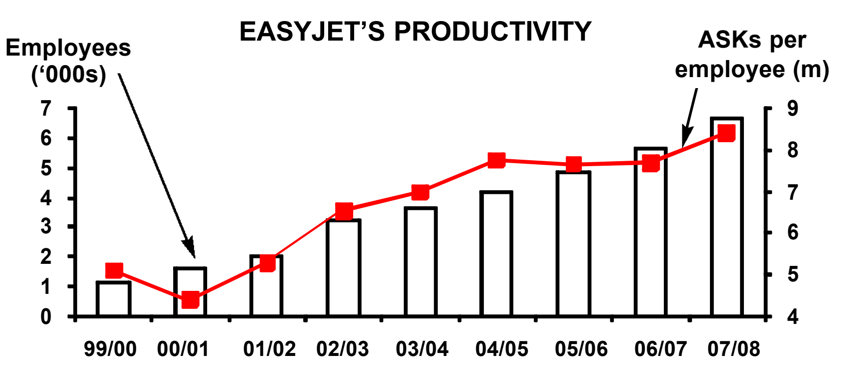




easyJet calculates that the top 50 airports in Europe account for 88% of all intra-European capacity, and that the airline operates to/from 37 of these 50 airports (the largest airports that easyJet does not operate to are - unsurprisingly - Heathrow and Frankfurt). easyJet is steadily increasing frequency on key European routes, with emphasis on more departures in peak times for business travellers. It now claims to be Europe's leading airline in terms of presence on the busiest 100 routes, being present on 38 of these (compared with 29 for BA, 26 for Air France/KLM and 26 for Ryanair). Crucially, 36 of these 38 routes connect primary airports, whereas easyJet claims only eight out of 26 Ryanair routes

EASYJET'S FLEET

	Fleet	On order	Options
A319	110	80	88
A320	9	25	
A321	7		
737-700	28		
Total	**154**	**105**	**88**



connect two primary airports. This shift to European routes can be seen in easyJet's sector length (see graph, right), which in 2007/08 compared with 2006/07 jumped from 978km to 1,073km (up 10%).

The largest growth in passenger numbers recently has been in Italy, Spain and France, and in terms of passengers carried easyJet is already the leading airline at Gatwick, Luton, Milan and Geneva, and the second largest at Paris.

In France, so far this year easyJet has opened bases at Paris CDG and Lyon; nine aircraft will be based in the former by the end of 2008, operating 20 routes, while in April Lyon became easyJet's 20th base. Lyon is the third largest city in France and easyJet is investing hundreds of millions of pounds over the next few years as the basis of a major push into the French market. In 2007 easyJet carried 6m passengers to/from France, and the airline wants to double that figure by 2011.

At Paris CDG and Orly (where nine aircraft are based between them) easyJet is now the second largest airline with around 6% share of all passengers, yet it still manages a 30 minute turnaround time through a variety of measures such as a seven minute preparation time for the aircraft by cabin crew and contractual obligations on ground handlers, whereby they are penalised if they are responsible for any departure delay.

At Madrid easyJet is aiming to take advantages of the problems at Spanair, Clickair and Vueling. It has six aircraft at Barajas, and passengers to/from Spain account for 25% of all the airline's passengers. However, easyJet's performance at Madrid is coming under pressure, with increasing capacity from competitors, even despite their current difficulties.

This winter easyJet is also expanding out of Milan Malpensa, increasing aircraft stationed there from 13 to 15, adding five new routes and increasing employees based there to 500. easyJet is now the leading airline at the airport with around 20% of capacity and with a forecast 3.5m passengers carried to/from the airport in the 2007/08 FY (40%+ up on the previous year). It is now easyJet's largest base in continental Europe just two and half years after it was opened, and easyJet is eager to fill the gap created by Alitalia's strategic withdrawal from Malpensa as a hub. easyJet executives also claim that yields are rising strongly out of Malpensa. easyJet would also like to develop a domestic and international network out of Rome Fiumicino, again taking advantage of the strategic disarray at Alitalia.

In the UK easyJet, like Ryanair, is cutting back capacity significantly out of London Stansted; in its case by around 12%. easyJet is obviously concentrating its London catchment area effort on Gatwick, and the GB Airways deal has turned easyJet into the leading short-haul airline at Gatwick (GB had 29 slot pairs at the airport), with around a 35% share of all capacity, and with its 25 aircraft there expected to carry 8.3m passengers in the next 12 month period. BA's gradual withdrawal from short-haul out of Gatwick (even despite the launch of a dozen routes in the summer to European holiday destinations) means that in 2008 easyJet will offer more capacity than BA out of the airport. easyJet operates out of both North and South terminals at Gatwick, but in the medium-term the airline is looking to consolidate into one terminal (North).

Winter routes are being launched from London Gatwick to Istanbul, Lyon, Basle, Helsinki and Salzburg. After Gatwick, the best performing UK bases are believed to be Scotland and Newcastle, while Belfast "continues to be challenging" thanks to increasing capacity to/from the airport.

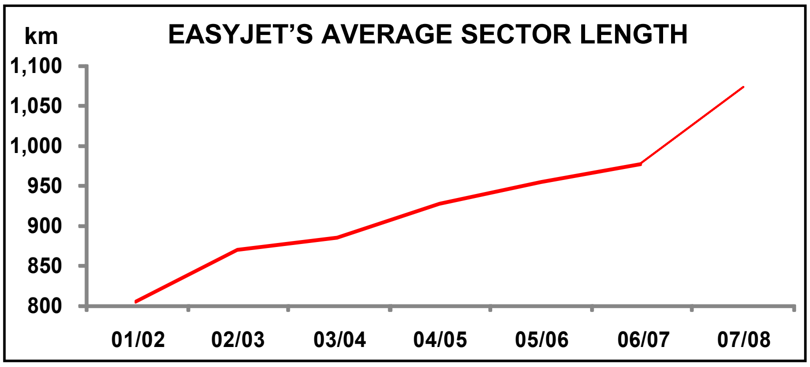
Although easyJet operates approximately 360 routes from 19 bases, around 10% of all routes is discarded every year by easyJet as it reacts to changing market conditions and routes that become less - or negatively - profitable. For example, in October easyJet closed its base Dortmund, where it had operated 11 routes and stationed three aircraft. The move was due primarily to concerns about restricted operating hours that easyJet says made it difficult to achieve the aircraft utilisation it requires to be profitable.

And there are some temporary route suspensions over the winter - for example Madrid-Oviedo and Geneva-Oviedo, with that capacity being redirected to other routes in the Spanish market.

Ancillary push

In September easyJet stated that the weakness of the Euro and lower expenditure by consumers meant that the market was volatile going forward, and that overall revenue per seat growth this winter would reduce to "a low single digit percentage" over the previous winter, which would offset strong revenue per seat growth in the summer. That's why ancillary revenue is crucial to easyJet going forward; it actually doubled in 2007/08, thanks partly to easyJet's charge for checked-in baggage, which was introduced in late 2007, and an upgraded "speedy boarding" service.

Intriguingly, Stelios Haji-Ioannou - the founder of easyJet - has started legal action against the airline in the UK saying that it is damaging his "easy" brand by having too many ancillary businesses. A brand licence between the airline and Stelios's easyGroup stipulates that no more than 25% of easyJet' revenue can come from non-core (i.e. non air travel) business. The dispute centres on the definition of what is core, and easyJet contends that baggage charges and "speedy boarding" are core revenues. As *Aviation Strategy* went to press Stelios was also involved in a public row with the easyJet board, with Stelios wanting a more "cautious" strategy at the airline, with orders scaled back and the company paying dividends for the first time. It's an unwelcome distraction for management, but with Stelios increasing his stake in easyJet to 26% (through consolidating family holdings) it's one that cannot be ignored.



While boosting ancillary revenue is a key part of most LCCs' strategies, one key difference between Ryanair and easyJet is that the latter appears much keener to maintain good relationships with travel agents. While Ryanair no longer allows travel agents to make bookings through "screen scrapers", easyJet is taking a more conciliatory attitude by encouraging agents to make bookings on Global Distribution Systems (GDSs) directly linked with the easyJet Application Programming Interface.

After consulting with agents, easyJet has just reduced its point of sales fee to agents booking via GDSs to £3.30 per seat, down from variable pricing that had previously cost agents up to £5 per seat booked. easyJet hopes this fee reduction and what it calls "collaborative rather than confrontational" relations with agents will encourage greater business from corporate travel agencies, allied to easyJet's strategy of flying to primary rather than secondary airports.

Well set for the future?

Although 2009 will be a very tough year for all airlines, easyJet argues it is well positioned and it's hard not to agree with that assessment, whether from a short-term financial performance perspective, or - more crucially - in terms of its strategy, though Stelios takes a different view.

The short-term focus for easyJet will remain on more intra-European and domestic European routes, defending its position at Gatwick, increasing ancillary sales and keeping up the pressure on costs. In the medium-term easyJet is unlikely to make any more acquisitions, preferring instead to digest GB Airways and grow organically as its order book of 105 aircraft is delivered. Harrison says that complexity of operations equals higher costs, and asks "what would we want to buy?"

Crucially, easyJet did not dip into a loss in 2007/08 FY, although its target of 15% RoE is out of the question for the moment. RoE had grown from 7.1% in 2004/05 to 13.6% in 2006/07, but fell back to 7.6% in 2007/08. But given the current climate, that is a very creditable performance. And easyJet is strong financially - it has low gearing and as of the end of September had long-term debt of £570m. At the same date cash and cash equivalents stood at £632m, and in addition the proceeds of the sale of 12 A319s and A321s (some $400m) will flow into the 2008/09 FY.

In common with other airlines, easyJet's share price had been on a steady downward path earlier this year, although in late September RBS's analyst Andrew Lobbenberg raised its view of easyJet (and Ryanair) from a hold to a buy, on the basis that falling fuel costs will be more beneficial to LCCs than network carriers (as fuel is a greater proportion of costs at LCCs, and that LCCs will be more able to maintain baggage charges than network carriers, who may now be suffering from a drop off in long-haul premium business). Of all Europe's LCCs, easyJet appears the best placed, not only to survive the current recession, but to be profitable throughout this period as well.

The question raised by Stelios is how much of the profit should be paid out in dividends rather than invested in growth. From a stockmarket perspective, Andrew Lobbenberg comments that “calling for dividends fails, in our view, to recognise the key drivers that draw investors to airlines: first aviation is and in our view remains a structural growth industry, second, airlines are deep cyclical trading stocks which double and halve with alarming regularity. Investing in them for a couple of percent yield rather misses the point.”

US Airways: The riskiest legacy or a possible overperformer?

US Airways has significantly shored up its liquidity position in recent months and, because of its domestic focus, is now poised to benefit more than its peers from the dramatic decline in fuel prices and the 10% reduction in domestic industry capacity this winter. The airline is also well-positioned to grow ancillary revenues and to diversify risk through international expansion. Is US Airways now a likely long-term survivor?

The new US Airways, the sixth largest airline in the US, is the result of the first merger between US legacy carriers in the post-2001 era: America West's acquisition of the old US Airways in September 2005. (The second post-2001 merger, between Delta and Northwest, closed on October 29 - see *Aviation Strategy*, September 2008, for analysis).

The merger created an AWA-managed operator described as the "first full-service, low-cost, low-fare airline" - a new type of legacy/LCC hybrid. This means CASM between the legacy and LCC ranges and characteristics and strategies from both groups. However, in reality US Airways is more similar to (and usually grouped with) the legacies. It is a network carrier with a nationwide presence and a family of two owned and seven affiliated feeder airlines. It has an international franchise that accounts for a quarter of its mainline ASMs and includes 20 cities in Europe, with service to other continents following in the next year or two. US Airways offers a combination of premium amenities not available on LCCs, including a global FFP, airport clubs, first class cabin and the hourly US Airways Shuttle between Boston, New York and

Washington.

The 2005 transaction effectively provided a lifeline for both carriers. US Airways was in its second post-2001 stay in bankruptcy protection. Even though it had restructured its balance sheet and even succeeded in substantially reducing labour costs and lining up new equity funding, it was struggling to come up with an acceptable business plan and was widely expected to liquidate. While AWA was already a low-cost carrier, its geographically limited, leisure oriented network posed a hurdle to long-term survival as a stand-alone entity. The merger offered something AWA had coveted for years: access to the higher-yield East Coast market.

The merger was the brainchild of US Airways' current chairman/CEO Doug Parker, who, while at the helm of AWA, saw the opportunity provided by Chapter 11. The bankruptcy process had enabled the old US Airways to get the right cost structure - most importantly, reduce its high legacy labour costs to effectively LCC levels, which made it a lower-risk merger target. Also, removing aircraft and capacity while in Chapter 11 made it easier to avoid duplication and obtain synergies. The merger was notable for its speedy completion and for raising as much as $1.7bn in new equity investment and partner support (see *Aviation Strategy*, December 2005).

But the subsequent integration effort did not go well. The new entity had terrible problems combining reservations systems, which led to serious operational issues. By early 2007 US Airways occupied the bottom ranking in the airline on-time performance league compiled by the DOT.

The other problem area has been labour integration. After three years, US Airways and AWA still have separate pilot groups, each with different sets of work rules and pay rates and not permitted to fly the other party's aircraft. The management insists that labour issues have never caused operational problems, but there are obviously negative implications in terms of efficiency and staff morale.

However, US Airways has staged an impressive operational turnaround this year, thanks to a specific programme. The airline has literally leapt from the bottom to the top of the industry league, ranking number one in on-time performance among the ten largest airlines in January-August.

Until very recently, the new US Airways outperformed its peers in terms of financial results. The new entity turned profitable quickly after the merger, had the highest pretax margin among the US network carriers in 2006 and continued top-level performance through 2007 and first-half 2008. The strong results reflected industry-leading RASM performance, as well as the low cost structure. US Airways enjoyed double-digit RASM growth well before its peers, thanks to the 10% capacity reduction associated with the merger and the revenue benefits derived from combining the two networks.

But US Airways underperformed its peers in the quarter ended September 30, posting a disappointing $242m net loss excluding special items, or an $865m net loss including such items, on revenues of $3.3bn. The staggering $623m of special charges included $488m of unrealised mark-to-market losses on fuel hedges (required by the accounting rules) and $127m of impairment charges. A comparison by Merrill Lynch indicated that the negative 7% pretax margin (excluding special items and mark-to-market hedging losses) was the worst among the network carriers.

US Airways was disadvantaged in several ways in the third quarter. First, it felt the full brunt of the fuel price hike (in a period that saw crude oil peak at $147 per barrel) because of its higher fuel cost exposure relative to its peers - reflecting its older fleet and lower non-fuel cost structure.

Second, because it is primarily a domestic operator, US Airways benefited less than its peers from the strength in international markets. With much capacity in leisure markets such as Florida, Arizona and Nevada, and with a bit more overlap with Southwest than other carriers, US Airways took the full brunt of the weaker RASM growth seen domestically over the summer.

Third, US Airways reduced its mainline capacity by only 1.4% - much less than the industry average. This was partly because it lacked flexibility on the fleet front due to a high percentage of operating leases and as a result of the Chapter 11 and merger-related restructurings.

As a result, US Airways' mainline passenger unit revenues (PRASM) increased by only 4.4% in the third quarter - much less than the industry average. There were also non-fuel cost pressures: ex-fuel CASM rose by 5.3%, mainly due to higher maintenance costs.

But the good news is that some of those disadvantages may reverse in the upcoming quarters. US Airways' top executives have argued recently that the airline is well-positioned for the future vis-à-vis its peers especially for two reasons. First, US Airways stands to benefit more than the legacies from the massive industry domestic capacity reduction implemented this autumn and in 2009. Second, just as it suffered more when fuel prices surged, the airline is poised to benefit disproportionately from the decline in fuel prices.

US Airways is also likely to see one of the highest growth rates in ancillary revenues. This is because in the US those efforts focus mainly on the domestic market (international services being mostly excluded from the new fees) and because US Airways has enthusiastically embraced a la carte pricing strategies this year. It has gone a step further than its peers with programmes such as "Choice Seats", which allow customers to reserve a window or aisle seat for a fee.

Most importantly, US Airways has decisively addressed earlier concerns about its liquidity position. With the help of old trusted business partners (Airbus, GE Capital, etc.), it has raised a staggering $1.2bn in additional liquidity since July.

Domestic capacity reductions

In June, in response to the unprecedented spring/early summer run-up in fuel prices, US Airways joined its peers in announcing a sizable pull-back of domestic service this autumn. Current plans see domestic mainline capacity declining by 6-8% in the fourth quarter and by 8-10% in 2009, while regional capacity will fall by 1-3% and 5-7% in those periods. International ASMs will down by a modest 1-3% in the fourth quarter, followed by 9-11% growth next year. The cuts have resulted in 2,200 job reductions across the board (6.5% of the workforce), which were implemented in the third quarter through a combination of voluntary and involuntary furloughs and attrition.

The first phase of fleet reductions involved returning to lessors 10 aircraft (six 737-700s this year and four A320s in first-half 2009) and cancelling leases on two A330-200s that US Airways was due to receive from ILFC in the second half of next year. There will be further fleet reductions in 2009 and 2010.

The cuts have focused on the Las Vegas hub, where US Airways closed most of its night operation in early September. Daily departures there are reduced from 141 a year ago to 77 by year-end. The move was not related to Virgin America's recent inroads; rather, the Las Vegas night operation was US Airways' lowest-RASM flying and the revenues no longer exceeded the incremental cost. The Las Vegas cuts follow serious downsizing at the Pittsburgh hub in recent years. This time, US Airways has also closed certain uneconomic airport lounges and cargo stations and removed its in-flight entertainment system from domestic aircraft (to save $10m annually in fuel expenses through reduced weight). This year's planned non-aircraft capital spending has been slashed by $90m to $225m. US Airways is maintaining "critical operational projects" such as cabin and airport club refurbishments and investments in check-in kiosks and new technology.

US Airways' domestic capacity reduction has been smaller than the double-digit (even 20%) cuts implemented by its legacy peers. This is mainly because US Airways leases 95% of its aircraft and negotiating out of those contracts would have been cash-negative in the near term.

US Airways also has contractual impediments in its pilot agreement that prevent significant further fleet downsizing; it must maintain a certain minimum number of mainline aircraft. It was not a limiting factor this year but could mean reduced flexibility to respond to a severe downturn.

Of course, US Airways still has significant numbers of old-generation 737s in the fleet - some 70 737-300/400s at the end of 2008, down from 87 a year ago. The 737s are being gradually retired upon lease expiration and as A320s are delivered. At year-end, the A319/320/321 fleet will total 201 and there are 97 firm orders or commitments.

If additional capacity cuts become necessary, US Airways has the ability to sell its 25 owned E-190s, which are flown as mainline aircraft. The airline could also further reduce daily aircraft utilisation by perhaps 3-4%. Some of the 300-plus regional aircraft in the Express carrier fleets could also be grounded.

New revenue initiatives

US Airways has moved to develop ancillary revenues more aggressively than any of the other top 10 US carriers this year. In addition to first and second checked bag fees, call centre fees and FFP award processing fees (all of which have become quite commonplace in the US this year), the airline has begun charging for advance seat selection, soft drinks in domestic coach class, pillows, blankets, headsets, etc. These programmes have been highly successful and are now expected to generate $400-500m of additional annual revenue, up from initially estimated $100m, at no material cost.

US Airways has had no large operational issues and no observed market share impacts, even in markets where it competes directly with Southwest (which is at the other extreme and has a rather clever "Freedom from Fees" advertising campaign).

Furthermore, US Airways has found that the new strategies have created a cleaner and more consistent product. First, the bag fees have led to a 25% reduction in total checked bags, which has improved on-time and baggage handling performance. Second, charging for soft drinks has resulted in only 25% of customers buying drinks which, according to the management, has created a "much calmer and more efficient" cabin environment. Previously 90% of the customers took a drink because it was free, resulting in logjams on the aisle, lines for restrooms and the need to collect large volumes of rubbish. With the a la carte products, US Airways is better able to fulfil its raison d'etre, which is to "get people where they want to go, on time, with the minimum amount of hassle and with their bags".

US AIRWAYS' MAINLINE FLEET

	2007	2008
E-190	11	25
737-300	47	30
737-400	40	40
A319	93	93
A320	75	75
A321	28	33
A330-300	9	9
A330-200	0	0
A350	0	0
757	43	39
767	10	10
Total	**356**	**354**

Note: Firm orders (delivery date): Total A319/A320/A321 commitments = 92 (2009 - 2012), A330-200 = 15 (2009 onwards), A350 = 22 (2015 - 2018).
Fleets at year-end 2007 and 2008

Consequently, the a la carte offerings are being expanded. The "Choice Seats" programme now covers 25% of the main cabin (rather than just a few rows) and by year-end will be available at all airport kiosks and ticket counters (rather than only at web check-in). More initiatives, particularly related to charging for premium seats, will be rolled out next year.

International expansion

US Airways has not grown its widebody fleet since the merger but has still managed to expand in Europe with its 10 767s and nine A330-300s. 2006 and 2007 saw the addition of Milan, Athens, Zurich and Brussels, as well as seasonal flights to Stockholm, Lisbon, Shannon, Venice, Barcelona and Glasgow, and Heathrow followed in March 2008. Most of the new service has been from Philadelphia.

Building an international franchise is a top priority for US Airways, because international service has proved lucrative for the other large US carriers in recent years and is seen as a good way to diversify risk. With currently only 24% of it mainline ASMs derived outside North America, US Airways has a lot of catching up to do with the rest of the industry.

Last year saw US Airways move into a higher gear on that front. The airline added some A330 orders, announced that it would be adding three or four new international markets per year in 2009-2011, applied to extend the network to South America (Bogota, Colombia) and Asia (Beijing) and reaffirmed its commitment to the A350.

There have been some setbacks: the Bogota application was turned down by the DOT, and, like other US carriers, US Airways had to delay its planned China service by a year due to weak market conditions (Philadelphia-Beijing is now expected to start in March 2010). But, with the longer-range A330-200 deliveries starting in 2009, the stage has been set for a new international growth phase and expansion further afield. To start with, US Airways is launching its first route to the Middle East, Philadelphia-Tel Aviv, in July. Next summer's plans also include new seasonal service to Birmingham (UK) and Oslo, with 757ETOPs.

As of the October 23 third-quarter earnings conference call, international demand had remained strong but US Airways was closely monitoring the situation. In the event of a slowdown (which some other US airlines have detected), US Airways could reduce frequencies or move some 757s back to domestic flying.

There is much flexibility in the fleet plans. The 15 A330-200s currently on firm order will provide for growth and facilitate the retirement of the 767 fleet. But they can also be converted to the larger, shorter-haul A330-300s or A340s (which might be the preferred aircraft for the China service).

US Airways' A350 orders total 22 and include both 800- and 900-series models. Deliveries are now expected to begin in 2015 and continue through 2018. The aircraft can be used for modest international expansion or replacement, eventually forming the single intercontinental fleet type for US Airways. The A350 will open up new profitable markets across the globe. US Airways envisages eventually operating intercontinental service also from its West Coast hubs.

The liquidity situation

US Airways is fortunate in that it got a major liquidity-raising effort under way in mid-August, a month before the turmoil began in the global financial markets. The company has raised $1.2bn in additional cash, financings, liquidity commitments and partner support. It is all the more impressive that most of those transactions closed in October and some $150m remain on target to be completed by year-end.

To start with, US Airways raised $179m in a public equity offering in mid-August, taking advantage of a month-long slide in oil prices. The $790m of transactions that closed in October included a $200m pre-purchase of frequent-flyer miles by credit-card partner Barclays, $355m of new (mostly GE Capital-administered) loans secured by aircraft and spare engines, a $200m cash advance from Airbus (related to US Airways' October 2007 purchase agreement; the details are confidential) and $35m in loans from regional partner Republic.

US Airways used $400m of the October proceeds to partially prepay a $1.6bn syndicated loan. As a result, the unrestricted cash covenant on that loan was reduced from $1.25bn to $850m. The remaining $370m of the net proceeds went to boost the cash position.

These liquidity-raising moves were important for two reasons. First, they provided a comfortable cushion against the term loan's covenant, removing a near-term risk of default. US Airways' unrestricted liquidity had been only $250m above the covenant; now the cushion is well over $1bn.

Second, the transactions improved US Airways' cash position. When oil prices peaked in July, some Wall Street analysts had considered US Airways one of likeliest Chapter 11 candidates in 2009 because of its below-peer cash reserves and poorer capital-raising potential (lack of non-core assets, few unencumbered aircraft, etc.). The airline ended the third quarter with one of the weakest cash positions among the large network carriers: $2.28bn of total cash and marketable securities, of which $1.54m was unrestricted. After the October transactions, total cash amounted to $2.65bn, which, at 22% of lagging 12-month revenues, was the best among the large network carriers. However, in terms of unrestricted cash ($1.9bn or 15.9% of revenues) - arguably a more appropriate measure - US Airways was in the middle of the pack.

That middle position is not so comfortable when considering that all the other legacy carriers have much better remaining liquidity raising options. Furthermore, US Airways' fuel hedges are seriously out of money; if oil prices remain at the $70 level, the airline expects to have to post another $275m in collateral (on top of the current $159m) at hedge counterparties at year-end. (US Airways did suspend its fuel hedging programme in the third quarter and is currently only 14% hedged for 2009.)

On the positive side, the dramatic decline in fuel prices has significantly improved the liquidity risk for all US carriers. US Airways does not have any material debt payments until 2014. While aircraft capital spending will increase next year, all of its aircraft are financed through mid-2009.

Prospects

Like most other US carriers, US Airways will report a steep loss for 2008 but is poised to return to profitability in 2009, as long as oil prices do not return to the $100-plus range. The maths are very simple: Each $1 decline in the price of oil per barrel translates into a $35m improvement to US Airways' bottom line. So a decline from the July peak of $147 to $97 would bring in $1.75bn, or a decline to $70 would be worth $2.7bn. CEO Doug Parker noted in the late-October conference call that, given the magnitude of the oil price decline, "it would take a truly unprecedented decline in demand to overcome the impact of oil".

The industry's 10% domestic capacity reduction in the current quarter is expected to result in a strong RASM environment. Over the winter, the domestic market is certainly likely to outperform the international market (which always tends to be hit harder in a recession anyway), and US Airways is well positioned to benefit from that.

The current (November 3) consensus estimate for US Airways is a profit of $2.14 per share, or about $240m, on revenues of $12.35bn in 2009, following from a loss of $7.42 per share ($740m) this year. However, given the volatility in fuel prices and all the economic uncertainty, the range in individual analysts' estimates is rather wide: from a marginal loss to a profit of over $900m in 2009. Calyon Securities' $2.89 EPS forecast (introduced in late October and slightly higher than the current consensus) assumes the WTI oil price averaging $71.50 in 2009 (Credit Agricole Group's forecast, recently lowered from $96.50).

US Airways' challenges include completing the AWA integration by getting joint contracts in place with the two pilot and flight attendant groups. The top executives stressed recently that the company wants to get single contracts "because it is the right thing to do". US Airways expects the pilot contract to ultimately increase its costs by $120m annually, compared to a financial benefit of around $10m.

Oddly enough, despite being one of the strongest proponents of industry consolidation, US Airways has been almost sidelined in the latest round of link-ups between the legacy carriers. After being spurned by Delta (January 2007) and United (May 2008), US Airways now finds itself playing third wheel on the US side of the Star alliance, which will be dominated by United and Continental. However, Parker said recently that Continental's future entry to Star was "probably a slight positive" for US Airways, making it more likely that US Airways stays in Star for a long time. But domestically, as the smallest of the network carriers, US Airways undoubtedly still hopes to gain strength through a merger at some point.

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		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group employees
Air France/	Apr-Jun 07	8,011	7,486	724	566	9.0%	7.1%	63,376	51,567	81.4%	19,325	103,978
KLM Group	Jul-Sep 07	9,183	7,855	1,328	1041	14.5%	11.3%	67,375	57,009	84.6%	20,448	
YE 31/03	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	
	Year 2007/08	**34,173**	**32,182**	**1,991**	**1,087**	**5.8%**	**3.2%**	**256,314**	**207,227**	**80.8%**	**74,795**	104,659
	Apr-Jun 08	9,830	9,464	366	266	3.7%	2.7%	66,610	53,472	80.3%	19,744	
	Jul-Sep 08											
BA	Oct-Dec 06	4,051	3,798	253	210	6.2%	5.2%	36,563	27,073	74.0%	7,878	42,197
YE 31/03	Jan-Mar 07	3,792	3,731	61	-140	1.6%	-3.7%	36,405	26,003	71.4%	7,269	42,073
	Year 2006/07	**16,149**	**15,004**	**1,145**	**578**	**7.1%**	**3.6%**	**148,321**	**112,851**	**76.1%**	**33,068**	**43,501**
	Apr-Jun 07	4,395	3,868	527	539	12.0%	12.3%	37,514	28,836	76.9%	8,648	
	Jul-Sep 07	4,729	4,118	611	458	12.9%	9.7%	38,191	30,500	79.9%	9,206	42,024
	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	
	Year 2007/08	**17,315**	**15,584**	**1,731**	**1,377**	**10.0%**	**8.0%**	**149,572**	**113,016**	**75.6%**	**33,161**	**41,745**
	Apr-Jun 08	4,455	4,386	69	53	1.5%	1.2%	37,815	27,757	73.4%	8,327	
	Jul-Sep 08	4,725	4,524	201	-134	4.3%	-2.8%	38,911	29,480	75.8%	8,831	42,330
Iberia	Oct-Dec 06	1,811	1,750	61	-12	3.4%	-0.7%	16,458	13,132	79.8%	6,682	
YE 31/12	**Year 2006**	**6,545**	**6,391**	**154**	**72**	**2.4%**	**1.1%**	**65,802**	**52,493**	**79.8%**	**27,799**	**23,901**
	Jan-Mar 07	1,745	1,734	16	16	0.9%	0.9%	16,104	12,798	79.5%	6,318	22,661
	Apr-Jun 07	1,829	1,752	75	83	4.1%	4.5%	16,458	13,307	80.9%	6,863	22,324
	Jul-Sep 07	2,080	1,882	198	211	9.5%	10.1%	17,119	14,653	85.6%	7,216	22,803
	Oct-Dec 07	1,963	1,681	279	140	14.2%	7.1%	16,773	13,471	80.3%	6,463	22,168
	Year 2007	**7,617**	**7,049**	**568**	**450**	**7.5%**	**5.9%**	**66,454**	**54,229**	**81.6%**	**26,860**	22,515
	Jan-Mar 08	1,948	1,990	-42	-661	-2.2%	-33.9%	16,360	12,990	79.4%		21,574
	Apr-Jun 08	2,142	2,148	-6	33	-0.3%	1.5%	16,771	13,372	79.7%		21,793
	Jul-Sep 08	2,181	2,156	25	45	1.1%	2.1%	17,093	14,220	83.2%		21,988
Lufthansa	Oct-Dec 06	6,316	6,062	254	529	4.0%	8.4%	36,204	27,056	74.7%	13,103	
YE 31/12	**Year 2006**	**24,979**	**23,913**	**1,066**	**1,014**	**4.3%**	**4.1%**	**146,720**	**110,330**	**75.2%**	**53,432**	**93,541**
	Jan-Mar 07	6,258	6,184	74	593	1.2%	9.5%	35,028	26,109	74.5%	12,329	95,696
	Apr-Jun 07	7,267	6,506	761	663	10.5%	9.1%	39,573	30,544	77.2%	14,629	97,067
	Jul-Sep 07 *	8,960	8,004	956	843	10.7%	9.4%	48,662	39,112	80.4%	18,836	
	Oct-Dec 07*	8,197	8,103	94	165	1.1%	2.0%	45,845	35,128	76.6%	17,106	
	Year 2007	**30,682**	**28,797**	**1,885**	**2,264**	**6.1%**	**7.4%**	**169,108**	**130,893**	**77.4%**	**62,900**	**100,779**
	Jan-Mar 08*	8,368	8,086	282	85	3.4%	1.0%	45,131	34,828	77.2%	15,992	106,307
	Apr-Jun 08*	10,113	9,285	829	541	8.2%	5.3%	50,738	40,258	79.3%	18,488	108,073
	Jul-Sep 08*	9,835	9,542	293	230	3.0%	2.3%	52,487	42,437	80.9%	18,913	109,401
SAS	Oct-Dec 06	2,215	2,121	94	679	4.2%	30.7%	13,672	9,343	68.3%	9,705	25,534
YE 31/12	**Year 2006**	**5,270**	**5,010**	**260**	**169**	**4.9%**	**3.2%**	**54,907**	**39,247**	**71.5%**	**39,059**	**31,965**
	Jan-Mar 07	1,978	2,025	-47	-7	-2.4%	-0.4%	12,844	8,543	66.5%	9,088	26,136
	Apr-Jun 07	2,383	2,247	136	89	5.7%	3.7%	15,091	10,915	72.3%	11,045	26,916
	Jul-Sep 07	2,612	2,518	94	109	3.6%	4.2%	15,352	11,890	77.4%	11,031	27,447
	Oct-Dec 07	2,041	2,039	2	-96	0.1%	-4.7%	14,263	9,701	68.0%	9,923	25,651
	Year 2007	**5,969**	**5,676**	**293**	**259**	**4.9%**	**4.3%**	**57,551**	**41,048**	**71.3%**	**41,087**	**26,538**
	Jan-Mar 08	2,046	2,185	-139	-181	-6.8%	-8.8%	10,669	7,235	67.8%	7,277	25,477
	Apr-Jun 08	2,959	2,968	-9	-69	-0.3%	-2.3%	16,465	11,851	72.0%	11,622	26,916
	Jul-Sep 08	2,604	2,869	-265	-319	-10.2%	-12.3%	14,587	10,879	74.6%	9,846	24,298
Ryanair	Oct-Dec 06	651	575	76	63	11.7%	9.7%			82.0%	10,300	4,209
YE 31/03	Jan-Mar 07	661	611	48	41	7.3%	6.2%				10,019	
	Year 2006/07	**2,887**	**2,278**	**609**	**518**	**21.1%**	**17.9%**	**48,924**	**40,118**	**82.0%**	**42,500**	
	Apr-Jun 07	934	722	212	187	22.7%	20.0%			82.0%	12,600	
	Jul-Sep 07	1,229	795	434	384	35.3%	31.2%			86.0%	13,952	
	Oct-Dec 07	824	760	64	68	7.7%	8.3%					
	Jan-Mar 08	859	808	51	-85	6.0%	-9.9%					
	Year 2007/08	**3,846**	**3,085**	**761**	**554**	**19.8%**	**14.4%**			**82.0%**	**50,900**	
	Apr-Jun 08	1,215	1,202	13	-141	1.0%	-11.6%			81.0%	15,000	
	Jul-Sep 08	1,555	1,250	305	280	19.6%	18.0%			88.0%	16,600	
easyJet	**Year 2004/05**	**2,478**	**2,356**	**122**	**109**	**4.9%**	**4.4%**	**32,141**	**27,448**	**85.2%**	**29,600**	**4,152**
YE 30/09	Oct 05-Mar 06	1,095	1,177	-82	-50	-7.5%	-4.6%	16,672	13,642	81.8%	14,900	
	Year 2005/06	**2,917**	**2,705**	**212**	**170**	**7.3%**	**5.8%**	**37,088**	**31,621**	**84.8%**	**33,000**	**4,859**
	Oct 06-Mar 07	1,411	1,333	-47	-25	-3.3%	-1.8%	19,108	15,790	81.2%	16,400	
	Year 2006/07	**3,679**	**3,069**	**610**	**311**	**16.6%**	**8.5%**	**43,501**	**36,976**	**83.7%**	**37,200**	
	Oct 07-Mar 08	1,795	1,772	22	-87	1.2%	-4.8%	23,442	19,300	82.3%	18,900	
	Apr-Jun 08							14,800	12,600	83.5%	11,500	
	Jul-Sep 08											

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

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Alaska	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**
	Jan-Mar 08*	840	889	-50	-36	-5.9%	-4.3%	9,791	7,284	74.4%	4,080	9,881
	Apr-Jun 08*	931	824	107	63	11.4%	6.8%	10,039	7,841	78.1%	4,425	9,880
	Jul-Sep 08*	1,065	1,185	-120	-87	-11.3%	-8.2%	10,148	8,066	79.5%	4,532	9,594
American	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**
	Jan-Mar 08	5,697	5,884	-187	-328	-3.3%	-5.8%	66,065	52,283	79.1%	23,048	85,500
	Apr-Jun 08	6,179	7,469	-1,290	-1,448	-20.9%	-23.4%	67,137	55,358	82.5%	24,278	85,700
	Jul-Sep 08	6,421	6,637	-216	45	-3.4%	0.7%	67,534	55,506	82.2%	24,001	84,100
Continental	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**
	Jan-Mar 08	3,570	3,636	-66	-80	-1.8%	-2.2%	45,665	35,855	78.5%	16,440	
	Apr-Jun 08	4,044	4,115	-71	-3	-1.8%	-0.1%	48,895	39,824	81.4%	17,962	46,000
	Jul-Sep 08	4,156	4,308	-152	-236	-3.7%	-5.7%	48,768	39,969	82.0%	17,108	43,000
Delta	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**	**54,467**
	Jan-Mar 08	4,766	11,027	-6,261	-6,390	-131.4%	-134.1%	58,083	45,390	78.1%	25,586	55,382
	Apr-Jun 08	5,499	6,586	-1,087	-1,044	-19.8%	-19.0%	62,338	51,931	83.3%	27,459	55,397
	Jul-Sep 08	5,719	5,588	131	-50	2.3%	-0.9%	64,969	54,702	84.2%	27,716	52,386
Northwest	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**	**29,871**
	Jan-Mar 08	3,127	7,180	-4,053	-4,139	-129.6%	-132.4%	37,592	30,921	82.3%	15,874	30,053
	Apr-Jun 08	3,576	3,876	-300	-377	-8.4%	-10.5%	39,458	33,557	85.0%	17,500	29,295
	Jul-Sep 08	3,798	4,014	-216	-317	-5.7%	-8.3%	39,568	33,858	85.6%	17,100	25,057
Southwest	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**	**33,655**
	Jan-Mar 08	2,530	2,442	88	34	3.5%	1.3%	40,454	28,311	69.8%	21,505	33,895
	Apr-Jun 08	2,869	2,664	205	321	7.1%	11.2%	42,381	31,882	75.2%	23,993	34,027
	Jul-Sep 08	2,891	2,805	86	-120	3.0%	-4.2%	42,304	30,292	71.6%	22,243	34,545
United	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**
	Jan-Mar 08	4,711	5,152	-441	-537	**-9.4%**	-11.4%	61,812	47,854	77.4%	15,250	52,500
	Apr-Jun 08	5,371	8,065	-2,694	-2,729	-50.2%	-50.8%	63,600	52,433	82.4%	16,994	51,100
	Jul-Sep 08	5,565	6,056	-491	-779	-8.8%	-14.0%	63,213	52,108	82.4%	16,758	49,000
US Airways Grp.	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**	
	Jan-Mar 08	2,840	3,036	-196	-236	-6.9%	-8.3%	35,298	27,316	77.4%	19,731	34,684
	Apr-Jun 08	3,257	3,793	-536	-567	-16.5%	-17.4%	37,465	30,736	82.0%	21,481	34,359
	Jul-Sep 08	3,261	3,950	-689	-865	-21.1%	-26.5%	37,569	30,918	82.3%	21,185	32,779
JetBlue	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**	**9,473**
	Jan-Mar 08	816	799	17	-8	2.1%	-1.0%	13,510	10,562	78.2%	5,518	10,165
	Apr-Jun 08	859	838	21	-7	2.4%	-0.8%	13,491	10,872	80.6%	5,637	9,547
	Jul-Sep 08	902	880	22	-4	2.4%	-0.4%	13,122	11,020	84.0%	5,657	8,482

Notes: 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. *Mainline stats for ASKs, RPKs, pax. and employees. ** = 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.

		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	**Year 2003/04**	11,529	11,204	325	234	2.8%	2.0%	87,772	55,807	63.6%	44,800	28,870
YE 31/03	**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	
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
	Jan-Jun 08	5,443	5,461	-18	-71	-0.3%	-1.3%	56,949	45,559	80.0%	12,463	
JAL	**Year 2003/04**	18,398	19,042	-644	-844	-3.5%	-4.6%	145,900	93,847	64.3%	58,241	21,197
YE 31/03	**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	
Korean Air	**Year 2003**	5,172	4,911	261	-202	5.0%	-3.9%	59,074	40,507	68.6%	21,811	15,352
YE 31/12	**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	**Year 2003/04**	3,061	3,012	49	86	1.6%	2.8%	55,692	37,659	67.6%		20,789
YE 31/03	**Year 2004/05**	3,141	3,555	-414	-421	-13.2%	-13.4%	64,115	44,226	69.0%		22,513
Apr-Dec 05	**2005**	2,428	2,760	-332	-331	-13.7%	-13.6%	49,786	35,597	71.5%		22,835
YE 31/12	**2006**	3,696	3,751	-55	-37	-1.5%	-1.0%	58,924	41,129	69.8%	15,466	19,596
YE 31/12	**2007**	4,464	4,208	256	248	5.7%	5.6%	56,104	40,096	71.5%	13,962	
Qantas	Jul-Dec 04	5,017	4,493	524	358	10.4%	7.1%	57,402	43,907	76.5%	16,548	35,310
YE 30/06	**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%	122,119	97,622	79.9%	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
	Year 2007/08	14,515	13,283	1,232	869	8.5%	6.0%	127,019	102,466	80.7%	38,621	33,670
Singapore	**Year 2003/04**	5,732	5,332	400	525	7.0%	9.2%	88,253	64,685	73.3%	13,278	14,010
YE 31/03	**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
Air China	**Year 2004**	4,050	3,508	542	288	13.4%	7.1%	64,894	46,644	71.9%	24,500	29,133
YE 31/12	**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	
China Southern	**Year 2004**	2,897	2,787	110	19	3.8%	0.7%	53,769	37,196	69.2%	28,210	18,221
YE 31/12	**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	
China Eastern	**Year 2004**	2,584	2,524	60	39	2.3%	1.5%	41,599	27,581	66.3%	17,710	20,817
YE 31/12	**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	
AirAsia	**Year 2004/05**	152	122	30	25	19.7%	16.4%	6,525	4,881	74.8%	4,410	2,016
YE 30/06	**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	166	126	40	50	24.1%	30.1%	4,364	2,970	68.1%	2,612	
	Apr-Jun 08	190	142	48	3	25.3%	1.5%	4,514	3,286	72.8%	2,823	

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

EUROPEAN SCHEDULED TRAFFIC

	Intra-Europe			North Atlantic			Europe-Far East			Total long-haul			Total Int'l		
	ASK	RPK	LF	ASK	RPK	LF	ASK	RPK	LF	ASK	RPK	LF	ASK	RPK	LF
	bn	bn	%	bn	bn	%	bn	bn	%	bn	bn	%	bn	bn	%
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
Sep-08	31.2	22.0	70.6	22.2	17.9	80.9	16.0	12.9	80.8	53.9	43.6	80.8	81.9	63.6	77.6
Ann. change	1.5%	-3.8%	-3.9	-0.5%	-1.1%	-0.5	4.0%	-0.8%	-3.9	2.4%	0.0%	-2.0	3.0%	-0.1%	-2.4
Jan-Sep 08	272.2	187.3	68.8	188.7	152.0	80.5	143.9	115.2	80.1	481.0	386.2	80.3	792.0	601.7	76.1
Ann. change	3.1%	1.5%	-1.0	2.2%	0.8%	-1.1	4.1%	1.2%	-2.3	4.7%	2.3%	-1.9	4.3%	2.3%	-1.5

Source: AEA

EIGHT LARGEST US PASSENGER AIRLINES' SCHEDULED TRAFFIC

	Domestic			Atlantic			Pacific			Latin America			Total Int'l		
	ASK	RPK	LF	ASK	RPK	LF	ASK	RPK	LF	ASK	RPK	LF	ASK	RPK	LF
	bn	bn	%	bn	bn	%	bn	bn	%	bn	bn	%	bn	bn	%
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	221.3	172.8	78.1	51.3	40.9	79.7	28.3	22.8	80.7	26.1	20.2	77.4	105.7	83.9	79.4
2007	**896.9**	**724.2**	**80.7**	**207.6**	**168.2**	**81.0**	**112.3**	**93.5**	**83.3**	**109.0**	**84.9**	**77.9**	**428.7**	**346.5**	**80.8**

Note: *Legacy airlines plus Alaska and Southwest.*

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	31 Oct	Uzbekistan AW	4 x 767-300ERs	
	14 Oct	Ryanair	10 x 737-800s	
	25 Sep	ANA	9 x 767-300ERs	
	2 Sep	Ryanair	4 x 737-800s	
Airbus	22 Oct	Croatia Airlines	4 x A19s	
	15 Oct	MTAD	4 x A330-200s	
	2 Sep	MAZ Aviation	5 x A350-900s, 1 x A350-800	
	1 Sep	Alafco	4 x A320s	
	1 Sep	Air One	5 x A320s	

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