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US cautiously expects healthy profits in 2009

The collapse of the price of oil in the past six months and the significant domestic capacity cuts since the autumn have meant that the US sector, which posted an aggregate net loss of around $4.4bn for 2008, will turn profitable this year. Outlandish as it sounds in light of the current economic turmoil, the US airline industry could even achieve record profits this year.

A mid-January forecast from JP Morgan floated the prospect of a $10.6bn aggregate operating profit for the sector in 2009, which would be about $3bn higher than the previous annual record. It would mean individual network carriers achieving operating margins in the 6-11.5% range.

The JP Morgan forecast assumes the price of oil averaging $55 per-barrel, industry capacity falling by 5.5% and sector revenues declining by 4.5% this year. The latter would be more than the typical 1-2% revenue declines seen in past recessions but not as severe as the 7-8% fall seen in 2002 in the wake of September 11 (when people were afraid to fly).

At the other extreme, Delta's management has for some months been predicting that industry revenue could decline by as much as 8-12% in 2009, while some analysts are currently assuming a 7-8% decline. But, according to JP Morgan, even a 9% revenue decline would still produce a healthy operating profit similar to 2006's $5.1bn.

The problem is that airlines have little visibility beyond the very near-term to predict demand and revenues. But the macroeconomic doom and gloom has certainly intensified in recent weeks, both globally and in the US. There is a sense that the recession will be more severe than previously thought and that the worst is yet to come in terms of job losses and corporate bankruptcies. And Iata's monthly statistics have painted a dire picture of international premium traffic and cargo trends.

Consequently, there is growing concern among investors and analysts about US airlines' traffic and revenue prospects in 2009. Much of the questioning at the fourth-quarter earnings conference calls in late January focused on that subject. Exactly what trends are the airlines seeing? How much flexibility do they have to respond to any negative developments? Having slashed domestic capacity, are they prepared to do the same internationally?

Anatomy of a financial recovery

US airlines can look forward to profits in 2009 essentially because of two developments: the collapse of the price of oil in recent months and the industry's timely and significant collective response last year

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to the threat posed by $130-plus oil, which included a 12% domestic capacity reduction and lucrative new ancillary revenue streams.

However, the foundations for the recovery were laid in the preceding years, in the aftermath of September 11. The multi-year Chapter 11 restructurings and heavy cost-cutting (in or out of bankruptcy) played a key role in "recalibrating the industry earnings model from $30 oil input to the mid-$80s" (as one analyst put it). Including last year's actions, it is now estimated that the US airline industry has adapted to the tune of achieving operating break-even at $120 oil – a stunning achievement.

In recent years, attitudes have changed about capacity addition, so the latest cutbacks were not that great a psychological leap. American led the way several years ago with extremely disciplined capacity growth, the idea caught on and there was a period of constrained industry capacity expansion.

Also illustrating the new disciplined approach, many of the US legacies have taken a break from ordering aircraft in the post-September 11 era, if only because they could not justify the acquisitions on an ROI basis. This has meant that the vicious circle of ordering aircraft in good times and taking lots of deliveries when times are bad has been broken.

Importantly, US airlines will not be much affected by the credit crisis because they have adequate cash reserves and minimal aircraft funding needs in 2009.

Oil price collapse

The key factor fuelling this year's financial recovery has been the dramatic decline in the price of oil, from a peak of $147 per barrel in early July to the $40-level as of early February. This has provided enormous cost relief for the airline industry. The decline from last year's average price of about $100 to $40 would represent a $27bn aggregate cost saving for US airlines in 2009 (based on Merrill Lynch's earlier estimate that every $1 move in the price of oil swings annual industry profitability by $450m). It would take a 20-25% decline in industry revenues to negate that benefit.

Of course, the sharp decline in oil prices has meant that airlines with sizable fuel hedges in place have incurred large mark-to-market unrealised losses on hedge contracts, as required by accounting rules. Such charges played havoc with financial results in the second half of 2008, even causing Southwest (which has had the industry's largest fuel hedge position by a wide margin) to report net losses in the past two quarters. Many airlines also saw their cash positions decline due to significant cash collateral posting requirements related to their out-of-money fuel hedges.

The fourth quarter may have represented the worst on the combined fuel cost/hedging loss/cash outflow front for US airlines. Fuel prices were still up significantly year-over-year, and both the mark-to-market losses and cash collateral requirements probably peaked. If oil prices stay at reasonably low levels, US airlines should begin to fully realise the benefits by mid-year, as the expensive fuel hedges expire or are settled.

Several of the airline executives commented in the fourth-quarter calls that the industry again has a natural hedge against declining demand. Continental's CEO noted that "we are blessed to be in an industry where, as demand has fallen, our single largest expense item, fuel, has fallen materially as well."

Given that this recession is truly global in nature, with Europe, the US and Japan all being hit hard at the same time, it seems likely that oil prices will not start heading back up anytime soon. But there is always a risk that the oil price/demand relationship does not hold. JP Morgan analysts noted that an unlikely scenario, but one that they feared the most, would be a fuel price spike later this year for some reason other than economic improvement (terrorism, geopolitical upheaval, unprecedented OPEC coordination, etc.).

While some US airlines still have significant fuel hedges in place for 2009, most of the programmes are winding down. Notably, Southwest has reduced its net hedge position to only 10% of its fuel needs each year between 2009 and 2013. That was done by selling swaps against the existing out-of money fuel hedge positions, effectively capping the mark-to-market losses at around $1bn. Southwest paid no additional premiums, avoided having to fork out an additional $500m

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in cash collateral and will realise the $1bn in losses as future fuel is consumed.

Those airlines that have continued hedging, such as AMR and UAL, are now doing it at a slower pace and using more conservative instruments. Most of the airlines have stressed that they continue to believe in systematic fuel hedging as a way to protect their cost structures and earnings from market volatility and catastrophic price increases. They are ready to jump back in as opportunities arise, but right now is not the time to be long on energy.

Massive domestic capacity cuts

The second key factor fuelling US airlines' financial recovery is the massive domestic capacity reduction, which will help airlines maintain pricing traction as demand declines. The cuts, which airlines began announcing in the spring and early summer 2008, resulted in an aggregate 12% domestic ASM reduction in the fourth quarter, with a similar 10%-plus cut implemented in the current quarter. As of mid-January, analysts had pencilled in a 5-7% industry ASM reduction for 2009, though that will increase if economic conditions worsen.

This is the first time that the US airline industry has acted proactively in front of a recession to pare back capacity. In the face of $150 oil (or $200, as Goldman Sachs predicted last spring), the airlines really had no choice. First, because of overcapacity and intense competition in the US, it was not possible to raise fares to come close to matching the increased costs. Second, Chapter 11 was no longer an option. So airlines slashed capacity just as fuel prices plummeted, leaving them well-positioned to face the next challenge: recession.

The current capacity cuts are all the more beneficial because the airlines are now succeeding better in removing the associated costs. Merrill Lynch noted in a late-November report that "the old adage that it was impossible for an airline to shrink to profitability should be discarded". It made sense in a world where the fixed/variable cost mix was 80%/20%, whereas "today's 35%/65% split has allowed the industry to cut capacity and costs at the same time".

Getting rid of costs has been easier because of the large numbers of older, fully-depreciated aircraft in many US carrier fleets. In some instances, whole domestic fleet types are being retired.

Most significantly, all of the LCCs have joined in. Even Southwest is now cutting capacity by 4% in 2009 – its first-ever annual contraction. The airline announced rather dramatically in January that it had suspended indefinitely its fleet growth plans and that it was entering a "no-growth era". This is an enormous positive for the entire US airline industry in 2009.

Boost from ancillary revenues

The third factor helping US airlines this year is ancillary revenues. The spring and summer of 2008 saw the legacies move en masse to increase existing ticketing, change and excess-baggage fees, create new revenue streams by charging for a la carte service such as checked bags and introduce new travel enhancement products such as cabin upgrades. These activities have only limited associated costs and are turning out to be a lucrative revenue source. By some estimates, a la carte activities will boost industry revenues by $3-5bn in 2009.

Because many of the new fees were introduced in May/June, the revenue boost will be the greatest in the first half of this year – just when the airlines may need it the most. Although some of the fees have been modestly scaled back in recent months, airlines say that ancillary revenues appear not to be particularly sensitive to the economy (rather, they are correlated to load factors).

These new pricing models, which were pioneered by European LCCs like Ryanair, appear to have been broadly accepted by the US travelling public. All US airlines have benefited. At one extreme, United, a global carrier with a focus on premium traffic, calls ancillary revenues a "proven and meaningful contributor" to its bottom line, estimated to generate some $1.2bn of revenues this year. US Airways, a primarily domestic carrier with more leisure focus, is on target to realise $400-500m of ancillary revenues this year. And Southwest has also been doing well with a strategy that charges no fees for basic services but sells new premium-type products.

Demand and revenue challenges

US airlines have been eased into this recession more gently than their counterparts in other worlds regions. While airlines elsewhere began reporting sharp premium traffic declines in September or October, US airlines detected a broad weakening in that segment only in the latter half of the fourth quarter, and their total RASM held up well right through the year-end holiday period.

This is mainly because the sharp domestic capacity cuts have really helped limit the financial damage. The domestic market still accounts for the bulk of the US legacies' operations (though Continental is now 50/50 and Delta about 40% international).

In the fourth quarter, the top four US legacies – Delta (including Northwest), American, United and Continental – saw a combined 7.6% decline in their mainline (domestic and international) ASMs. Traffic fell by 8%, resulting in a slight 0.3-point decline in load factor, which remained at a historically high 79.8%. Because of the extremely constrained capacity, industry RASM improved throughout the period: up 8.8% in October, 0.4% in November and around 5% in December.

January saw continuation of the capacity cuts and a slightly steeper 10% traffic decline, resulting in a 1-2 point fall in load factors. However, the positive unit revenue trend has reversed. Based on some airlines' reports, in early February the expectation was that industry RASM was down by 4-5% in January.

The negative RASM trend reflects several factors: significantly weaker premium cabin demand, a sharp decline in international bookings and increased fare discounting domestically to cope with some softening of leisure demand.

United, which probably carries more premium traffic than the other legacies, in late January reported seeing a double-digit year-over-year decline in international premium travel. In the fourth quarter, premium cabin demand was off as much as 25%, as some traffic evidently moved to the coach cabin. In January, United's total international traffic fell by a staggering 15.1%.

Having seen much weakness in business bookings domestically in recent months, in late January Continental was seeing a significant decline of its front-cabin RASM internationally, due to both lower yields and load factor. Many airlines noted that higher coach yields mitigated some of the decline in premium class bookings – another indication that international business passengers are switching to coach.

In terms of forward bookings (typically for up to six weeks), American said in late January that international booked load factors were down nearly 8 points, compared to a 2.5-point decline domestically. Delta reported 7-9 point lower load factors internationally for February and March, compared to 2-4 point declines domestically.

The worst-affected international market is the transatlantic, especially New York-London. United's London market PRASM fell by 4% in the fourth quarter, contrasting with a 3% PRASM improvement to the rest of Europe. Continental noted that the declines in both the load factor (down six points) and the premium cabin RASM are the worst on the transatlantic, where the back cabin is holding up much better. Continental executives noted that this is a time they are "really grateful to be flying so many 757-200s to Europe" (which have a smaller number of seats allocated to the front cabin than competitors' aircraft).

Latin America, which has been the brightest spot internationally for US carriers in recent quarters, is performing less well now but still better than the other regions. RASM growth continued to be in the mid-single digits in the fourth quarter, but Continental noted that the load factor is now running 1-2 points behind last year's.

The Pacific market has exhibited mixed trends. American's RASM there surged by 11% in the fourth quarter. United saw only a slight overall RASM increase, with Japan remaining strong (up 9%), China surprisingly improving by 2% and South Pacific seeing a double digit decline (Australia was down 20%). United noted steep declines in the premium cabin. Delta/Northwest reported relatively strong performance for its Pacific entity, particularly in the resort and beach markets, which are being helped by the strong yen. But demand to India and the Middle East has been affected by the conflicts in those regions and terrorism concerns.

Like their counterparts in Europe and Asia, US airlines have witnessed sharp declines in international cargo traffic – a lead indicator for the global economy. Freight volumes have

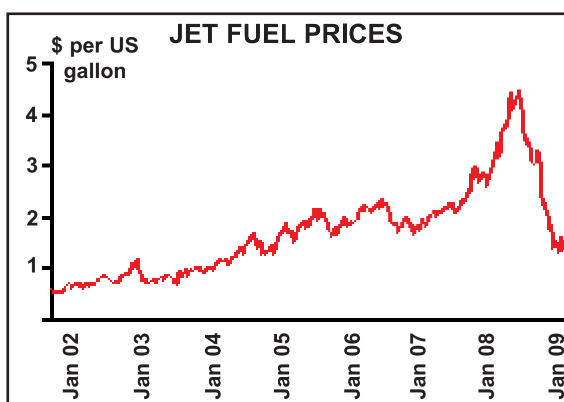
been particularly hard hit on the Pacific. Total international freight revenues typically fell by 20-25% in the fourth quarter. American and Continental saw 27% and 23% cargo traffic declines, respectively, in January, which was in line with the 23% fall in international cargo traffic reported by Iata for December.

Domestically, the more business-oriented markets around the country have suffered the most. Delta noted that certain industries like financial services and automotive are significantly weaker, while the aerospace and health care sectors have held up better. As companies continue to trim travel budgets, business customers are making fewer trips, downgrading more to coach class or buying tickets further in advance to take advantage of lower fares.

Leisure demand in the US has remained surprisingly resilient - some airlines have suggested this is because leisure travel has become less discretionary (just something that people do), plus domestic air fares remain cheap and air travel a great bargain. However, since January airlines have been seeing lower yields on leisure bookings – something that US Airways called its biggest disappointment. This is because the industry has started pricing leisure travel more aggressively.

More aggressive fare sales in the near term are probably inevitable and are not a great concern for several reasons. First, continued extremely tight industry capacity is likely to keep a lid on discounting and hence excess yield dilution. Second, yield management systems are now much more sophisticated than in previous recessions, enabling airlines to monitor and make the right tradeoff between fares, availability and demand to maximize revenues, on a flight-by-flight, market-by-market and day-by-day basis. This is particularly the case with LCCs, many of which have invested in new yield management systems and strengthened that function considerably in recent years. Southwest's executives noted (in response to a question in the fourth-quarter call) that the airlines are now "able to discount without destroying RASM".

In an early-February report, Calyon Securities estimated that February would see US airlines' traffic decline in the "low-teens" and load factors generally holding up. RASM decline could be similar to January's mid-single digit fall, as airlines discount selectively to cope



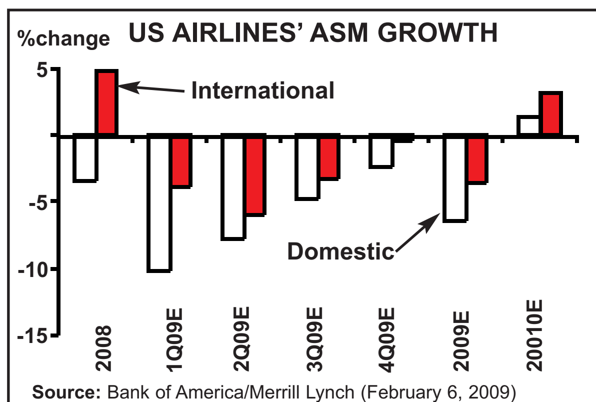
with seasonal and economic weakness and passengers trade down to coach class. The shift of Easter from March to April this year will make for a tougher first-quarter comparison – airlines noted that this has historically cost 1-2 load factor points. But Calyon Securities optimistically calls the late Easter a "major kick-off for the heavy summer travel season".

When commenting on demand in the fourth-quarter calls, all of the airlines stressed that it was difficult to draw any meaningful conclusions regarding trends because of a shortened booking curve and extreme volatility. Except for some premium passengers taking advantage of lower fares by booking further in advance, far more people are refraining from making travel decisions until the last minute. Airlines are seeing fewer bookings and March is looking particularly weak, but bookings may build closer in to the actual travel date. US Airways noted that its forward-bookings and revenue data were "significantly more volatile than at any time in the past" and that its ability to forecast revenues was "extremely murky at this point".

Of course, the biggest question, shrouded in total uncertainty, is how deep the recession will go, when it will bottom out and how long it will last. The best attitude, expressed by Southwest's CEO Gary Kelly, is that "our outlook must be cautious given the recessionary environment".

Domestic airlines best-positioned

Regardless of how the economy will turn out, it seems likely that the US domestic market will outperform the international market on the revenue front this year, reversing the trend seen in



Source: Bank of America/Merrill Lynch (February 6, 2009)

the last few years. This would mean that primarily domestic carriers like US Airways, Southwest and JetBlue are best-positioned in the short term.

This is a particularly welcome development for US Airways, which had a difficult 2008 and saw its unrestricted cash position dwindle to just 10% of annual revenues at year-end (though, it must be stressed, there are no real liquidity concerns). In addition to gaining from the domestic pricing environment, US Airways can expect to record the biggest ancillary revenue gains (80% domestic exposure; most international tickets remain "bundled"). It has less exposure to the international cargo market, which is really suffering. And it could benefit the most from Southwest's historic capacity cuts since its network has more overlap with Southwest than anybody else.

Although Southwest faces some new challenges – among them maintaining its cost structure and employee morale during a period of contraction – it has historically always outperformed the industry in recessionary times. Southwest has made good scheduling adjustments over the past year, focusing growth in a few key markets and enhancing the overall profitability of its network. It has enhanced its revenue management capabilities. It is expected to benefit from a 15% reduction in competitive capacity in its markets in the first half of this year.

Thanks to new product and revenue initiatives rolled out last year, Southwest's brand is probably stronger than ever. This was indicated by its 9% RASM improvement in the fourth quarter, which was twice as high as the 4.5% mainline domestic RASM increase recorded by the legacies, even though Southwest's capacity was up by 0.8% and the legacies' was down by 12%. As of late last month, Southwest was expecting a 7% RASM improvement in January. Even though the airline mentioned "notable softness" in its post-January bookings, it also noted that measuring any impact was tough since its booking curve was so short.

LCCs like JetBlue and AirTran may find that their shorter-haul international routes to the Caribbean will be significantly more recession-resistant than the legacies' long-haul international services. When money is tight and the economy uncertain, people tend to opt for shorter-haul vacation travel.

More international cuts?

Alarming near-term demand and revenue trends, lack of visibility beyond 6-8 weeks, tremendous uncertainty about the global economy and the need to remain cautious – how does all that play out into the decision-making about international capacity plans in 2009?

The short answer is that at this point US airlines are not planning additional international service reductions, but they are watching trends very closely and are prepared to act if recession proves worse.

The initial rounds of cuts last year saw some trimming of international ASM growth rates and elimination of some marginal European and Asian routes, effective in the fourth quarter or in 2009, as well as one-year delays to new China service launch by United, Northwest, US Airways and American. Recent months have seen further actions, including a significant trimming of international winter schedules by Delta/Northwest following the completion of their merger. In January, American announced that it would take advantage Boeing delivery delays to further modestly trim its capacity this year: it will not use MD-80s to backfill flying associated with seven 737s whose deliveries were delayed from 2009 to 2010.

US legacies' international capacity is currently expected to decline by about 3% in 2009. This is about half of their planned domestic contraction rate.

The Delta/Northwest combine has effectively put on hold its earlier ambitious growth plans and is currently looking at a 3-5% international capacity reduction in 2009. In January the airline terminated its Seattle-Heathrow, Detroit-

Frankfurt and second daily Atlanta-Gatwick services, and the JFK-Heathrow morning flight will be axed in April. Planned new routes to China, Paris, Tel Aviv and Gothenburg have been delayed, though Detroit-Shanghai and Seattle-Beijing are currently still due to start in June (with reduced frequencies).

Delta is committed to capacity discipline and has significant flexibility to ground more aircraft if necessary. At the same time, the airline believes that its expected $6.5bn in merger synergies and cost savings in 2009 and its size make it well-positioned to compete globally.

Having announced the modest further cuts in January, American stated in early February that it was holding off from any further capacity reductions. The airline grew international service much less aggressively than its competitors last year. Its international capacity is currently slated to fall by 2.5% this year.

As in the domestic market, United has the most aggressive international capacity cuts in place for this year, with ASMs slated to decline by 5-6%. The airline is on track to complete the removal of 100 aircraft from its fleet by the end of this year, including all of its 737s and six 747s.

United is also reducing the number of first and business class seats on its 767s, 777s and 747s by 20%, which will help offset some of the effects of the premium traffic decline. The process began in late 2007 and will be completed in late 2010.

United is understandably determined to preserve the breadth and relevance of its global network. While cutting back in many markets, the airline is going ahead with the launch of its nonstop Washington-Moscow service in March (with the reconfigured 767s), after starting Washington-Dubai in October 2008.

Likewise, Continental is going ahead with the launch of a daily Newark-Shanghai service in March. This long flight will boost system ASMs by about 2%, meaning that Continental's international capacity is currently expected to decline by only 1-2% this year. The decision has raised a few eyebrows, but the route is an important part of Continental's long-term strategy and the airline clearly feels that it can be viable. Continental executives noted in the recent conference call that the international business is "still solid, just less profitable than it used to be" and that long-haul flights have benefited disproportionately from the fuel price collapse.

While Continental also hopes to launch new routes such as Houston-Frankfurt and Houston-Rio this year, the airline expects to reduce capacity further in several markets through frequency reductions, aircraft downgrades, day-of-week reductions, seasonal reductions or market exits.

US Airways still expects to grow its international capacity by 10% in 2009, because it is behind competitors in international operations. This year's planned new services include Philadelphia-Tel Aviv and new transatlantic routes to Birmingham, Oslo and Paris. The airline has applied for Charlotte-Rio, which would be its first route to South America. But US Airways is also considering frequency reductions on certain underperforming European routes.

Of course, international routes plans are increasingly tied to alliances – probably the least risky way to venture into new markets during a global recession. For example, American hopes to operate Dallas-Madrid from May – on the expectation that its oneworld JV and ATI applications will be approved. United plans to operate Washington-Madrid as part of an extended partnership with Aer Lingus (which will supply the A330s).

Investing for the long term

In recent months many of the US airlines have made the (perhaps obvious) point that while making short-term adjustments to cope with the recession, they also need to take strategic decisions for the longer term. That is why airlines are still going ahead with some of the long-haul route launches and why American recently launched is long-haul fleet modernization effort with the large (though conditional) order for 787-900s. US airlines have also continued to invest in the product (such as flat bed seats), which they hope will pay dividends in terms of revenues.

The airlines are in the fortunate position of having adequate liquidity, as well as promising prospects for building cash levels through the year. A recent Merrill Lynch report noted that compared to the last recession, industry balance sheets are relatively stronger with double the cash (about $20bn) and 30% less liabilities (on and off balance sheet). The US airline industry should get through 2009 without bankruptcies.

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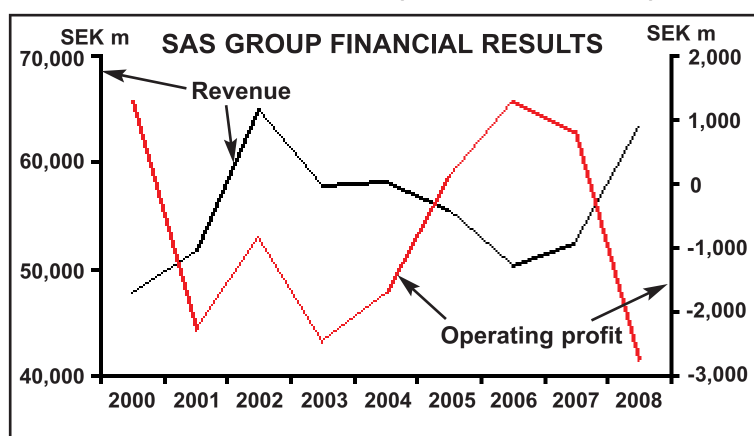
SAS fighting battle to retain independence

It seems often to be forgotten in all the hype about industry consolidation in Europe that it was in fact SAS - Europe's fourth largest legacy carrier by passenger numbers - that was the first to forge a true multinational cross-border airline.

Back in 1947, the national carriers of Sweden (AB Aerotransport and Svensk Interkontinental Luftrafik AB), Norway (Den Norske Luftfartselskab) and Denmark (Det Danske Luftfartselskap) first joined forces to operate transatlantic services. In the early 1950s the three governments and four companies - after much political wrangling - set up a consortium effectively merging their scheduled operations, to be named the Scandinavian Airline System; ownership was split 3/7ths to the Swedes and 2/7ths each to Norway and Denmark.

Ironically, it appears that they had also hoped at the time to include Finnair in the negotiations - but in that icy post-war period it was obviously difficult enough to have four companies and three governments at the negotiating table and - by all accounts - an agreement was only reached after some heavy-handed tactics from the Wallenberg family (shareholders in SILA). To get past the national ownership restrictions inherent in the Chicago convention, the four companies effectively derogated their route rights to the operating consortium - the four companies each retaining their respective ownership structures - with the natural insistence that fleet registrations, employment and resources would be split according to their share of ownership in the consortium.



The industry has changed much over the past 60 years - through most of the time Scandinavian Airlines being remarkably commercial, profitable and run with little state intervention. It was finally at the turn of the millennium that the management persuaded the governments to agree to modernise the ownership structure; initially the separate company shares were aligned and then a single share class and a holding company structure was created: the SAS Group.

Geographical advantages

Historically the airline's strength has been its position on the northern periphery of Europe. Each of the three Scandinavian countries have relatively small populations individually, but collectively they boast 20m inhabitants. The geography of the area, and the superior standards of living, generate an above average propensity to travel by air (most notably in Norway) while the close ties between the three nations encourage significant levels of business (and travel) between the major centres. Taking advantage of deregulatory pressures, SAS nearly managed to sew up its domestic markets - through first the acquisition of Swedish domestic carrier Linjeflyg in the 1980s and then of long-term rival Braathens SAFE in Norway in 2002 - and continues to boast a 40% share of traffic in the region (and 60% in Norway).

In the regulated era SAS successfully developed Copenhagen as a hub - for regional, European and long-haul operations - while pioneering shortest journey time connections (it was one of the first to develop

polar routings, however difficult that is to market to the public at large).

As deregulation spread its populist wings SAS expanded out of its home base - building a 40% stake (now reduced to 20%) in British Midland in the UK; creating Spanair in Spain in the 1990s; developing Blue1 in Finland; and acquiring stakes in airBaltic and Estonian to try to expand its base to the whole of the Nordic region.

It has tended to be at the forefront of industry innovation - from the introduction of polar routings in the 1950s to the development of an intra-European business class in the 1980s. Under the dynamic leadership of Jan Carlzon it was one of the first to develop the zest for international alliances, creating "air bridges" between Copenhagen and New York with Continental (along with an ill-fated 20% equity stake in Texas - remember them?) and Bangkok with Thai International. With all the fall out from the initial alliance turmoils of the 1990s and on the rebound from the failed Alcazar merger negotiations with Swissair, KLM and Austrian, SAS ended up as a founding member of the Star alliance, along with Lufthansa, United and its old friend Thai.

Operational difficulties

Since the onset of full deregulation in Europe in 1992 however, SAS has not fared so well financially, and the erstwhile strength of its position in Scandinavia has turned into a significant opportunity for others. It did manage to achieve record levels of profitability in 1995, but since then - and especially since the disasters of 2001 - operational performance has been exceedingly difficult.

In particular its rescue acquisition of Braathens in 2002 (and the consequent ban on the use of frequent flyer programmes on domestic Norwegian travel) created the opportunity for low cost carrier Norwegian Air Shuttle to attack the near monopoly this created; and despite apparent "dirty tricks" (a court case is coming again to appeal this year), Norwegian has managed to claim 40% market share within Norway and is extending its attack to

SAS MAINLINE FLEET

	Fleet	Orders	Options
A319	4		
A321	8		
A330	4		
A340	7		
737-600	17		
737-800	4	4	
MD-80s	44		
CRJ900	2	8	17
Total	**90**	**12**	**17**

Sweden (see *Aviation Strategy*, December 2008) in co-operation with arch-enemy Finnair. The prime reason - as always - for this disappointing performance is that the legacy carrier's costs are just too high and productivity too low. In SAS's case this is further exacerbated by the nature of its route structure: the average trip length hovers around 1,000km - the shortest of all the legacy carriers in Europe.

SAS has tried to respond - with reasonable success at least up to 2007. It reorganised its structure completely; the former Scandinavian Airlines System was broken into three constituent and virtually standalone "national" carriers - SAS Norge, SAS Sverige and SAS Danmark - while the long-haul services were placed into a new SAS International operation. This was designed to give the separate entities greater flexibility, accountability and visibility in order to generate greater operational efficiency. The group re-emphasised its belief in core operations - with hotel business Radisson SAS sold in 2006.

True to historical form, SAS was one of the first legacy carriers to start fighting back at the new generation LCCs in offering one-way fares while (accepting that still 60% of its traffic is travelling on business) scheduling operations far more closely linked to daily, weekly and seasonal demand.

By the end of 2006 it had achieved some reasonable progress; most indicators were showing improved signs of underlying profitability, albeit still below the sustainable cash flow returns on investment it needed to renew its fleet. 2007 brought in a new CEO - Mats Jansson - a new(ish) strategy, a new

SAS STRATEGY 2010 IN BRIEF (VERBATIM)

• "SAS will carry out a cultural turnaround characterized by a stronger cus tomer orientation, clearer management and greater commitment among all our employees.
• "We are focusing on airline operations. This is where we create the greatest value for our customers and where we can be unique.
• "We are concentrating on air travel to, from and within Northern Europe. We are harmonizing and developing our offerings.
• "Our customers shall see distinct, uniform, flexible and value-for-money offerings regardless of which of our airlines they fly with.
• "We have to become competitive in all parts of our business and continue to reduce our costs. Moreover, we also have to regain world-class punctuality and regularity.
• "Profitable growth. The target is for the Group to have 20% more passengers in 2011 compared with 2007, with higher resource utilization and less complexity in business operations."

cost saving plan, a series of strikes and a disaster requiring the grounding of most of the Dash-8 Q400 fleet. 2008 proved worse - with the rollercoaster of oil prices, the accelerating economic downturn and the fatal Spanair accident in Madrid in August.

The new "Strategy 2011" (see above) is fairly basic: concentrate on core activities, which is defined as aviation in northern Europe. Underlying SAS's strategy is the need to boost earnings towards a 7% operating margin that would provide the returns on investment necessary to cover the cost of capital and provide for the long-term fleet renewal: this translates into a medium-term aim of generating earnings of around SEK4bn (€400m) - against the SEK1.2bn earned in 2007.

Initially this strategy envisaged generating annualised cost savings of SEK2.8bn - given the poor results in the past year this has been extended to try to create additional savings of some SEK4bn on top of the SEK1.5bn emergency effort in the attempt to rescue results for 2008.

One of the core elements of the strategy is to encourage a "cultural turnaround". The management started the process of improving relations with the unions at the back end of 2007, and started intense negotiations in November last year. This has at last culminated in an agreement signed this January, with the main unions providing a new collective agreement that should generate some 12% saving on the unionised salary bill - partly through salary reductions (the pilots have apparently accepted a 6% reduction in salaries that has been matched by the management and even the board of directors) but mostly from working practice changes - creating an annual SEK1.35bn cost savings and a one-off benefit of SEK156m from reversal of pensions in SAS Norway.

A second - but perhaps more worrying - aspect of the strategy is the apparent aim to grow into cost savings, with a target to increase total passenger numbers by 20% over the four years to 2011; this means an average annual growth rate of 5%.

Portfolio changes

The structural reorganisation is well under way even though some of the plans have taken longer to come to fruition because of the economic background. The group sold its Spanish ground handling operation (very imaginatively called Newco), put up for sale its stakes in bmi, Spanair and Air Greenland; and put in question its ownership of airBaltic and Estonian failing a majority ownership.

It also gave its hitherto uncompetitive ground handling operation SGS an effective ultimatum - to turn round the profitability by mid-2009 or be sold. In the past month it has sold its involvement in airBaltic (for SEK220m) to the management, having failed to persuade the government to pursue full privatisation, and come to an agreement to sell AerBal (a 717 feeder to Spanair).

Initial statements of interest in Spanair proved apparently somewhat below SAS's expectations - mainly because of the mess in the Spanish domestic market - and SAS having put it on the "for sale" list, (so it did not have to consolidate the numbers in the 2007 accounts) then reconsolidated the company midway through 2008.

In the middle of December the group finally reached an agreement to sell a majority stake to Spanish investors. The opportunities for selling the stake in bmi, however, are even more fraught. Last year Michael Bishop cannily exercised his

option to put his 50%+ stake in Heathrow's second largest carrier to 30% holder Lufthansa for €400m. SAS is left as a minority 20% holder in a private company, albeit a subsidiary of its long-term partner, and (always depending on what Lufthansa decides to do with bmi) with only one possible buyer for its stake. It is apparently trying to insist that Lufthansa buy out its stake at the same exercise price to generate a useful €160m in cash - much to Lufthansa's chagrin.

A disastrous year

One of the major problems in looking at the SAS Group is that the company puts out so much information to help financial analysts that it is sometimes difficult to differentiate the spruce from the forest. Nevertheless, whichever way you interpret the numbers, 2008 turned out to have been a truly disastrous year. For the full year total revenues (of continuing operations) were up by 3%, with a reasonable improvement in underlying yields even though passenger numbers were at the same level as the previous year (having fallen by 9% and 8% respectively in the last two quarters).

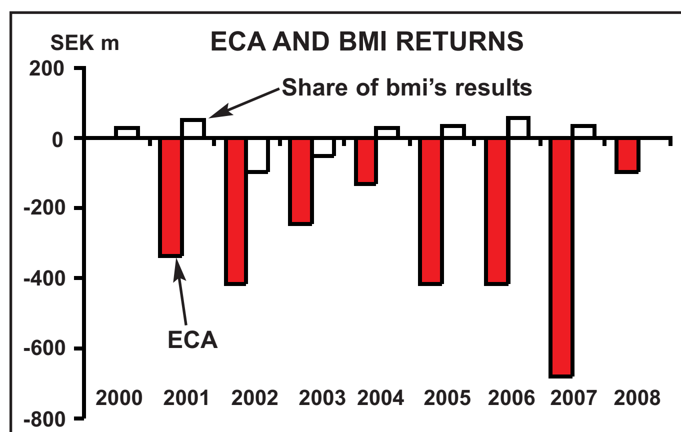
Mainly because of the fuel price movements earlier in the year, EBITDAR for the period fell by a quarter to SEK3.9bn and the group reported an underlying operating loss for the year of SEK395m against a profit of SEK1.2bn in the prior year - the real underlying deterioration was even worse as this excluded the losses from the bmi ECA agreement (although for some reason some SEK100m losses crept into the last quarter of the year) as well as the effects of the prior year strikes and some slightly reduced additional leasing costs attributed to the grounding of the Q400 fleet.

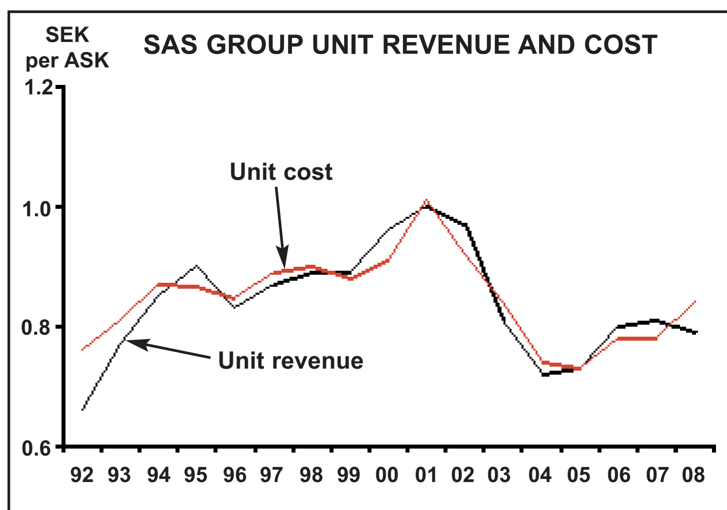
On top of all this, SAS has finally come to an agreement to sell the majority of its stake in Spanair (for a nominal €1), and this has once again been reallocated to "assets held for sale". Under the increasingly inane accounting policies this means that SAS does not have to report all the gory details of the skeletons and can treat everything as "below the line".

However, the Spanish subsidiary managed to lose yet another SEK560m in the final quarter, giving a full year operating loss of SEK1.3bn. In addition, on top of a SEK1.9bn charge SAS had written off in the first nine months against goodwill, there was a further allocation of SEK1.6bn for restructuring costs and capital loss on the sale of its investment. As a result, all skeletons and various kitchen sinks included, the SAS Group reported a bottom line net loss for the full year of a whopping SEK6.3bn, compared with a net profit of SEK636m in the prior year period.

Hardly surprisingly, the group needs to restore the damage to its balance sheet and - at the same time as the results announcement - revealed plans to raise some SEK6bn through a rights issue (incidentally on the same day that Qantas decided to do the same). This is apparently done with the full backing of the three governments as well as the Wallenberg Foundation. To provide some incentive, the group has outlined yet another new strategy: under the soubriquet of "Core SAS".

In one sense this is an extension to the earlier "Strategy 2011", with the aim of concentrating on the core Nordic region and trying to bring the cost base closer to that of its competitors by an additional SEK4bn. Under this plan the group will retreat completely from all but airline operations in the Nordic region - with further acceleration of plans to dispose of non-Nordic, non-core investments (keeping Blue1 but selling Estonian, Air Greenland etc), slimming down and sell-





ing and/or outsourcing the uncompetitive ground handling operations and MRO activities outside the main bases.

Instead of trying to grow the business into cost reductions, the group will now dramatically cut capacity, withdraw from a plethora of unprofitable routes (for a possible net benefit of SEK800m) and - SAS always says this when it gets into trouble - focus more intensively on profitable business routes, with even greater emphasis on the business passenger. SAS states that it plans to cut the total number of city pairs operated by some 40% and capacity (as measured by ASKs) by 20%, while disposing of (or presumably parking) 20 aircraft.

As a result there will be a mass of redundancies - hopefully, following the recent collective agreements, without strike action - with 3,000 going from the SAS companies while the asset disposals will account for another 5,000 staff leaving the group, out of a current staffing complement of 24,600.

Far more importantly, the group is tearing up the organisational structure it put in place three years ago: the three national SAS airlines will be reintegrated into a single operating company and SAS International will disappear as a separate reporting unit.

This will come at a cost - with an anticipated restructuring cost of around SEK0.9bn - but is all anticipated to improve underlying operating profitability by some SEK700m.

By James Halstead

Continuing independence?

This new (even more) improved strategy might work. However, while growing into cost savings is the favoured industry approach (and rarely really works), cutting unit costs is always exceedingly difficult to achieve while slashing operations to such a dramatic extent. The deep-seated problem for SAS, however, is the very constitution of its avowed core competency: its business passengers on its core business routes also fly on holidays to tourist destinations; an airline seat is a commodity and in a commodity market the lowest cost producer will win. The least that may happen is that the erstwhile pioneer of globalised network operations retreats to become a regional, marginal European legacy network carrier.

The unanswerable question is whether SAS has the ability to push through this strategy to generate the returns to allow it to survive beyond this economic downturn as an independent entity - or at least put it in a position to be sold in the next upturn. The local stock markets seem to have the idea that SAS will be looking to combine with another company in much closer co-operation - with a significant recent outperformance of its shares against peers - at least until the rights issue annoucement.

The natural choice for a rescuer might appear to be Lufthansa - but it also has its own problems (apart from anything else, facing the questions of Austrian, SN Brussels and bmi) and has already been able to garner benefits from the alliance link with SAS over the years, not least of which comes from the monopolistic joint venture on German-Scandinavia routes.

Ironically the other day Finnair raised its head from across the Baltic suggesting - and maybe masking its own strategic shortfalls - a truly Nordic solution. That could really upset the alliance structures in Europe. In the end, with the governments still owning 50% of the SAS shares, the outcome will no doubt come down to politics.

AirAsia: expanding out of the downturn

AirAsia shows no sign of slowing its aggressive expansion plans despite reporting a net loss in the July-September 2008 period – its first quarterly loss since going public in 2004. Is that quarter's result a one-off, or is Asia's largest LCC heading for troubled times?

Undoubtedly July-September 2008 was a bad quarter for AirAsia – despite a 42.6% year-on-year rise in revenue to RM 658m (US$197m), operating profit at the core Malaysian operation fell 37.2% to RM 92m (US$28m), and a net profit of RM 180m in July-September 2007 turned into a RM 466m (US$140m) net loss in July-September 2008.

AirAsia's first quarterly net loss was due primarily to two items, the first of which was a large RM 293m (US$88m) finance charge, comprising higher interest charges on increased borrowings and a RM 213m (US$64m) exchange loss due to the weakening of the Malaysian Ringgit against the US Dollar (see *Aviation Strategy,* March 2008). Secondly, the airline suffered a RM 215m (US$65m) exceptional charge for unwinding fuel contracts that had been signed at prices in excess of the current spot price, as well as for the anticipated non-recovery of hedging deposits held with Lehman Brothers, which went bankrupt in September 2008.

In the July-September quarter the Malaysia operation carried 3m passengers (24% up on a year earlier) but capacity (ASK) growth of 33% was ahead of a 27% traffic (RPK) increase, resulting in a 3.9 percentage point drop in load factor, to 75.4%. In the first nine months of 2008 the group carried 13.5m passengers (compared with 11m in the January-September 2007 period), and it expects to carry around 19.5m passengers in full 2008.

AirAsia describes the exceptional losses as "short-term pain for long-term gains" and says that both its medium- and long-term prospects are good. The October-December period is traditionally AirAsia's strongest quarter, and with the price of fuel dropping (AirAsia and AirAsia X removed all fuel surcharges in November 2008) the airline expects to post "satisfactory" results for this period. AirAsia is seeing "more passengers switching to LCCs as their primary travel option", although the Ringgit is continuing its weakness against the US Dollar, which will again hit the net result.

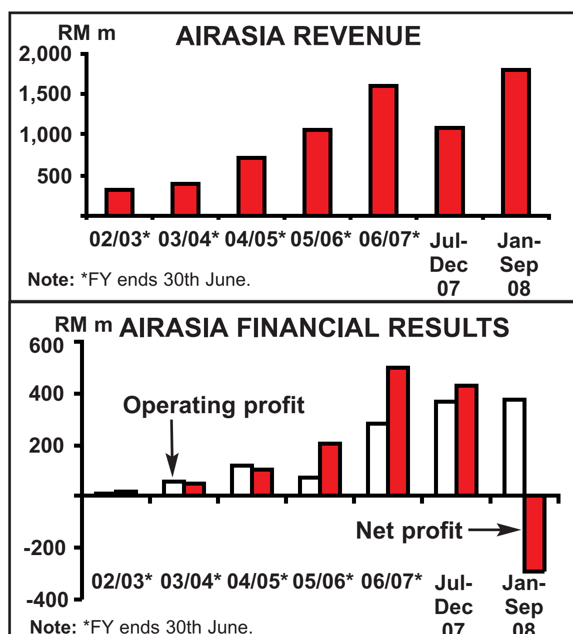
The AirAsia group is thus still intent on expanding its way out of the downturn, with Tony Fernandes, AirAsia group CEO, saying that "we have always taken the contrarian approach and gone against conventional wisdom". Indeed AirAsia believes the downturn is beneficial, as business customers that flew on legacy carriers are now switching to AirAsia in order to cut costs.

The group now operates 110 routes, with more than 30 of these launched in 2008. Its network covers 11 ASEAN countries and serves 70 southeast Asian destinations, and these are operated with a fleet of 76 aircraft. There are 121 A320s on order, to be delivered by the end of 2013, and the group also has options to buy another 50 aircraft at a heavily discounted price.

The question that needs to be asked is just where AirAsia will place these aircraft? This is particularly pertinent given the problems AirAsia is having in expanding operations into other Asian countries outside of its Malaysia home.

AIRASIA FLEET

	Fleet	Orders	Options
AirAsia (Malaysia)			
A320-200	44	121	50
Thai AirAsia			
A320-200	8		
737-300	8		
Indonesia AirAsia			
A320-200	2		
737-300	12		
AirAsiaX			
A330-300	2	24	
Total	**76**	**145**	**50**



Malaysia strength

The Malaysian market remains the heart of the group's operations, accounting for 60% of group capacity. The last 737-300 was taken out of service on Malaysian AirAsia in October 2008 and the carrier now operates a fleet of 44 A320s. AirAsia has the advantage of using Kuala Lumpur airport's Low-Cost Carrier Terminal (LCCT), which has fees around half of that charged at the main terminal, and this low cost base has been key to AirAsia's success. However, although the facility was only opened in 2006 it is already operating at full capacity, and despite recently being extended to handle 15m passengers a year in 2009, this again is not sufficient for AirAsia's plans.

So in December 2008 the Malaysian government announced that it had given permission for AirAsia to build its own low cost airport in Kuala Lumpur. The new airport would have been separate from the LCCT and Kuala Lumpur International Airport (KLIA), although it was to be called KLIA East. The US$0.5bn facility would have been built by a local conglomerate called Sime Darby, with AirAsia managing and owning the airport. With 70 aircraft stands and handling up to 30m passengers a year, work was scheduled to begin in the first half of this year, with a completion date of March 2011

Unlike the LCCT, the new airport would have had rail links to both Kuala Lumpur city and KLIA (and be closer to KLIA's main terminal than the LCCT, which is 20km away), allowing easier connections (than possible between the LCCT and KLIA) between AirAsia flights and those of other airlines. But state-owned Malaysia Airports - which operates KLIA and LCCT - was unhappy about the new airport, and in late January the Malaysian government abruptly withdrew permission for the development. It may be that AirAsia's plans were designed to force Malaysia Airports to develop KLIA in the way AirAsia wants, but whether it happens through this route or via a new airport, AirAsia appears determined to keep driving its operating costs down further.

AirAsia apparently no longer sees Malaysia Airlines as its key competitor, with Fernandes saying that the "battle with MAS is over", given that it has now been allowed onto key MAS routes. This may be a little presumptuous, as MAS is cutting costs and the difference in fare levels between MAS and AirAsia is now starting to narrow.

AirAsia is likely to put many of its incoming aircraft onto new international routes out of Kuala Lumpur, and key target markets are China and India. AirAsia currently serves seven Chinese destinations out of Kuala Lumpur, the latest being Guilin (a tourist destination in the southern part of China, close to Beijing), which started in September 2008. AirAsia's first route to India began in December 2008 with a daily flight on Kuala Lumpur-Trichy (also known as Tiruchirapalli) - in the south of India - and the airline aims to open 10 more routes to India over the next 18 months.

AirAsia has taken full advantage of access onto the lucrative Kuala-Lumpur-Singapore route, now fully liberalised after being previously dominated by Singapore Airlines and MAS. The process began in early 2008 when rivals to MAS and SIA were allowed for the first time, and through the year AirAsia experienced load factors into the 90s on the route. AirAsia's service rose from two to seven round-trips a day from December 2008, once the route was completely opened up in order to comply with the Association of Southeast Asian Nations agreement that required unlimited passenger flights between capital cities of member nations by the end of that year. Of course this has also meant increased competition from others (e.g. Jetstar Asia, Tiger

Airways and from SIA subsidiary SilkAir), but AirAsia is confident that it can make a substantial profit on the route.

Thailand and Indonesia woes

Elsewhere, however, the group is facing difficulties, and the Thailand and Indonesian operations (in each of which it owns a 49% stake) continue to rack up losses, although AirAsia says that "operational losses have reduced substantially" at these subsidiaries recently. The Thai operation made a THB 250m (US$7m) loss in the July-September 2008 period, 44% down compared with April-June 2008, while the Indonesian subsidiary lost IDR 12bn (US$1.3m), 88% down on the previous quarter.

Indonesia AirAsia is attempting to reduce unit costs through phasing out its 737-300s – it received its first A320 in September last year and a fleet of 32 A320s is expected by 2013, when its current 12 737s will have all gone. It carried around 2.5m passengers in 2008 and is expanding onto new routes and destinations around Asia as the A320s come on stream; for example, it launched its first service to Singapore in August 2008. Indonesia AirAsia is also being helped by the closure of Indonesian LCC Adam Air in early 2008.

The Indonesian operation appears to be doing better than Thai AirAsia, which postponed its plans to IPO in Thailand last year thanks to the economic downturn. It operates to 20 domestic and international destinations (and has an estimated 40% market share of the domestic market), but political unrest in Thailand has affected the carrier significantly, with passengers carried in 2008 expected to be around 0.5m less than the targeted 4.6m. The airline currently operates to 11 domestic destinations, and future expansion is focused entirely on international routes.

Thirty of the group's A320s on order are destined for the Thai subsidiary and are due for delivery by 2013, by when the airline will have an all-A320 fleet. It currently has eight A320s and eight 737s and at least the new A320s have enabled Thai AirAsia to improve its punctuality, which has previously been a problem when operating ageing 737-300s. Fernandes insists that the Thai subsidiary will break even this year, and this target will be helped by contraction of key Thai LCC rivals Nok Air (39% owned by Thai Airways) and One-Two-GO.

Elsewhere, the group has also long had plans (announced in 2007) to launch a Vietnamese subsidiary, in partnership with the state's Vietnam Shipbuilding Industry Corp. However, AirAsia appears to be having problems obtaining the necessary approval from the Vietnamese government, and this plan has stalled.

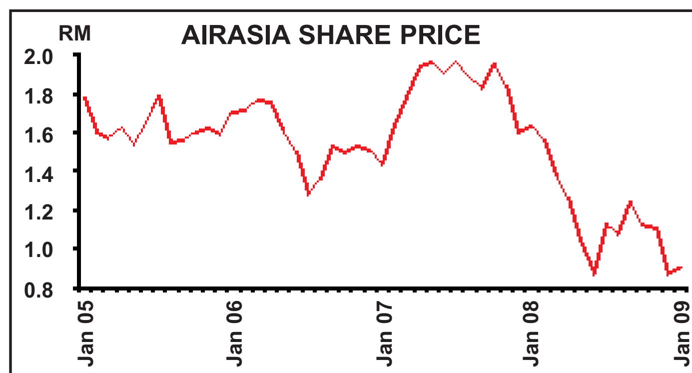
The Philippines remains another possibility, and a lower priority is to launch another subsidiary in the northeast of Asia, such as out of Macau, to which AirAsia already operates four routes out of Malaysia, as well as to/from Bangkok via Thai AirAsia.

AirAsia X ambition

Though not formally part of the AirAsia group, AirAsia X operates to destinations that are more than four hours flight time away from Kuala Lumpur, leaving the shorter routes to the AirAsia group carriers. 48% of AirAsia X is owned by Aero Ventures (controlled by Tony Fernandes), with the Virgin Group and AirAsia each having 16% and the Bahrain-based Manara Consortium and the Japanese lessor, Orix Corporation each acquiring 10% in February 2008 for approximately RM 125m (US$39m) each.

AirAsia X currently operates four routes out of Kuala Lumpur, to Hangzhou, Perth, the Gold Coast and Melbourne, which, the airline says, are "performing well". Despite the global economic situation AirAsia X remains bullish about its plans, and indeed the airline now wants to become the first global, long-haul LCC. Azran Osman-Rani, AirAsia X chief executive, says that it has "no legacy base to cutback from" and will instead use the current opportunity to

Note: *FY ends 30th June.



expand into other routes as other airlines contract, on the assumption that many business trips and leisure demand will hold up, albeit it at the cheapest fares possible.

Despite this ambitious statement, the majority of new AirAsia X routes in the short-term are likely to be to the Asia/Pacific and Middle East regions, with a key factor being that new destinations will be chosen primarily because they have the potential to feed into other AirAsia flights out of Kuala Lumpur. Also, AirAsia X prefers airports and local authorities that are willing to promote new air services.

India is a priority with AirAsia X too, as in November 2008 Malaysia and India updated their bilateral to allow more flights to Indian cities. AirAsia X is looking to launch flights to Delhi, Mumbai and Amritsar, at least one of which will be served by a new route in 2009. Altogether AirAsia X will launch around five new routes in 2009, and as well as one Indian destination other possibilities are a fourth Australian city (probably Sydney), a second one in China (likely to be Beijing or Tianjin), and potentially destinations in Taiwan, Japan or Korea. AirAsia X is also looking at the Middle East, with Dubai, Abu Dhabi, Sharjah, Jeddah and Bahrain all being considered - although the earliest those routes would be launched is 2010.

The only intercontinental route to be launched in 2009 is to London Stansted, which will commence in March. However, AirAsia X still has to decide its overall strategy for Europe, with Fernandes saying that the key decision is whether "we put all our efforts into London, which becomes our hub for Europe, or whether we have a hub in central Europe and eastern Europe, for example". The short-term goal, however, is to increase frequency on Kuala Lumpur-London to two services a day, although there is talk of this eventually increasing to five flights a day via a "shuttle service" linking hubs at either end of the route. The initial five flights a week service will be operated with an A340-300 leased from Orix, and it will have a break-even load factor of the mid-70s, although AirAsia X is looking for a figure in the low-to-mid 80s. Although 20% of the London routes have seats at £99 (one-way, excluding taxes and charges), it also has premium seats that recline fully from £549.

The A340 is a stop-gap while the carrier decides on either the 787 or A350 XWB, with the latter believed to be the preference at the moment. Whichever model it chooses, approximately 25 aircraft are likely to be ordered; Fernandes says the airline is in "active discussions" with the two manufacturers. At least two further A340s will be leased in the short-term,

AirAsia X received its first new A330-300 in November 2008 and this was used immediately on the Kuala Lumpur-Perth route that was launched the same month. A second aircraft arrived in December and the 24 other aircraft on order will be delivered over the period to 2013 (with three due for delivery in 2009, four in 2010, six in 2011 and 2012, and the rest in 2013).

AirAsia X operates the A330 with nine crew per flight, as opposed to the 13 to 15-strong crew used by other airlines. AirAsia X claims its overall costs per ASK are around 4 US Cents, which is at least half that of legacy long-haul carriers, and that this will go down to 3.5 US Cents once all the A330s are delivered. Also contributing to low unit costs are the facts that AirAsia X has no interlining, in-flight meals are paid for and (most crucially of all) the carrier is looking to get 18.5 hours utilisation out of its aircraft – a rate that few (if any) long-haul airlines have achieved.

AirAsia X's plan is to operate to around 50 destinations in Asia/Pacific, Indian-sub continent, Europe and - in the longer term - North America (with Los Angeles a potential destination). An IPO is planned for 2010, although some analysts are making comparisons with Oasis Hong Kong Airlines, which launched as a long-haul LCC in October 2006 with routes to Vancouver and London Gatwick, but which closed down in April 2008. Fernandes says such a comparison is not valid, as unlike Oasis AirAsia X has a well-known brand and has a large amount of Asian services into Kuala Lumpur's LCCT, which will ensure feed for the long-haul flights. More importantly per-

haps, it has the backing of shareholders with relatively deep pockets.

The future

AirAsia's net loss in July-September 2008 must be seen as a short-term blip, as the fundamentals for the group look reasonably sound. The new airport in Kuala Lumpur will help drive unit costs down further, and other cost saving measures include the opening of a new call centre in Kuala Lumpur in February, which will handle all bookings across the group. Ancillary revenue is also developing well – in the third quarter of 2008 it totalled RM 69.7m (US$21m) at the Malaysian operation, 88% up on the previous year, with average ancillary expenditure growing 52% in a year, to RM 37.1 (US$11.1) per passenger. This was due partly to the introduction of a checked baggage fee in April 2008. And in the short-term AirAsia says that forward contracts to buy US dollars mean that it could enjoy gains of as much as RM 365.6m (US$110m), based on the current exchange rate.

Operationally AirAsia is still profitable, and its strategy of expansion while other airlines contract and/or increase fares is sensible (though not without risk), so it should be in a good position whenever the economic downturn recedes. Fernandes says that the current recession is just the latest in a series of crises that AirAsia has successfully gone through: "We have experienced SARS, terrorism, the bird flu and the Bali bombing. The worst was SARS, but we found a way to get out of it."

AirAsia expects passengers carried to grow by 25% this year, and that appears a realistic ambition. Although accurate figures are difficult to obtain in Asia, LCCs account for an estimated 10% of passengers carried in the Asia/Pacific region, compared with the approximate 30% carried by LCCs in Europe and North America, and so there appears to be plenty of room for expansion for the AirAsia group - even if short-term may be tricky. The only question is whether the group really needs to set up subsidiaries in other countries. The Thailand and Indonesian subsidiaries have racked up losses for the AirAsia group and the wisdom of this strategy is doubtful, since the only real advantage that can be gained by formally having other Asian subsidiaries is being able to enter domestic markets. In India or China this would be sensible, but the wisdom of setting up subsidiaries in Vietnam or Thailand can be queried.

The other concern is that AirAsia's debt has risen in order to pay for the large order book. While cash and cash equivalents stood at RM 774m (US$232m) as at the end of September 2008, long-term debt stood at RM 5.5bn (US$1.7bn) – some RM 2.1bn higher than at the end of 2007, and this is producing a significant increase in interest charges.

Nevertheless, given its strategy and the longer-term prospects, AirAsia - and particularly its majority owner Tune Air - is bullish. Indeed Tune Air believes that AirAsia is undervalued: in 2004 it floated at RM 1.4, reaching a high of RM 2.11 in May 2007 before a steady slide to well under RM 1 in June 2008 (see graph, page 16) – and it was reported that a Cayman Islands-based hedge fund called Nomad started buying AirAsia shares once the price went under RM 1.

AirAsia's shares recovered in the last few months of 2008 after oil prices started to subside significantly from September onwards, and due to news that Tune Air (owned by Tony Fernandes and deputy chief executive Kamaruddin Meranun) wanted to buy out other shareholders and delist the airline from the Malaysian stock exchange. Tune Air currently owns 30.7% of AirAsia, with the Employees Provident Fund – the largest private pension fund in Malaysia – owning 8.9%, and with 43.5% floated. But by December this plan collapsed, due to an inability by Tune Air to find acceptable finance. Tune Air had indicated it would offer RM 1.35 per share, which would have meant raising up to RM 2.2bn (US$660m) to buy out the remaining shareholders, but this simply wasn't possible in the current economic climate.

In early February the shares were still trading at under RM 1, and whether Tune Air will try again to raise the finance to take the airline private remains to be seen. There were reports in late 2008 that AirAsia and Qantas's LCC Jetstar Asia were in merger talks, but this was denied by both Jetstar and AirAsia, and a tie-up between the two airlines would have little obvious benefit to AirAsia.

In December Tony Fernandes somewhat mischievously suggested that one day he would like to make a bid for Singapore Airlines - but that was largely a side sweep at reports that MAS may enter a strategic alliance with BA and Qantas. A more likely possibility is that a legacy airline makes a bid for AirAsia – particularly if it agrees with Tune Air's assessment that the airline's shares are undervalued and that the future for the group is sound.

Boeing and Airbus managed to book 1,449 net new orders between them in 2008 - another impressive year. The situation is now reversing with negative net orders being recorded for January as cancellations start to accelerate.

Now the attention is on the delivery rate, which the two manufacturers are still estimating at around last year's level – 860 units – based on record backlogs. The threat is, however, that demand continues to weaken and, perhaps more importantly, the supply of primary finance dries up to such an extent that even the guarantees provided by Export Credit Agencies will not fill the funding gap. Steven Udvar-Hazy, the chief executive of ILFC, who normally gets these things right, foresees 30-35% production cuts at both Boeing and Airbus in 2010, with output being severely reduced in the final quarter of this year. He also notes that it is possible that there will be a negative net order total for 2009.

BOEING ORDERS 2008

	737	747	767	777	787	Total
Air France				7		**7**
Blue Air	5					**5**
British Airways				2		**2**
PrivatAir					1	**1**
Ryanair	17					**17**
Saga Airlines	2					**2**
SAS	2					**2**
SkyEurope	2					**2**
EUROPEAN TOTAL	**28**	**0**	**0**	**9**	**1**	**38**
American Airlines	36					**36**
Aviation Capital Group	32					**32**
Boeing Business Jet	10	3	1			**14**
Continental Airlines	19			6		**25**
Delta Air Lines				2		**2**
GECAS				2		**2**
Southwest Airlines	17					**17**
United States Navy	2					**2**
Westjet	4					**4**
NORTH AMERICA TOTAL	**120**	**3**	**1**	**10**	**0**	**134**
COPA Airlines	6					**6**
LAN Airlines			4			**4**
LATIN AMERICA TOTAL	**6**	**0**	**4**	**0**	**0**	**10**
Air China	30					**30**
All Nippon Airways			9			**9**
Asiana Airlines				3		**3**
Azerbaijan Airlines	2		2			**4**
Biman Bangladesh Airlines	2			4	4	**10**
Garuda Indonesia				4		**4**
Korean Air				1		**1**
Lion Air	56					**56**
Malaysia Airlines	35					**35**
Turkmenistan Airlines	3			1		**4**
Uzbekistan Airways			4			**4**
ASIA/PACIFIC TOTAL	**128**	**0**	**15**	**13**	**4**	**160**
Arik Air	7					**7**
Egyptair				2		**2**
El Al Israel Airlines				4		**4**
Etihad Airways				10	35	**45**
FlyDubai	50					**50**
Gulf Air					16	**16**
Ministry of Finance,Iraq	30					**30**
Oman Air	6					**6**
Rak Airways	4					**4**
AFRICA/M. EAST TOTAL	**97**	**0**	**0**	**16**	**51**	**164**
Unidentified Customer	109	0	9	6	38	**162**
Total Gross Orders	**488**	**4***	**29**	**54**	**94**	**669**
Cancellations	**-4**	**-1**	**-1**	**0**	**-1**	**-7**
TOTAL NET ORDERS	**484**	**3**	**28**	**54**	**93**	**662**

Note: Excludes cancellation in year of order.

AIRBUS ORDERS 2008

	A318	A319	A320	A321	A330	A340	A350	A380	Total
Aer Lingus			4		6		6		16
Aeroflot				11					11
Air Astana		6							6
Air France			12	6					18
Air One			10		12		12		34
Atlantic Airways		1							1
AWAS			75						75
British Airways			2						2
Comlux Aviation			1						1
Croatia Airlines		4							4
Finnair					1				1
Hamburg International		2							2
Iberia						2			2
JETALLIANCE	2	1							3
Lufthansa					2				2
MTAD					18				18
Uzbekistan Airways			4						4
EUROPEAN TOTAL	**2**	**14**	**108**	**17**	**39**	**2**	**18**	**0**	**200**
ACG			23						23
CIT		9	16		5				30
Hawaiian Airlines					6		6		12
MatlinPatterson					6				6
Petters Group	1								1
Virgin America			2						2
NORTH AMERICA TOTAL	**1**	**9**	**41**	**0**	**17**	**0**	**6**	**0**	**74**
Synergy Aerospace							10		10
TACA International AL		3	12						15
TAM - Linhas Aereas		3	9	8	4		22		46
LATIN AMERICA TOTAL	**0**	**6**	**21**	**8**	**4**	**0**	**32**	**0**	**71**
Air China					20				20
AirAsia			25						25
AirAsia X					10				10
Asiana Airlines							30		30
BOC Aviation		17	3		5				25
CASGC			110						110
China Airlines							14		14
China Southern					10				10
Korean Airlines								3	3
Philippine Airlines			2						2
Vietnam AC Leasing				10					10
Vietnam Airlines				10			10		20
ASIA/PACIFIC TOTAL	**0**	**17**	**140**	**20**	**45**	**0**	**54**	**3**	**279**
Afriqiyah Airways							6		6
Arik Air						2			2
Libyan Airlines			7		4		4		15
Tunis Air			10		3		3		16
Air Arabia			10						10
Al Jaber Aviation	2	2							4
Alafco			4						4
DAE Capital			70				30		100
Etihad Airways			20				25	6	51
Gulf Air			15		20				35
MAZ Aviation							6		6
Nile Air				9					9
Saudi Arabian AL					8				8
AFRICA/M. EAST TOTAL	**2**	**2**	**136**	**9**	**35**	**2**	**74**	**6**	**266**
Private Customers	0	6	0	0	0	2	2	0	10
Total Gross Orders	**5**	**54**	**446**	**54**	**140**	**6**	**186**	**9**	**900**
Cancellations	-18	-65	-4	0	-3	-5	-23	0	-123*
TOTAL NET ORDERS	**-13**	**-11**	**442**	**54**	**137**	**1**	**163**	**9**	**777**

Note: *Including five A310 cancellations.

		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/ KLM Group YE 31/03	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	
	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	106,700
	Jul-Sep 08	10,071	9,462	609	44	6.0%	0.4%	69,930	58,041	83.0%	20,439	107,364
	Oct-Dec 08											
BA YE 31/03	Oct-Dec 06	4,051	3,798	253	210	6.2%	5.2%	36,563	27,073	74.0%	7,878	42,197
	Jan-Mar 07	3,792	3,731	61	-140	1.6%	-3.7%	36,405	26,003	71.4%	7,269	42,073
	Year 2006/07	**16,149**	**15,004**	**1,145**	**578**	**7.1%**	**3.6%**	**148,321**	**112,851**	**76.1%**	**33,068**	**43,501**
	Apr-Jun 07	4,395	3,868	527	539	12.0%	12.3%	37,514	28,836	76.9%	8,648	
	Jul-Sep 07	4,729	4,118	611	458	12.9%	9.7%	38,191	30,500	79.9%	9,206	42,024
	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
	Oct-Dec 08	3,612	3,692	-80	-134	-2.2%	-3.7%	36,300	31,335	86.3%	8,835	
Iberia YE 31/12	**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	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
	Oct-Dec 08											
Lufthansa 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
	Oct-Dec 08*											
SAS YE 31/12	Oct-Dec 06	2,215	2,121	94	679	4.2%	30.7%	13,672	9,343	68.3%	9,705	25,534
	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**	**34,529**
	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
	Oct-Dec 08	1,665	1,706	-42	-357	-2.5%	-21.4%	9,750	6,559	67.3%	6,612	23,082
Ryanair YE 31/03	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	
	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	
	Oct-Dec 08	798	942	-144	-157	-18.0%	-19.7%			71.3%	12,400	6,298
easyJet YE 30/09	**Year 2004/05**	**2,478**	**2,356**	**122**	**109**	**4.9%**	**4.4%**	**32,141**	**27,448**	**85.2%**	**29,600**	**4,152**
	Oct 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**	**5,674**
	Oct 07-Mar 08	1,795	1,772	22	-87	1.2%	-4.8%	23,442	19,300	82.3%	18,900	
	Apr-Sep 08	2,867	2,710	157	251	5.5%	8.7%	32,245	28,390	88.0%	24,800	
	Year 2007/08	**4,662**	**4,483**	**180**	**164**	3.9%	3.5%	**55,687**	**47,690**	**85.6%**	**43,700**	**6,107**
	Oct-Dec 08	867						13,000	10,800	83.1%	10,100	

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	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
	Oct-Dec 08*	827	934	-107	-75	-12.9%	-9.1%	8,996	6,923	77.0%	3,772	9,156
	Year 2008*	**3,663**	**3,835**	**-172**	**-136**	**-4.7%**	**-3.7%**	**38,974**	**30,113**	**77.3%**	**16,809**	**9,628**
American	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
	Oct-Dec 08	5,469	5,665	-196	-340	-3.6%	-6.2%	62,370	48,846	78.3%	21,444	81,100
	Year 2008	**23,766**	**25,655**	**-1,889**	**-2,071**	**-7.9%**	**-8.7%**	**263,106**	**211,993**	**80.6%**	**92,771**	**84,100**
Continental	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
	Oct-Dec 08	3,471	3,496	-25	-266	-0.7%	-7.7%	42,563	33,514	78.7%	15,183	
	Year 2008	**15,241**	**15,555**	**-314**	**-585**	**-2.1%**	**-3.8%**	**185,892**	**149,160**	**80.2%**	**66,692**	**42,000**
Delta	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
	Oct-Dec 08	6,713	7,810	-1,097	-1,438	-16.3%	-21.4%	93,487	75,392	80.6%	40,376	75,000
	Year 2008	**22,697**	**31,011**	**-8,314**	**-8,922**	**-36.6%**	**-39.3%**	**396,152**	**326,247**	**82.4%**	**171,572**	**75,000**
Northwest	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
	Oct-Dec 08	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	Year 2008	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Southwest	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%**	**101,911**	**33,655**
	Jan-Mar 08	2,530	2,442	88	34	3.5%	1.3%	40,454	28,311	69.8%	24,709	33,895
	Apr-Jun 08	2,869	2,664	205	321	7.1%	11.2%	42,381	31,882	75.2%	27,551	34,027
	Jul-Sep 08	2,891	2,805	86	-120	3.0%	-4.2%	42,304	30,292	71.6%	25,686	34,545
	Oct-Dec 08	2,734	2,664	70	-56	2.6%	-2.0%	40,966	27,785	67.8%	23,975	35,499
	Year 2008	**11,023**	**10,574**	**449**	**178**	**4.1%**	**1.6%**	**166,194**	**118,271**	**71.2%**	**101,921**	**35,499**
United	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
	Oct-Dec 08	4,547	5,359	-812	-1,303	-17.9%	-28.7%	56,029	44,288	79.0%	14,147	45,900
	Year 2008	**20,194**	**24,632**	**-4,438**	**-5,358**	**-22.0%**	**-26.5%**	**244,654**	**196,682**	**80.4%**	**63,149**	**49,600**
US Airways Grp.	Oct-Dec 07	2,776	2,850	-74	-79	-2.7%	-2.8%	34,859	26,812	76.9%	19,828	34,437
	Year 2007	**11,700**	**11,167**	**533**	**427**	**4.6%**	**3.6%**	**127,344**	**102,248**	**80.3%**	**83,619**	**34,437**
	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
	Oct-Dec 08	2,761	3,139	-378	-541	-13.7%	-19.6%	33,065	25,974	78.6%	19,156	32,671
	Year 2008	**12,118**	**13,918**	**-1,800**	**-2,210**	**-14.9%**	**-18.2%**	**143,395**	**114,944**	**80.2%**	**81,552**	**32,671**
JetBlue	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
	Oct-Dec 08	811	762	49		6.0%	0.0%	12,086	9,501	78.6%	5,108	9,895
	Year 2008	**3,388**	**3,279**	**109**		**3.2%**	0.0%	**52,209**	**41,956**	**80.4%**	**21,920**	**9,895**

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 2004	6,332	5,994	338	414	5.3%	6.5%	64,533	45,879	71.1%	21,280	14,994
YE 31/12	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	
Air Asia	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	
	Jul-Sep 08	196	168	27	-139	14.0%	-70.8%	4,833	3,429	70.9%	3,018	

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 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
Nov-08	26.4	16.5	62.6	17.2	13.5	78.4	15.5	12.3	79.1	49.2	38.7	78.7	73.6	54.4	73.9
Ann. change	-6.2%	-8.7%	-1.7	-4.9%	-7.0%	-1.8	0.3%	-3.0%	-2.7	-1.5%	-3.8%	-1.9	-1.6%	-3.6%	-1.5
Jan-Nov 08	329.5	225.6	68.5	227.2	184.9	81.4	175.9	142.0	80.7	584.3	472.6	80.9	881.6	680.0	77.1
Ann. change	2.0%	0.2%	-1.2	1.3%	0.2%	-0.9	3.9%	1.0%	-2.3	4.0%	1.8%	-1.7	4.2%	2.3%	-1.4

Source: AEA

EIGHT LARGEST US PASSENGER AIRLINES' SCHEDULED TRAFFIC

	Domestic			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	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	15 Dec	COPA Airlines	4 x 737-800s	
	10 Nov	LAN Airlines	4 x 767-300ERs	
Airbus	26 Dec	Nile Air	9 x A321s	
	26 Dec	Aeroflot	6 x A321s	
	17 Dec	Uzbekistan AW	4 x A320s	
	1 Dec	Iberia	2 x A340-600s	
	30 Nov	Etihad Airways	20 x A320s	
	17 Nov	Comlux Aviation	1 x A320	
	12 Nov	Air Arabia	10 x A320s	
	4 Nov	BOC Aviation	17 x A319s, 3 x A320s	
	3 Nov	Philippine Airlines	2 x A320s	

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

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