Issue No: 142 # Aviation Strategy **July/August 2009**

Airport valuations – market correction

Strong demand for airport assets, limited supply and the availability of relatively cheap debt made airport transactions one of the most dynamic sectors in aviation finance in recent years. Inevitably, the recession and the credit crunch has changed perceptions of values.

Quoted airport shares have held up reasonably well – on average only 50% down from the peak in 2007, having bottomed at around 60% down. Some have fared worse. Ferrovial (BAA), Gemina (FCO) and Flughafen Wien (VIE) each saw their shares slump by 80%; the latter two a result of the dire circumstances of their respective hub carriers, Alitalia and Austrian; the former beset by the general woes of the Spanish economy as well as the broadside attack from the UK authorities demanding a breakup of BAA's seeming monopoly over the London and Scottish lowland airports.

The quoted airport sector, however, is relatively small even though it encompasses some of the largest airports in the world outside the US (where airport privatisation has never really caught on). It may appear nevertheless that private airport valuations could also have peaked in 2007/08 – although since the collapse of Lehman Bros last year there has not really been any real volume of transactions to suggest a meaningful trend.

Of course the airport market is still relatively young. Margaret Thatcher started the process with the privatisation of BAA 22 years ago, and since then there has been a smattering of IPOs and public market equity issues - the last being Aéroports de Paris in 2006 - sold on an average of just over eight times Enterprise Value (equity market value plus net debt) to EDITDA (operating cash flow). Equity markets have somewhat differing views of valuation from some private equity and corporate entities – and very long-term investments such as airports may be difficult to digest by a market sometimes dominated by thoughts of the next quarter's returns. (Although it is perhaps interesting to note that an investment in BAA held from privatisation in 1987 to take-out by Ferrovial in 2006 would have produced a 15% average annual total return.)

Private equity deals meanwhile, and trade sales, have generally achieved far higher sale multiples - on average, up to the end of 2008 at least, of more than twice that of the public markets at over 17 x EV/EBITDA. This average, however, is rather heavily weighted to some (*continued on page 2*)

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notable transactions from 2005 and onwards, including Budapest and London City (and would be even higher if the aborted Bratislava and Chicago Midway transactions had gone through) – with stratospheric multiples of nearer 30x.

In some cases the apparently high valuations may have been because the purchaser identified higher potential future returns from a small airport otherwise seen to be difficult to sell to the public markets. In others, it was the finance community's tendency to follow initially very successful funds (such as the Macquarie Airport Group) that increased the demand for the few airports available for investment. In part it was also due to the very availability of cheap debt, and the appetite for risk that allowed small amounts of equity to appear to be able to support substantial levels of gearing.

Airport fundamentals

Very usefully there is the general overriding principle in the ICAO Chicago Convention (Article 15) that airlines should pay in full for the use of aviation infrastructure - interpreted as giving an airport the right to charge airlines landing fees commensurate with the cost of providing the service plus an adequate return on capital investment irrespective of market conditions. This principle of course springs from the days when almost all airports were government- or local authority-run, and it does reflect the long-term highly capital-intensive nature of building the infrastructure. But this also by its nature helps create the view that it airports are monopolies – at least in local terms – bringing in the political need to regulate the finances to ensure no monopolistic market abuse.

As a result, we have all the wonderful permutations of control from the "single till" approach, where all returns on a regulated asset base are supposedly limited to a politically acceptable return above weighted average cost of capital (and may encourage spending, as Ryanair's O'Leary complains, without necessary regard to economy, or to airline users' needs); to the laissez-faire pragmatic consultative regulation of some such as Denmark; to the "double till" approach that limits returns on charges for infrastructure to the airlines but allows the airport to screw what it can from everyone else. Few of the regulatory regimes really consider operating costs – primarily staff and power – to be within their remit.

Meanwhile, the business is truly long-term and requires excellent long-term planning. It is somewhat ironic that a successful airport attracts businesses, jobs and accommodation needs close by those who then become affected by the incumbent noise and congestion (and even those who enjoy the benefits of being able to use the facility) and who complain about attempts at expansion – with ever-increasing pressure from environmental groups mistakenly convinced that aviation is the greatest contributor to climate change.

So airports enter the political arena, to complicate the business planning process further. As a result, in many countries (such as Germany, the UK, Spain) it can take decades to prepare even to consider building a new runway or new terminal facilities and the delays in the planning process for the fifth terminal at London Heathrow, or the fourth runway and third terminal at Frankfurt, have managed to provide severe congestion bottlenecks.

Even in the early 1980s the British Airports Authority (the precursor of BAA) was already planning for the need to knock down the Queen's Building and Terminals 1 and 2 at Heathrow by 2012 (a process just started), even before they had finished T4 or allowed plans for T5 to leak out. In one sense it may be argued that an airport should not expand and should allow traffic to be turned away to other destinations, but then of course there would be even more political complaints.

The long-term nature of the airport business feeds into the valuation process for airport transactions. The main driver for the development of the business is

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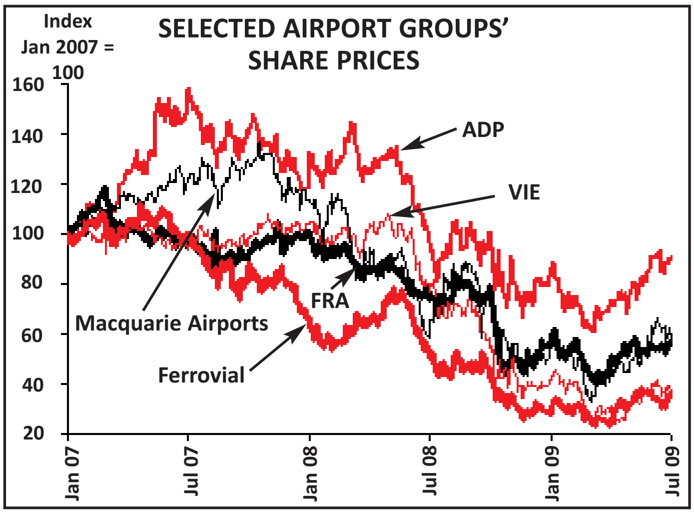
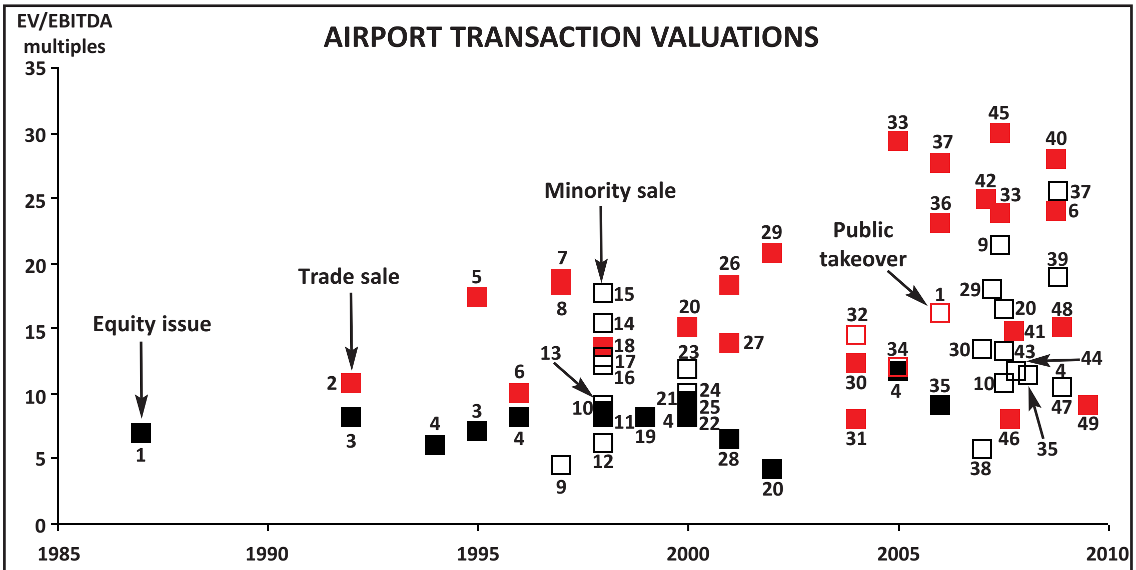
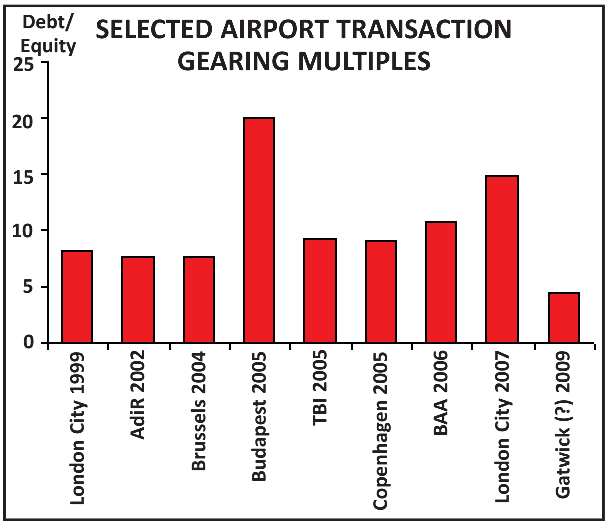
traffic growth – dependent as we all know on performance of GDP (worldwide, local and trading partners) and airline capacity. Many of these valuation models require detailed 30+ year forecasts of traffic; traditionally these are built from a short-term bottom-up approach extracted from existing airline schedules, known route development plans and short-term traffic trends, melded in with long-term econometric top-down modelling. From this derives all the modelled capital spending needs, costs and, combined with assumptions on revenue generation, returns over a generation. This is always a challenging exercise (considering that the whole industry only just celebrated its centenary last year), and that debt providers (for whom much of the modelling is really done) have a tendency to focus on little more than a year or two, even though the debt maturities can extend for half the modelled period. The resulting cash flow stream from the model is then discounted back at the rate of your choice to generate the valuation, or range of valuations. In all DCF models the early years weigh significantly higher in the net present value of the income stream – and at the moment, with traffic volumes continuing to crater, the pressure on short-term forecasts can be intense.



It is hardly surprising therefore that the deal of the year – Ferrovial's disposal of London Gatwick – has not gone entirely smoothly. When Grupo Ferrovial and its partners acquired BAA in 2006 they must have little expectation that they would be kicked so hard. The terrorist attacks in London that year and the resul-



KEY: 1) BAA 2) Prestwick 3) Vienna 4) Copenhagen 5) Cardiff 6) Belfast 7) Australia I 8) Australia II 9) Birmingham 10) ASUR 11) Aukland 12) Dusseldorf 13) Hannover 14) Luton 15) Mexico Pacific 16) Mexico SE 17) South Africa 18) Wellington 19) Malaysia 20) Rome Airports 21) Beijing 22) Florence 23) Hamburg 24) Mexico NC 25) Zurich 26) Bristol 27) East Midlands 28) Fraport 29) Sydney 30) Brussels 31) Norwich 32) TBI 33) Budapest 34) Venice 35) AdP 36) Bratislava 37) London City 38) APAC 39) Brisbane 40) Chicago Midway 41) Mexico 42) Exeter 43) Hainan Meilan 44) Japan AP Terminals 45) Leeds Bradford 46) Lima 47) Amsterdam 48) Cairns 49) Gatwick (estimate)



By James Halstead

tant increases in security requirements (along with the ban on liquids and restrictions on duty-free) and the results of the quinquennial regulatory review were bad enough – but then to find out that the establishment could now use the foreign takeover of a national asset as a catalyst to respond to demands for a breakup of the 21-year old private airport system on the basis that it was an unacceptable monopoly must have been severely galling. As a pre-emptive move the group put London Gatwick on the sale block towards the end of last year.

After a first round knockout, only three bidding groups were left in the running, deadlines were extended after the arrival of Mexican flu, and the bids were disappointing from Ferrovial's perspective. While the Spanish conglomerate was expecting some premium to the £1.6 million Regulated Asset Base (a theoretical balance sheet valuation used in regulating fees at the airport) all three consortia apparently bid well under. There was a major gap between the seller's and the buyers' views of airport value. Optimistically assuming a successful bid of around £1.5bn for Gatwick would produce an EV/EBITDA multiple of around 9x – a significant drop from the 16x achieved when Ferrovial and its partners acquired BAA.

BAA has appealed against the findings of the final competition report, which was published in March and recommended that BAA dispose of two of its London (i.e. Gatwick and Stansted) and one of the lowland Scottish airports.

The case is being held at the Competition Commission Tribunal in October. This will certainly help delay the enforcement orders and may provide enough time for a pickup in asset values; although a forced seller is never in a good position whatever the time of the cycle. Some may of course doubt that there could be much demand for Stansted, given the nature of the base carrier - Ryanair.

Just to add even more uncertainty, the DfT is expected to publish its proposals for future regulation of the UK airports – to provide the basis to update the 1986 Airports Act – in the autumn.

The return of privatisation

However, the economy will at some point recover and confidence will no doubt return to allow people to travel again; air travel growth may then follow a lower trend as some suggest, but there will undoubtedly still be growth. Importantly, the arguments for airport privatisation are still valid. Figures from the ACI earlier this year suggested that worldwide airport capital spending would top $50bn again in 2009 (more than 50% of industry turnover). China still plans to build 200 new airports over the next decade. The money will need to be found – and governments and local authorities now have less of that available than they previously thought.

BAA's 2008 RESULTS

	Revenues £m	Y-O-Y change	EBITDA £m	Y-O-Y change	Traffic (m)	Y-O-Y change
Heathrow	1,486.4	-18%	594.3	-27%	66.9	-1%
Gatwick	464.6	-22%	174.0	-22%	34.2	-3%
Stansted	258.4	-27%	113.8	-32%	22.3	-6%
Scotland	214.5	-31%	107.7	-29%	20.4	-5%
Southampton	26.4	-25%	8.0	-35%	2.0	-1%
Heathrow Express	156.5	-21%	41.5	-22%	na	na
UK total	**2,606.8**	**-21%**	**1,039.2**	**-27%**	**145.8**	**-3%**
Naples	47.7	-19%	14.4	-20%	5.6	-2%
Total	**2,654.4**	**-21%**	**1,053.6**	**-27%**	**151.4**	**-3%**

Global carriers: How real is the bankruptcy threat?

There is growing speculation not just about the fate of aircraft orders but about liquidity issues and even bankruptcies this upcoming winter.

"Could British Airways really go bust or not?" asked the headline of a (serious-sounding) article on the UK *Sunday Times*' website on June 21st. Who would have thought that question would ever be asked about BA, one of the world's most profitable global carriers in recent decades, given its unbeatable Heathrow hub and uniquely strong route franchise and market position.

BA is now incurring heavy losses and is aggressively trying to restructure its labour costs. Chief executive Willie Walsh warned dramatically in June that the airline faces a "fight for survival" and is pushing through a cost cutting package that includes salary reductions for the pilots (which has been accepted by BALPA), about 3,000 redundancies throughout the company and a voluntary scheme whereby employees are encouraged to take unpaid leave or, in a very limited number of cases, work unpaid for a month.

The other former leader in the global airline profit league, Singapore Airlines, while not actually a potential bankruptcy candidate, has also seen a shocking deterioration in its financial fortunes. SIA has seen its profits evaporate and may post losses for the June and September quarters, in part because its "luxury brand" business model is totally inappropriate for the current environment.

Japan Airlines, Asia's largest carrier (though never consistently profitable like BA and SIA), is now seeking ¥100-200bn (US$1-2bn) in state-guaranteed emergency funding to cope with financial losses this year.

In the US, there are fears that United Airlines, in particular, could face liquidity pressures this winter. UAL is expected to incur the legacy sector's steepest loss this year, reflecting its extensive global route system and greatest exposure to the premium sector. UAL also has heavy debt and capital lease obligations - $650m in April-December 2009 and another $1bn in 2010. Of course, the global airline currently most at risk is Air Canada, which is scrambling to put together a package of measures to avoid a second bankruptcy filing in six years (*see pages 16-19*). Air Canada faces a potential cash crunch and needs to raise at least C$600m in new liquidity to satisfy conditions in new labour deals and to make it through the winter.

What these airlines have in common is heavy exposure to global premium (business and first class) traffic, which has fallen sharply in the recession. Some - in particular SIA and other Asian carriers - also have heavy exposure to cargo traffic, which remains extremely depressed as it closely mirrors GDP growth.

In a cruel twist in late April, just as the global airlines thought that the worst was over and were looking forward to a reasonable summer season in which to build cash reserves for the winter, serious new challenges emerged. The impact of the H1N1 influenza, a sudden upward swing in fuel prices and a lack of any sign of improvement in the global economy combined to make May/June a miserable start to the northern hemisphere's peak season.

In June IATA doubled its global airline industry loss forecast for 2009 to $9bn, up from an estimate of $4.7bn in March. This would be almost as large as last year's loss of $10.4bn. IATA expects industry revenues to decline by an unprecedented 15% this year, much more than the 7% fall in the aftermath of September 11.

IATA expects Asia-Pacific carriers to account for $3.3bn of this year's industry loss, with European and North American airlines losing $1.8bn and $1bn respectively. The North American loss is relatively modest, and much narrower than last year's $5.1bn loss, in part because of US carriers' aggressive domestic capacity reductions in the past nine months.

In mid-June Bank of America/Merrill Lynch lowered its 2009 US industry earnings forecast from an operating profit of $4.7bn to $1.8bn; the net income forecast went from a profit of $1bn to a loss of $2.3bn.

On July 14th BOA/ML estimated that the eight largest US carriers had a combined $1.2bn net loss and only broke even on an operating basis in the June quarter, which is one of the industry's strongest periods seasonally. It would represent a tripling of the year-earlier net loss. Although jet fuel prices are 55% lower year-over-year, that nowhere near compensates for the estimated 21% decline in industry operating revenue.

Although fuel prices have somewhat eased up in the early part of July (a trend that could easily reverse), it is shaping out to be a weak summer demand/revenue-wise for airlines all around the globe. Also, prospects of any meaningful economic recovery this year look slim.

Consequently, the past couple of months have seen a frantic effort by airlines around the world to slash capacity, costs and capital spending. Even US airlines have modestly added to their already-significant capacity reductions, this time focusing more on international routes. But, in IATA's estimates in late June, capacity cuts globally so far this year have been only about half of the decline in volumes flown, forcing fares and yields to fall sharply in the past couple of months.

Impressive liquidity raising

One of the brighter spots has been the airline industry's ability to raise significant new liquidity, despite the supposedly tough financing environment and the lingering banking and credit crisis. The past few months have seen an impressive array of financing transactions.

May and June saw a number of convertible stock and debt offerings – easier to do than pure equity offerings. The process was started by the primarily-domestic US carriers: US Airways raised about $234m and JetBlue $265m, with Lufthansa reportedly participating in the latter to maintain its current 15.6% stake in the US carrier.

In late June Air France-KLM completed a highly successful €661m convertible bond issue, mainly to finance its fleet. The French government reportedly participated in the offering, to maintain its stake at 15.7%.

In mid-July there were reports that BA was considering joining the convertible bond bandwagon to boost cash reserves. The leadership told shareholders at the company's AGM that tapping the convertible market was potentially one of the best options when there were still a "number of key issues" to be revolved (especially a pension deficit of more than £1.74bn).

As of mid-July, ANA was in the process of selling stock for the first time in three years. The airline is offering new shares to raise up to ¥141.7bn ($1.5bn), mainly to fund new aircraft. This may seem amazing, given that ANA has been posting losses and faces very uncertain economic conditions, but Japan has seen a resurgent equity market in the first half of 2009 and ANA has a good growth story to sell. But it certainly contrasts with JAL having to seek an emergency loan from the government.

In the US, the legacy carriers have raised significant funds through secured debt financings in recent months. In June Continental completed a $390m EETC, the industry's first in nearly two years. Later that month, American issued pass-through certificates to finance 16 new 737-800s and refinance some existing aircraft; the deal was apparently structured in such a way to increase the likelihood that American would continue to pay on the certificates in bankruptcy. Even United was able to raise $175m from the sale of senior notes backed by aircraft spare parts in late June. However, the airline paid a very high price: the notes were issued at a heavy discount to their face value and carry a 12.75% interest rate.

Of course, none of this guarantees that the airlines will not end up in bankruptcy. With UAL the key concern is the potentially large amount of additional cash that needs to be raised if the recession lingers on, given the $1.7bn of scheduled debt and capital lease payments between April 2009 and the end of 2010.

The existence of the Chapter 11 – and the Canadian equivalent CCAA – processes, which facilitate restructuring under protection from creditors while allowing operations to continue normally, obviously make it easier in theory for North American airlines than, say, BA to file for bankruptcy. However, there is another key difference: the strength of balance sheets. Unlike UAL and Air Canada, BA and the other leading European carriers still have solid balance sheets. Even now, in the depths of the worst-ever global recession, their credit ratings are only 1-2 notches below investment grade.

Virgin Atlantic: Behind the impressive 08/09 results

Virgin Atlantic Airways posted impressive results for its 2008/09 financial year – and far better than bitter rival BA – but a closer look at the few figures that are available from the airline indicates that the situation may be very different to the optimistic sheen that Richard Branson and others are putting on it.

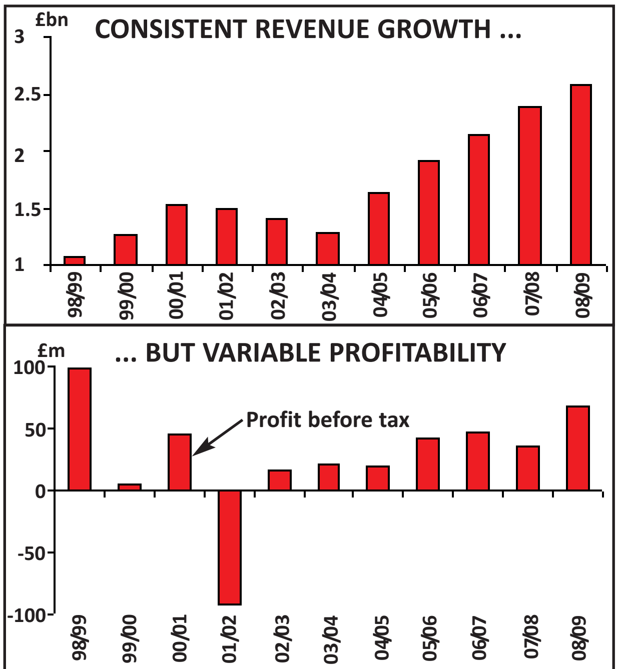
As a private company, Crawley-based Virgin Atlantic does not have to reveal most of the details a listed company has to, and what it does release tends to be the very minimum it has to make available under UK law. There's nothing wrong with that of course, but it does make it almost impossible to analyse the true financial situation of the airline.

Because of that paucity of information, it's understandable that much of the UK press took Virgin Atlantic's bullish statements about its 2008/09 financial results (covering the 12 months to the end of February 2009) at face value, and most particularly the apparent over-performance compared with BA's recently-released figures for its 2008/09 financial year.

In the 12 months to end of February 2009, Virgin Atlantic (which also includes tour operator Virgin Holidays) posted an 8.4% rise in revenue to £2.58bn ($4.57bn), with pre-tax profit reaching £68.4m ($121.1m) - compared with £34.8m in 2007/08 - and net profit of £45m, down just 6% on the previous 12 months. Passengers carried in the 12-month period rose by 70,000 to 5.77m, and overall load factor rose by around 2% to 78%, according to the airline.

Virgin Atlantic says the result is due to an increase in premium-class passengers and tight management but, before *Aviation Strategy* looks at the strategic and operational direction of the airline, a few points have to be made about the figures just released.

• GAAP versus IFRS. Virgin Atlantic's figures have been prepared under the UK's GAAP accounting rules (which it can legitimately do as it is not a listed company), rather than the international financial reporting standards (IFRS). There are a number of areas where large differences can occur in the two standards, not least in the reporting of derivatives - fuel and currency hedging losses have to be reported under IFRS, whereas in GAAP they are not taken onto published financial results. Worryingly, statements from the Singapore Airlines group - a 49% shareholder in Virgin Atlantic - imply that under IFRS Virgin Atlantic's results would be very different from those stated under GAAP. In its figures for the three-month period to end of March 2009, the SIA group said its associated companies had lost US$73m, with one SIA executive saying that this was "largely coming out of our investment in Virgin Atlantic". Altogether SIA says its stake in Virgin contributed just US$0.3m in profits over the full 12-month period to the end of March 2009, which means that Virgin Atlantic barely broke even under IFRS standards. Over the last couple of years Virgin Atlantic has become more aggressive in fuel and currency hedging, and



Note: Until 2003 FY is to end of April. 03/04 is 10 months to end Feb. 04/05 onwards is 12 months to end Feb.

fuel costs rose “just” £300m in 2008/09 year, to £1bn, which implies the hedging strategy has worked in that period. But there is a huge difference between the GAAP and IFRS numbers, so potentially there are costly unclosed derivative positions left for Virgin Atlantic.

• Financial year end. SIA’s statements about Virgin Atlantic’s relative performance in the full 12-month period and the three months to end March directly imply that Branson’s airline had a very poor January-March 2009 period. But Virgin Atlantic’s financial results just released only cover the 12-month period to the end of February 2009, and so if Virgin Atlantic’s performance is getting steadily worse as the year goes on, it has avoided reporting a poor March (everyone else reported a terrible March) by the fact that its financial year ends at the end of February. Of course this also makes a comparison with BA’s results – which do include March 2009 – even more unfair.

• Exceptionals. The GAAP figures provided by Virgin Atlantic include exceptionals that varied widely year-on-year. The £34.8m figure for pre-tax profits in 2007/08 is after exceptionals of £26.1m (largely provisions for potential losses on the fuel surcharge collusion case), while the £68.4m pre-tax profit figure for 2008/09 includes £15m from asset sales. Looking at a better measure, operating profit from continuing operations only - excluding exceptionals - fell year-on-year by a hefty 42%, from £44.4m in 2007/08 to £25.9m in 2008/09. And that £25.9m figure would have been a sigificant loss but for the fact that Virgin also benefited from a £68m non-exceptional “gain” from dollar-denominated cash balances.

Putting aside the smoke and mirrors of Virgin Atlantic’s accounts, is the airline’s underlying business model sound? Virgin Atlantic says that its apparently improved GAAP figures were due largely to an increase in premium passengers, with the 1% rise in premium traffic in the 12 month period stimulated primarily by fare reductions.

VIRGIN ATLANTIC FLEET

	Fleet	Orders	Options
A330-300		10	
A340-300	6		
A340-600	19	6	13
A380-800		6	6
747-400	13		
787-9		15	8
Total	**38**	**37**	**27**

That is in stark contrast to the reduction in premium passengers at BA, and there does appear to be a qualitative difference between the premium passengers carried by Virgin Atlantic and its main rival. BA has traditionally had a far greater reliance than Virgin on financiers and bankers crossing the Atlantic (thanks partly to its better global network); while that has been a strength when the economy has done well, it is a market that has been one of the hardest hit by the current recession (with a resulting disastrous effect on BA’s latest results). In contrast, Virgin’s premium passenger base is far more widely distributed between business sectors, and particularly among the creative and service industries (which are more attracted to Virgin Atlantic’s brand image than BA’s). In addition, Virgin Atlantic has built up a large slug of the UK public sector market (i.e. government officials and civil servants flying on business trips), which is a relatively robust market even in “credit crunch” times.

More than premium...

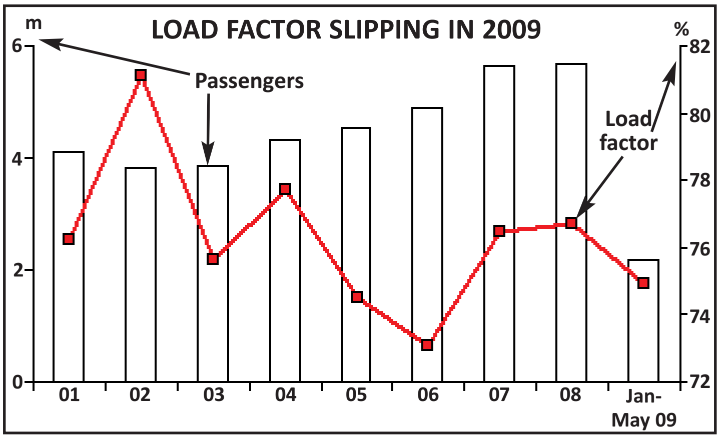
But it would be wrong to overemphasise the importance of the premium story. Plans announced by Virgin Atlantic back in 2007 to launch all-business class services between the US and Europe in 2008 have obviously come to nothing (Branson now calls those ambitions a “mistake”), and one analyst believes that the GAAP increase in post-exceptional profit in 2008/09 is probably due more to cost-cutting than to any great increase in premium passenger revenue.

Indeed Virgin says that it saw tough times coming as far back as 2006, and then began deferring deliveries scheduled for 2007 and 2008. The fleet currently stands at 38 aircraft (see table, left), with six A380s on order, for delivery from 2013, as well as six A340-600s and 15 787s. But Boeing’s delivery delay on the 787 forced Virgin Atlantic to look for capacity from 2011 onwards, to fill in the gap before the 787s are delivered, and at the end of June the airline announced a deal for 10 A330-300s. Four A330s are to be leased directly from AerCap, and six others will be bought initially from Airbus and then sold to and leased back from AerCap. Five of the aircraft will be delivered in 2011 and the rest in 2012, though it's understood the leases will be for 12 years, providing capacity way beyond that needed as an interim until the 787s arrive. Virgin says the aircraft will be put onto new routes to Shanghai, Cancun and Vancouver. Virgin Atlantic is also reportedly talking with Airbus about an order for A350s. These would replace 747s and potentially even the 787 order, given that a figure of 50 aircraft is being mentioned.

In the shorter-term Virgin is cutting between 7% and 10% of its capacity in the 2009/10 financial year (i.e. the 12 months to the end of February 2010) compared with 2008/09. Around 7% has already been taken out, most particularly on routes to New York, Washington and the Asia/Pacific region.

For example Virgin closed its London Heathrow-Mumbai route in May, instead replacing it with a codeshare with Jet Airways, which has a twice-daily service between these cities. Virgin still operates a Heathrow-Delhi route but closed the Mumbai service due to what it calls "irrational overcapacity"; the airline competed against BA, Jet Airways, Kingfisher Airlines and Air India on the route.

However Virgin will add capacity on some routes, such as from Manchester to Barbados and Orlando (after bmi and BA pulled out of long-haul services from the airport). And a weekly London Gatwick to Puerto Rico route (via Antigua) will be launched in November, which will join the existing Caribbean routes to Barbados, St Lucia, Grenada, Tobago, Havana, Montego Bay, Kingston and Jamaica. Altogether Virgin currently operates to 28 destinations from London Heathrow, London Gatwick, Manchester and Glasgow – nine US and eight Caribbean destinations, as well as four in Africa, five in the Asia/Pacific region, and one each in the Indian Ocean and the Middle East. Virgin Atlantic is examining potential routes to South America, Canada (Canadian routes were closed back in 2001) and various Asia/Pacific destinations (thought to include China and Thailand), but



any more new routes in 2009 are unlikely. Indeed in July Virgin said it would suspend its Heathrow-Chicago route in winter 2009/10.

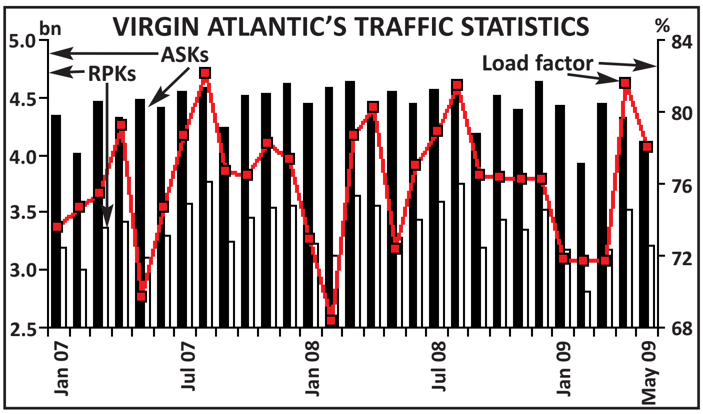
The other major cost effort by Virgin Atlantic has been on labour. In February the airline announced it would cut up to 600 positions in 2009, equivalent to 7% of its workforce as at the start of the year (which totalled 8,500). Virgin Atlantic also imposed a pay freeze for all staff during 2009, though this was somewhat eased by the fact that 10% of the GAAP pre-tax profits are now being distributed to staff as a bonus this year, equivalent to one or two week's extra pay. However in July the airline said another 600 positions could go this year (bringing the total to 1,200), which prompted Jim McAuslan, head of BALPA (which represents 90% of Virgin's pilots) to say the union would "pressure-test" the need for these cuts. Industrial action is not out of the question, with one employee saying: "The moral leadership at the top of this company is non-existent; the very day they were boasting about their profits they were making people redundant."

Another front in the effort to improve results is the attempt to offload Virgin Nigeria, the Lagos-based airline that was launched in 2005 and which currently has a fleet of six aircraft. Virgin Atlantic owns 49% of the airline but since last summer Virgin Atlantic has been trying to sell this as Virgin Nigeria's results have been dragging down the group figures. Virgin Atlantic now regards the airline as merely a regional player rather than a carrier that can provide feed into other Virgin airlines. Virgin Nigeria closed down long-haul routes to the UK and South Africa (which had used leased 767s) at the start of 2009 in the face of fierce competition, and it has also been in a serious dispute with the Nigerian government on access to terminals at Lagos airport. In short, while Nigeria is a tough market, Virgin Nigeria simply hasn't turned into the African long-haul airline that was envisaged a few years ago, and this must be seen as a strategic failure for Virgin.

Yet serious buyers for Virgin's stake look thin on the ground. The Nigerian-based United Bank for Africa (UBA) owns 7.5% of the carrier and is reported to want to buy the entire carrier, but the other Nigerian investors are believed to be resisting the bid. Potential buyers may be put off by the fact that Virgin Nigeria needs to raise more capital (at least $200m, which the airline had been trying to raise via a private placement) in order to help pay off what are believed to be high levels of debt. But in any case the Virgin brand will disappear from the airline in July, even before a new owner is found.

At least the Virgin empire's other forays into global airlines have been more successful than Virgin Nigeria. Domestic carrier Virgin America - though still at a very early stage - is growing, while Virgin Blue (which also owns New Zealand-based Pacific Blue and 49% of Samoan-based Polynesian Blue), finally launched its long-haul subsidiary - V Australia – in February.

Branson has long wanted to create a raft of successful Virgin airlines around the world and says he would like the existing carriers to "integrate as best we can", but that may not be so easy. The CEOs of Virgin Atlantic, Virgin Blue and Virgin America met in April this year to discuss areas for co-operation, which include everything from logos, sales and marketing to joint aircraft ordering, but all that seems to be happening at the moment are some efforts towards a linked FFP and combined "around-the-world" fares.



Elsewhere, Branson had previously been keen on launching an airline in India, but this idea seems to have drifted away given the major upheavals happening in the Indian market (see *Aviation Strategy,* December 2008). The Virgin group is also believed to be looking at potential new airlines in South America (Brazil in particular) and Russia, but the realistic short-term imperative for Branson must be to secure short-haul feed into Virgin Atlantic at London Heathrow.

With the purchase of bmi by Lufthansa finally going through, following a last minute agreement between Sir Michael Bishop and the Germans on the steps of the UK High Court, all prospects for a merger between Virgin and bmi have evaporated. In reality, such a merger was always a remote prospect, not because of the supposed antagonism between Branson and Bishop but because adding a limited and heavily loss-making European network to Virgin's generally profitable, point-to-point long-haul network did not make sense.

Lufthansa is now engaged in the process of trying to sell off bmi's Heathrow slots and Virgin might appear to be a prime candidate. But the global traffic downturn and the impact of US-EU open skies has probably reduced its appetite for investing in new slots. Would there be any logic in a Virgin/Lufthansa alliance or joint venture? Again, though rumoured, this is a highly unlikely development. Lufthansa's experience with the Swiss takeover has demonstrated that, with the correct local legal structure, directly owning a locally based airline is not required in order to operate ex-EU from Heathrow. Moreover, Lufthansa is not going to repeat SIA's mistake in taking a minority position with no effective influence, let alone control, over Virgin.

Virgin Atlantic's current strategy is all about slowing down capex, preserving cash and keeping revenues up through the bad times. But Steve Ridgway, the chief executive of Virgin Airways, warns that the airline will not make a profit this year, although cleverly this was wrapped up in a statement that no major airline will make a profit this year because of the decline in premium traffic.

A further clue to the tough year facing Virgin Atlantic is the fact that it says that unlike BA, where traffic began to drop off in July last year, Virgin managed to keep traffic levels up right until November 2008 - from when they started to drop. Assuming that this drop in traffic will not recover substantially before the end of the current financial year, Virgin Atlantic is likely to plunge into a large loss in 2009/10, whether by GAAP, IFRS or indeed any accounting standard it chooses.

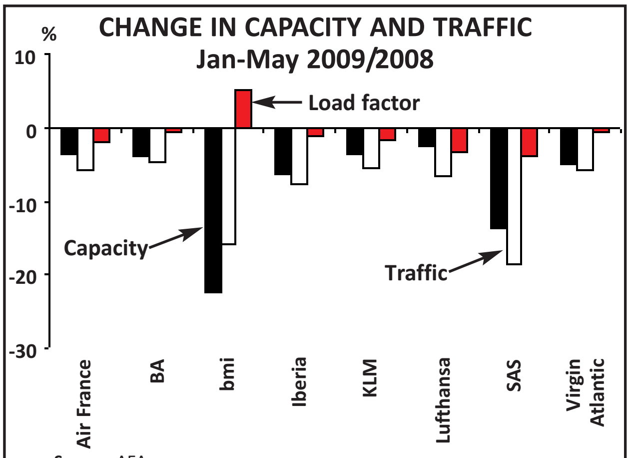
Cash is king

The debt and cash position for Virgin Atlantic will be critical, and of course there is an inextricable link between Virgin Atlantic's financial situation and the rest of the Virgin businesses, given that Branson's Virgin Group owns 51% of Virgin Atlantic Airways, and historically Branson has often tended to fund many of his businesses with cash generated from his other ventures.

Just how much cash the Virgin empire has is impossible to tell, again because of the offshore and/or private nature of most of the Virgin businesses. What we do know is that Virgin Atlantic had cash reserves of £838m as of June 2008 (it did not release any information about its cash position as at the end of February 2009), and that a stated aim of the airline is to preserve (whatever) its current cash position is. But a recent comment from Branson that he hadn't ruled out a bid for BA was met with incredulity by most analysts.

If there is a cash squeeze, it's no wonder that signals from Virgin Atlantic that it would team up with other airlines and make a bid for London Gatwick came to nothing, although not until after a curious incident when Virgin Atlantic claimed it was in discussions with easyJet over a bid for Gatwick - a claim that easyJet immediately and vehemently denied.

Again, without a published balance sheet it's impossible to know how much debt Virgin Atlantic is carrying. Every now and again Virgin Atlantic executives say they are interested in floating, although there are no plans in the short- or medium-term and therefore



Source: AEA.

no likelihood of analysts being able to examine the airline's accounts in depth.

Unsurprisingly, Virgin Atlantic continues to lobby against antitrust immunity for the transatlantic joint venture between BA, American Airlines and Iberia. Virgin says that it would lead to higher fares and Branson admits it "would obviously affect our revenue". Branson also says that he can't "guarantee Virgin Atlantic's survival" if antitrust immunity is granted to his competitors, but that is obviously bluster. His serious point is that competition on Heathrow-US would be reduced: Virgin Atlantic says that BA and American have an 80% market share of passengers on LHR-Boston, 73% on LHR-Miami, 64% on LHR-New York JFK, and 64% on LHR-Chicago (although if BA/American did raise fares then surely this would be beneficial to Virgin Atlantic?). Virgin also serves US leisure destinations from London Gatwick - a lower yielding but also lower cost operation. At least the row between the two airlines will be over soon, as the US DoT will rule on the BA/AA/Iberia application for antitrust immunity by October.

Perhaps the best judge of Virgin Atlantic must be the one entity that should have clear sight of how the carrier is doing – Singapore Airlines. It remains unhappy at the performance of Virgin Atlantic and is still open to offers for its 49% stake, which it bought back in 2000 for US$975m. SIA's "underperforming" investment – to quote SIA CEO Chew Choon Seng – is likely to have a very tough 2009, so buyers for SIA's stake are going to be very thin on the ground.

Azul: A third-force Brazilian carrier in the making

Amid all the doom and gloom this year, the Brazilian aviation market has seen an exciting new development: the rapid build-up of a promising new LCC, Azul Linhas Aereas Brasileiras, which took to the air with JetBlue-style E190/195 operations in December. David Neeleman's latest airline venture has been well received by Brazil's travelling public and already has had an impact on the pricing environment. But can it become profitable and co-exist successfully with the TAM/GOL duopoly?

Azul is off to a great start. The airline began operations on December 15th - a month earlier than planned in order to make the most of the Brazilian summer season – with three E195s and two E190s, linking its base at Viracopos Airport (at Campinas, some 90 kilometres from Sao Paulo) with two regional capitals. By mid-June the operation had grown to 11 E190/195s, 13 destinations around the country and 74 daily flights. Belo Horizonte is due to be added as the 14th destination in early August.

By May Azul already had a 4.16% domestic market share, making it the third largest airline in Brazil, ahead of Webjet and OceanAir (which had 3.99% and 2.88% shares, respectively). TAM and GOL's combined domestic market share in May was 87%, down from 94.5% a year ago.

The newcomer's load factor trends are also encouraging, although they may partly reflect discounting to increase customer awareness. Azul had an excellent 79.2% load factor in May, up 1.8 points from April and 10.5 points from March. It was much higher than the 57-60% domestic load factors achieved by GOL and TAM in May.

The airline's founder and chairman David Neeleman predicted at *Airfinance Journal's* New York conference in late April that Azul would start earning monthly profits by the end of this year.

Azul has an ambitious growth plan, backed by $1.4bn of firm E195 orders with Embraer, plus another $1.6bn of options and purchase rights. The plan envisages 42 aircraft and 25 cities by 2012. If all the options and purchase rights are taken up, the fleet would be 78 aircraft in four or five years' time.

This could potentially make Azul a sizable "third force" carrier in Brazil. But there are many challenges, including airport and ATC constraints, TAM's and GOL's solid market positions and financial muscle, and the constant influx of new competition on the domestic scene. Brazil has traditionally been a tough environment for airlines and has seen numerous failures, including those of Transbrasil, VASP, Varig and BRA in recent years.

Solid capital backing

Azul is among the world's best-funded airline entrants, having raised US$200m of start-up capital from investment funds in the US and Brazil. The initial investment facilitated the $1.4bn Embraer order in March 2008 and gave Azul good reserves to withstand price and market share battles with GOL and TAM.

The venture was able to secure such significant backing from institutions because of Neeleman's track record in creating successful airlines. He co-founded Morris Air in the 1980s (and sold it to Southwest in 1993), co-founded WestJet in 1996 and went on to create JetBlue in 1998. JetBlue's current CEO Dave Barger noted last year that Neeleman was "expert at exploring market opportunities in the airline industry and stimulating demand".

Neeleman was ousted from JetBlue CEO's position in the spring of 2007, because the board wanted more of a manager than a visionary. He subsequently sold a significant part of his ownership stake but remained chairman until May 2008, when he left the JetBlue board to devote his full attention to Azul.

Neeleman holds a 25% equity stake and 80% voting control in Azul. Being Brazilian-born, with both US and Brazilian nationality, the country's restrictions on foreign ownership of airlines do not apply to him. The US investors include Peacock Capital and other funds. One of the major Brazilian funds, Gavea Investimentos, had invested in low-cost carrier BRA, which ceased operations in November 2007.

Several former JetBlue executives assisted Neeleman in getting Azul off the ground, and some have stayed - notably Trey Urbahn, chief commercial officer, who was chief revenue officer at JetBlue. But Neeleman hired essentially a Brazilian management team. President Pedro Janot came from the retail industry, while COO Miguel Dau was technical/operational EVP at Varig.

Unique market opportunity

Like GOL and other recent new entrants, Azul is attracted by the enormous potential offered by Brazil's undeveloped and over-priced aviation market. Brazil has a population of about 190m (2007 census) and is Latin America's largest economy, but it has only 0.2-0.3 enplanements per capita annually, compared with 2.0 in Canada and 2.4 in the US. There are currently only about 50m domestic airline passengers annually, compared with 150m long-distance bus passengers. According to Neeleman, air fares were on average 50% higher than fares in the US on routes of comparable distance, so there was "tremendous opportunity to stimulate airline demand with lower prices".

Azul also believed that the highly concentrated market share between GOL and TAM - the result of GOL purchasing Varig in 2007 and fully integrating it last year - created an opportunity to establish a "significant, third Brazilian airline which can co-exist with GOL and TAM". When announcing Azul in March 2008, Neeleman suggested that "there is sufficient untapped potential to support all of us".

Analysts have noted that the Brazilian market traditionally supported up to five domestic airlines, though typically not profitably. But most of those airlines failed because they were poorly-run companies, with old-style managements, antiquated fleets and unimaginative strategies.

The Brazilian market is certainly dynamic. Even with fares relatively high by US standards, the domestic market registered double-digit RPK growth in 2004-2007 and a 7.4% increase last year. This reflected continued strong GDP growth, rising incomes, GOL's and TAM's efforts to stimulate leisure travel and growth of new entrants such as Webjet, OceanAir and TRIP.

As the "low-cost, low-fare" pioneer in Brazil, GOL has played a key role since 2001 in making air travel affordable to a larger segment of the Brazilian population. In addition to entering most markets with 20-30% lower fares, GOL was the first to identify the opportunity to pull passengers from the long-distance buses by offering night flights at bus rates. GOL captured a 22% domestic market share in just three years.

But Azul identified another factor that it believed had suppressed demand in Brazil: lack of air service between cities, even large ones. Neeleman noted in April that both GOL and TAM operate essentially hub-and-spoke networks and that their domestic networks are basically identical, with hubs centred in Sao Paulo, Rio de Janeiro and Brasilia. So people travelling to or from other cities usually have to make a connection.

BRAZILIAN AIRLINES' DOMESTIC MARKET SHARES

	% of total domestic RPKs	
	May 09	**May 08**
TAM	44.9%	49.3%
GOL/Varig	42.0%	45.2%
Azul	4.2%	0.0%
Webjet	4.0%	1.9%
OceanAir	2.9%	1.9%
TRIP	1.3%	0.9%
Others	0.7%	0.8%
TOTAL	**100%**	**100%**

Source: ANAC.

GOL's domestic strategy (which was covered in the September 2004 issue of *Aviation Strategy*) focuses on two types of markets. First, there are the high-density competitive markets, such as Sao Paulo-Rio de Janeiro, where the airline operates direct point-to-point service. Second, there are the thinner leisure-oriented markets where it operates multiple-stop service (a linear-type network that has all but disappeared in most mature aviation markets). Since the first or last segment is typically a major route such as Sao Paulo-Brasilia, the strategy enables GOL to offer more destinations and frequencies and achieve higher load factors. So even though GOL has played a Southwest-type role in Brazil, it has not provided the point-to-point coverage that LCCs typically do elsewhere.

Another factor that distinguishes Brazil from the US and other relatively mature aviation markets is that its regional airline sector is not well developed. According to Neeleman, regional jets account for only 5% of air service in Brazil.

So Azul has stepped in to try to fill those gaps. Its strategy is to create a point-to-point network, providing nonstop air service in markets where such service did not previously exist. The smaller size of the E190/195, compared to the 150-seat or larger aircraft operated by TAM and GOL, enables Azul to focus on smaller markets and/or provide high-frequency service in key city pairs. The strategy obviously supports the objective to successfully co-exist with GOL and TAM.

The Azul model

Azul seeks to stimulate demand through both low prices and greater convenience. It is targeting both leisure passengers/first-time flyers and high-end business travellers. Leisure passengers are targeted with offerings such as advance purchase fares (a fare category that apparently did not exist in Brazil before Azul arrived), which equal the bus fares. The aim is to get many of the 150m annual bus passengers to switch to air travel, as well as attract people who do not travel at all. Brazil has a 97m-strong, rapidly-growing "middle class". The effort to attract that segment also involves "teaching people how to fly"; among other things, Azul is creating a little booklet that explains how to fly and how to get credit.

Business travellers are wooed with frequent, nonstop flights that bypass hubs and reduce travel time, and by offering a superior in-flight service, including satellite TV from late 2009. "The Azul experience" includes single class, pre-assigned seating; leather seats in two-by-two configuration (no middle seats); extra legroom (31- or 34-inch pitch); individual video screens; a variety of branded snacks; and no overbooking. The 34-inch pitch seats in the first five rows of each aircraft can be purchased for an additional R$30 (US$15).

The 106-seat E190 and the 118-seat E195 obviously have higher unit costs than competitors' 150-seat or larger aircraft, but their trip costs are much lower, and by eliminating connecting hubs and other costs Azul can even obtain competitive unit costs. But Azul is not necessarily going to offer lower fares for all segments. It needs to attract business traffic, which it should be able to do. (Some 70% of all domestic trips in Brazil have traditionally been for business purposes, compared with 30% in the US.)

JetBlue replica

All of this is a close replica of JetBlue's E190 strategy (see *Aviation Strategy*, July/August 2003), which has worked well for the New York-based LCC in conjunction with its primary strategy of operating A320s. The key factor is the aircraft type, which offers not just attractive economics but has the look and feel of a small jet, rather than a regional jet. The E190 has met JetBlue's very exacting standards, which included a requirement to offer the same comforts as the A320s.

Neeleman has called the E195 "the perfect aircraft for the Brazilian market".

Azul has worked very closely with the Brazilian Development Bank (BNDES), which was set up to help Embraer exports but is now providing assistance also to Brazilian airlines. BNDES is believed to have offered attractive lease financings to Azul for some of the E195s. Although Azul has also sought commercial financings, the BNDES relationship is very valuable at a time like this.

Azul is very customer-driven and has a fresh approach, which many believe will carry it far in Brazil. Neeleman started on the right note by holding an online contest for the Brazilian public to name the airline. There were more than 150,000 entries from 108,000 people. While "Samba" actually received more votes, the team preferred "Azul" (Portuguese for "blue"). The airline gave free tickets to people who entered both names and lifetime passes for free travel to the first to cast their votes. The contest was described as "part of an ongoing dialogue with customers".

Growth plans

Since starting operations from its Campinas (Sao Paulo) base to Salvador in Brazil's northeast and Porto Allegre in the south in December, Azul has expanded its network to include three more cities in the northeast (Recife, Fortaleza and Maceio), three more in the south (Curitiba, Navegantes and Maringa), Manaus in the northwest, Campo Grande in the centre-west region and Rio de Janeiro and Vitoria on the southeast coast.

Most of the operations are to and from Campinas, but Azul is expected to soon start "connecting the dots".

Significantly, Azul gained access to Rio de Janeiro's centrally-located Santos Dumont airport in April, when the government lifted restrictions on flights to/from that airport (previously only 50-seat turboprops were allowed for any destinations other than Sao Paulo's Congonhas). Azul had originally wanted Santos Dumont as its main base. With the restrictions in place, it had added service from Campinas to Rio's more distant Galeao airport in February. Azul is now expected to develop Santos Dumont as one of its key hubs, eventually flying to 22 destinations from there.

The only problem with Santos Dumont is that it has seen a massive influx of new flights by TAM and GOL, as well as Webjet, OceanAir and TRIP, since the restrictions were lifted – some 95 new services within the first month. TAM has added flights to at least seven destinations from Santos Dumont. There has been significant fare-cutting in response to Azul, with reductions as large as 30-40% on some routes. So Rio de Janeiro has provided an early venue for a competitive clash between Azul and the incumbents.

Azul is currently much less of a threat to the incumbents in the Sao Paulo market, because Viracopos airport lacks easy access to Brazil's business capital (Campinas itself, with a population of 5m, provides a good local market for Azul). However, Azul continues to seek access to Sao Paulo's two centrally-located, slot-restricted airports, Congonhas and Guarulhos.

In addition to the planned addition of Belo Horizonte in early August, key future destinations include Brasilia (the federal capital), Goiania in the south and Cuiaba in the centre-west region. According to *AvNews,* Azul is in negotiations with nine state governments in the northeast to provide close to 30 new nonstop routes in the region.

The pace of the expansion will be dictated by the aircraft delivery schedule, which is roughly one E195 monthly until the fleet of 78 (including two ex-JetBlue E190s) is reached in 2013. Azul expects to carry 4m passengers in 2010 and end next year with 21 aircraft and 18 destinations.

Azul's plans envisage it ultimately serving most major markets throughout Brazil and perhaps "other South America" at some point. The E195, with its range of 2,200 nautical miles (4,077 kilometres), will be able to fly nonstop routes between any two major Brazilian cities. The E190, with a slightly better range, would reach any point in South America from Brasilia.

By Heini Nuutinen
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Air Canada: Seeking creative solutions to avert bankruptcy

Facing a potential cash crunch, Air Canada is scrambling to put together a package of measures to avoid a second bankruptcy visit in six years. One critical step was accomplished in June: tentative agreement with unions on a 21-month freeze on pension contributions and wage rates, which provided relief from credit card covenant issues this summer. Assuming that the labour deals are ratified, the next step is equally challenging: raising C$600m-plus in new liquidity in the current environment.

Of course, even if all of the pieces in the "near-term survival" puzzle fall into place, all that additional debt will not make it easier for Air Canada to become viable in the long run. The airline needs equity, not more debt. Perhaps a future project for Lufthansa?

Like other global carriers, Air Canada has been hit hard by the collapse of premium traffic due to recession. It has also faced stiff competition from LCCs, particularly WestJet, which has been pricing aggressively in recent months, is rapidly gaining market share and remains highly profitable.

There are special challenges, including a pension deficit of almost C$3bn ($2.6bn) and heavy debt obligations. Also, nearly all of Air Canada's union contracts became amendable in May and June. The workforce is unhappy, having made significant concessions in the last bankruptcy.

Air Canada completed an 18-month bankruptcy reorganisation in September 2004, emerging with a reduced cost structure and an improved balance sheet. The restructuring reduced net debt and capitalised leases from C$12bn to C$5bn and gave the company a relatively healthy cash position of C$1.9bn ($1.6bn). But the cost cutting programme initiated in bankruptcy fell far short of giving Air Canada a competitive cost structure (see *Aviation Strategy*, November 2004).

After a promising early turnaround in late 2004 (in the wake of three and a half years of losses totalling C$1.7bn), Air Canada was never able to consolidate it, achieving only marginal operating profits in 2005-2007 (2-4% of revenues) and an annual net profit only once this decade (in 2007).

Last year saw a steep C$1bn ($860m) net loss, and the first-quarter 2009 results were truly horrendous: operating and net losses of C$188m ($162m) and C$400m ($344m), respectively (7.9% and 16.7% of revenues). The net results included sizable foreign exchange losses.

Despite raising more than C$800m ($688m) in asset-backed financings since late 2008, Air Canada's cash reserves amounted to only C$1bn ($860m) or 10% of last year's revenues in early May. The reserves would not have covered the C$1.2bn ($1bn) of debt and pension obligations coming due in the next 12 months (before relief from labour deals). But the immediate concern was that Air Canada seemed certain to violate covenants in a credit card processor agreement on June 30th, potentially requiring it to post C$300m-plus ($258m) extra cash with the counterparty.

Leadership turmoil

Not surprisingly, there has been leadership turmoil. In late March Montie Brewer resigned from the president/CEO position, which he had held since December 2004, and was subsequently replaced by Calin Rovinescu, who was the chief restructuring officer during the 2003-2004 bankruptcy. Also, COO Bill Bredt retired and was replaced by Duncan Dee.

Because of Rovinescu's earlier role, there was initially much speculation that he was brought in to prepare Air Canada for a second round of bankruptcy. But the new CEO has made it clear that he is determined to avoid this. Furthermore, he wants to safeguard Air Canada's brand, network and other strengths, "so we can take advantage of the economic recovery when it comes, which it surely will".

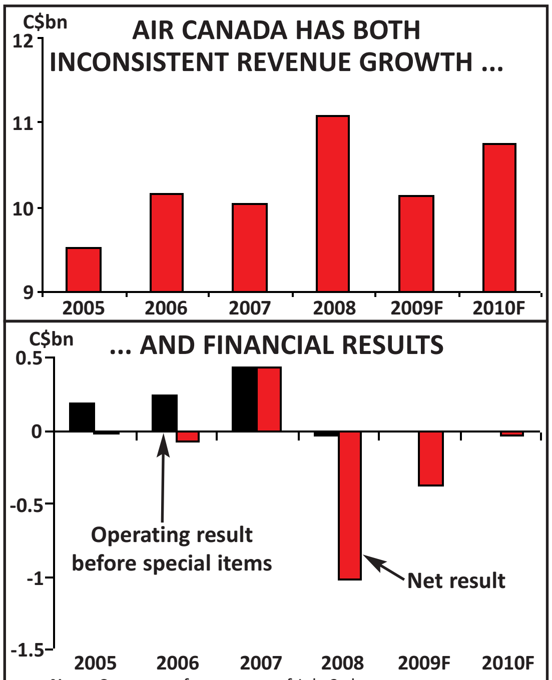
At Air Canada's AGM on May 8th, Rovinescu outlined five priorities that Air Canada must tackle: finding an alternative pension funding solution, achieving labour stability (likely to be required by financial institutions before providing assistance), building liquidity, attaining a competitive cost structure and finding new sources of revenue.

In late May, Air Canada won some breathing space by obtaining covenant relief with one of its main credit card processors. The problem had been that the unrestricted cash requirement in that particular agreement was due to increase from C$900m ($774m) to C$1.3bn ($1.1bn) on June 30. The MoU, dated May 25, lowered the minimum cash requirement to C$800m ($688m), in return for Air Canada providing the processor with some undisclosed security.

The credit card deal was conditional on Air Canada's unions agreeing to pension relief and labour stability by June 15th. Amazingly, the airline was able to secure tentative deals with all five of its unions in that tight timeframe. However, members of the largest union (machinists) narrowly rejected their pension deal on June 30th (50.8% voted against) – a disappointing but hopefully only temporary setback as Air Canada continues to work on other pieces of the puzzle.

Despite contributing more than C$1.7bn ($1.46bn) into its pension plans since 2004, Air Canada has a huge pension deficit, estimated at C$2.85bn ($2.45bn) at the end of March. The airline's defined benefit pension plans, covering some 25,000 retirees, were originally expected to require a staggering C$865m ($744m) cash contribution this year (a February estimate by Bank of America/Merrill Lynch). In March the Canadian government proposed temporary relief measures for federally regulated pension plans that, among other things, extended the funding timeline from five to 10 years. Under the proposed new rules, Air Canada would have had to make a contribution of around C$570m ($490m) this year, of which some C$225m ($194m) was due in July.

But Air Canada needed a more radical interim solution, so it approached its unions in the spring. The tentative labour deals concluded in June include a 21-month moratorium on pension plan contributions, to be followed by modest fixed payments for three years: C$150m in 2011, C$175m in 2012 and C$225m in 2013.



Note: Consensus forecasts as of July 3rd.

Concurrently, Air Canada secured what it calls "labour stability" agreements for the same period, meaning extension of existing contracts "on a cost-neutral basis" (no changes to wage rates) and "no strike" provisions.

As of July 6th, two of the five unions had ratified their agreements, and flight attendants and pilots were expected to conclude voting on July 12th. After a weekend of talks and "clarification of certain issues", the machinists' agreement was due to be resubmitted for ratification on July 14th. It appears that the deal was sweetened to include job security assurances. Union members had worried that their aircraft maintenance, repair and overhaul could in the future be transferred to Air Canada's El Salvador-based sister company Aveos Fleet Performance (formerly Air Canada Technical Services), which ACE spun off in 2007 (retaining a 27.8% stake). Aveos currently does not have the capability to do that work but could expand facilities.

All the labour deals are contingent on Air Canada raising a minimum of C$600m ($516m) in new financing. The pension plan moratoriums also require government approval.

As part of the deals, unionised employees will take a 15% equity stake in the airline and receive a board seat. Proceeds from the stock sale will be used to reduce the pension deficit.

Significantly, the unions got the pension protections they had hoped for. Air Canada has promised its workers that it will retain the current defined benefit plans without restructuring the pension benefit formula. The benefits offered by the current plans are believed to be among the best in the private sector. Nor does Air Canada contemplate a transition to a defined contribution plan design - the cheaper formula that the US legacies have typically adopted after terminating their defined benefit plans in Chapter 11.

Pension protections are without concessions – it would seem that Air Canada's unionised workers are getting a great deal under the circumstances. Add to that the strong possibility that the pension plans would be terminated in a new round of bankruptcy, and it seems inconceivable that the labour deals would not be ratified.

Building liquidity

Raising C$600m-plus of fresh liquidity - which can probably only be through debt issuance - will be a challenge even if the labour deals are ratified, given the horrendous combination of tight credit markets, lack of any sign of economic upturn, banks being less interested in aircraft and related assets these days, and Air Canada's perilous financial position and already highly leveraged capital structure.

But the credit markets appear to be stabilising. US airlines have been very active in raising funds through secured financings in recent weeks. Even United, which many fear could face liquidity pressures this winter, managed to sell US$175m of bonds secured by aircraft spare parts in late June. But United paid a very high price, and rating agencies warned that it may have difficulty raising a large amount of new capital in the near term.

Air Canada was able to raise C$800m ($688m) in December-May through a multitude of small secured transactions, including many sale-leasebacks with GE Capital. It still has up to C$1bn ($860m) of assets that could be monetised, including 777s, Embraer aircraft, airport slots and real estate. But CEO Rovinescu noted at the AGM that "creative solutions will be required".

Air Canada is casting its net wide and has said that it is in talks with "several potential lenders". To start with, it is believed to have asked Export Development Canada, the federal financing agency, for a C$200m ($172m) asset-backed commercial loan.

Then there are the "key corporate and commercial partners that derive benefit and expect to continue to benefit from a financially strong Air Canada" (as Rovinescu put it). The most obvious of those is Groupe Aeroplan, which operates Air Canada's FFP.

Air Canada is disadvantaged, compared with its US legacy counterparts, in that it no longer owns key assets such as an FFP that could be used to generate liquidity. In the past two years US carriers have raised significant cash through the forward-sale of frequent-flyer miles to financial institutions. Air Canada's FFP, maintenance unit and regional feeder Jazz were sold to parent company ACE as part of the restructuring in September 2004.

However, Rovinescu made the point recently that ACE purchased those subsidiaries at fair market value from Air Canada, based on independent valuations, and that the C$2.2bn ($1.9bn) proceeds collected by Air Canada helped fund essential fleet renewal (60 Embraer aircraft and 16 777s), aircraft refurbishment and the pension plan.

Nevertheless, it is an odd situation. One would think that ACE, as the 75% owner of Air Canada and with C$800m-plus in cash at year-end, would be the first to come to the airline's rescue. But, having spun off most of its stakes in the former Air Canada units, ACE is looking to wind down the holding company structure and distribute its net assets to shareholders at the earliest opportunity.

Aeroplan, a key partner that depends on its commercial relationship with Air Canada, has been helping out. At the end of June, it provided Air Canada with a new secured, revolving loan of up to C$100m (equal to the previous 60 days' purchases of reward seats). This effectively replaced a November 2008 "faster payment" agreement and will terminate in June 2010 or when Air Canada has raised the C$600m required by the union agreements. The loan is secured by the airline's interest in Air Canada Vacations.

Air Canada's ability to raise the full C$600m – and whether that will be enough – will also depend on how the current July/August peak demand period shapes out and whether the economy shows any sign of improvement by the autumn. In the absence of the latter, lenders might balk at helping Air Canada and, as demand weakens into the winter, its problems could intensify.

Cost cuts, no major shrinkage

Air Canada now aims to trim "at least C$250m ($215m)" from its annual costs by 2011. But that would be only 2.2% of last year's C$11.1bn operating costs. Capacity is now slated to fall by 4-5% in 2009 (slightly more than previously envisaged), following a 1.2% decline last year.

Some analysts have called for much tougher measures. In April one Toronto-based analyst suggested that Air Canada needed to cut over C$2bn ($1.72bn) from its fixed costs, that it had spread its operations too thin, that the number of routes should be slashed by over 50% and that such a drastic surgery could best be achieved in bankruptcy (an unusual argument from an equity analyst, but at that point the stock had probably already lost most of its value).

Air Canada's management has firmly rejected the "shrink to profitability" calls. Rovinescu said in May that "this is not about massive layoffs or shrinkage, but about operating in a better, smarter, more effective way with a benchmarked matrix for 'best of class' while not conceding market share". Also, an overriding consideration would be to safeguard the brand.

This is an understandable (and reasonable) strategy for a carrier that enjoys so many inherent advantages. Air Canada still controls 60% of the domestic market, is the only airline in Canada that offers a business class product, has well-situated hubs (Toronto, Montreal, Vancouver and Calgary), has a strong global network and is likely to remain Canada's dominant long-haul international carrier for many years to come. It has a new fleet – the renewal programme will be completed in the current quarter with the delivery of the 18th and final 777 – and one of the world's best customer loyalty programmes. When economic growth resumes and business travel comes back, Air Canada is uniquely placed to benefit from it.

So while cutting capacity in the weakest markets, Air Canada has undertaken a surprising amount of new expansion. This year has already seen three new long-haul destinations (Geneva, Fort de France and a return to Rome), a 35% increase in transatlantic capacity from Montreal, more Toronto-Italy and Vancouver-China flights, new transborder routes such as Calgary to San Diego and Portland, and many new domestic routes. Nevertheless, mainline ASMs still fell by 8.1% in January-June, slightly less than the 9% traffic decline.

Air Canada is also trying to "put creativity to work to generate new sources of revenue". But most of the initiatives announced so far (a low fare guarantee, elimination of the call centre booking fee, planned FFP enhancements, etc) seem more aimed at defending market share from WestJet than creating new revenue streams, for example, with new travel enhancement products. Ancillary revenues have proved lucrative and recession-resistant in the US. Then again, Air Canada is the expert: it pioneered a la carte offerings and other innovative revenue strategies in North America earlier this decade, so perhaps those activities are already fully developed.

Air Canada is well aware that it needs to get its costs down to levels that make it competitive in North America. Its non-fuel unit costs are significantly higher than the US network carriers'. It does have a unit revenue advantage. But as Rovinescu put it: "while premium customers will continue to be a priority for us, we cannot rely on this market segment to fully cover our cost disadvantage".

The other long-term goal is to get EBITDAR margins to a "more competitive and financeable 16% once we see the end of the recession". But, as with the unit cost reduction goal, it is not at all clear how Air Canada will get there.

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		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Air France/	Jul-Sep 07	9,183	7,855	1,328	1,041	14.5%	11.3%	67,375	57,009	84.6%	20,448	
KLM Group	Oct-Dec 07	8,678	8,202	476	207	5.5%	2.4%	62,615	49,591	79.2%	17,868	104,482
YE 31/03	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	7,880	8,136	-256	-666	-3.2%	-8.5%	64,457	51,255	79.5%	17,934	106,773
	Jan-Mar 09	6,560	7,310	-751	-661	-11.4%	-10.1%	61,235	46,214	75.5%	15,727	106,895
	Year 2008/09	**34,152**	**34,335**	**-184**	**-1,160**	**-0.5%**	**-3.4%**	**262,359**	**209,060**	**79.7%**	**73,844**	**106,933**
BA	Apr-Jun 07	4,395	3,868	527	539	12.0%	12.3%	37,514	28,836	76.9%	8,648	
YE 31/03	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	
	Jan-Mar 09	2,689	3,257	-568	-402	-21.1%	-14.9%	35,478	25,774	72.6%	7,124	
	Year 2008/09	**15,481**	**15,860**	**-379**	**-616**	**-2.4%**	**-4.0%**	**148,504**	**114,346**	**77.0%**	**33,117**	**41,473**
Iberia	Jul-Sep 07	2,080	1,882	198	211	9.5%	10.1%	17,119	14,653	85.6%	7,216	22,803
YE 31/12	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	1,753	1,836	-83	-25	-4.7%	-1.4%	15,875	12,302	77.5%		20,956
	Year 2008	**8,019**	**8,135**	**-116**	**47**	**-1.4%**	**0.6%**	**66,098**	**52,885**	**80.0%**		**21,578**
	Jan-Mar 09	1,436	1,629	-193	-121	-13.4%	-8.4%	15,369	11,752	76.5%		20,715
Lufthansa	Apr-Jun 07	7,267	6,506	761	663	10.5%	9.1%	39,573	30,544	77.2%	14,629	97,067
YE 31/12	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	8,274	7,693	582	70	7.0%	0.8%	47,075	36,632	77.8%	17,107	108,711
	Year 2008	**36,592**	**34,600**	**1,992**	**896**	**5.4%**	**2.4%**	**195,431**	**154,155**	**78.9%**	**70,500**	**108,123**
	Jan-Mar 09	6,560	6,617	-58	-335	-0.9%	-5.1%	44,179	32,681	74.0%	15,033	106,840
SAS	Apr-Jun 07	2,383	2,247	136	89	5.7%	3.7%	10,281	7,677	74.7%	7,696	26,916
YE 31/12	Jul-Sep 07	2,612	2,518	94	109	3.6%	4.2%	10,452	8,228	78.7%	7,523	27,447
	Oct-Dec 07	2,041	2,039	2	-96	0.1%	-4.7%	9,985	7,034	70.4%	7,195	25,651
	Year 2007	**5,969**	**5,676**	**293**	**259**	**4.9%**	**4.3%**	**40,030**	**29,365**	**73.4%**	**29,164**	**26,538**
	Jan-Mar 08	2,046	2,185	-139	-181	-6.8%	-8.8%	9,696	6,700	69.1%	6,803	25,477
	Apr-Jun 08	2,959	2,968	-9	-69	-0.3%	-2.3%	11,564	11,851	102.5%	8,260	26,916
	Jul-Sep 08	2,604	2,869	-265	-319	-10.2%	-12.3%	10,984	10,879	99.0%	7,325	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
	Year 2008	**8,170**	**8,288**	**-117**	**-971**	**-1.4%**	**-11.9%**	**41,994**	**29,928**	**71.3%**	**29,000**	**24,635**
	Jan-Mar 09	1,359	1,482	-123	-90	-9.0%	-6.6%	8,870	5,541	62.5%	5,748	22,133
Ryanair	Apr-Jun 07	934	722	212	187	22.7%	20.0%			82.0%	12,600	
YE 31/03	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	792	67	-85	7.8%	-9.9%					
	Year 2007/08	**3,846**	**3,070**	**777**	**554**	**20.2%**	**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
	Jan-Mar 09	623	592	31	-223	5.0%	-35.8%			74.6%	14,500	
	Year 2008/09	**4,191**	**3,986**	**205**	**-241**	**4.9%**	**-5.7%**			**81.0%**	**58,500**	
easyJet	Oct 05-Mar 06	1,095	1,177	-82	-50	-7.5%	-4.6%	16,672	13,642	81.8%	14,900	
YE 30/09	**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	
	Oct 08-Mar 09	1,557	1,731	-174	-130	-11.2%	-8.3%	24,754	21,017	84.9%	19,400	

Note: 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	**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	892	-52	-37	-6.2%	-4.4%	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**
	Jan-Mar 09	742	754	-12	-19	-1.6%	-2.6%	8,883	6,725	75.7%	3,573	9,021
American	**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	-341	-3.3%	-6.0%	66,065	52,283	79.1%	23,051	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**
	Jan-Mar 09	4,839	5,033	-194	-375	-4.0%	-7.7%	60,804	46,015	75.7%	20,331	79,500
Continental	**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	-82	-1.8%	-2.3%	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**
	Jan-Mar 09	2,962	3,017	-55	-136	-1.9%	-4.6%	42,362	31,848	75.2%	14,408	43,000
Delta	**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**
	Jan-Mar 09	6,684	7,167	-483	-794	-7.2%	-11.9%	89,702	69,136	77.1%	37,310	83,822
Northwest	**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**
	Jan-Mar 09	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Southwest	**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	34,793
	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**
	Jan-Mar 09	2,357	2,407	-50	-91	-2.1%	-3.9%	38,899	27,184	69.9%	23,050	35,512
United	**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%	20,981	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**
	Jan-Mar 09	3,691	3,973	-282	-382	-7.6%	-10.3%	54,834	41,533	75.7%	18,668	44,800
US Airways Group	**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**
	Jan-Mar 09	2,455	2,480	-25	-103	-1.0%	-4.2%	32,884	25,239	76.7%	18,387	32,245
JetBlue	**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	-10	2.1%	-1.2%	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	-57	6.0%	-7.0%	12,086	9,501	78.6%	5,108	9,895
	Year 2008	**3,388**	**3,279**	**109**	**-76**	**3.2%**	**-2.2%**	**52,209**	**41,956**	**80.4%**	**21,920**	**9,895**
	Jan-Mar 09	793	720	73	12	9.2%	1.5%	12,781	9,720	76.0%	5,291	10,047

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation. 1 ASM = 1.6093 ASK. All US airline financial year ends are December 31st.

		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 2004/05**	**12,024**	**11,301**	**723**	**251**	**6.0%**	**2.1%**	**85,838**	**55,807**	**65.0%**	**48,860**	**29,098**
YE 31/03	**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**	
	Year 2008/09	**13,925**	**13,849**	**75**	**-42**	**0.5%**	**-0.3%**	**87,127**	**56,957**	**65.4%**	**47,185**	
Cathay Pacific	**Year 2005**	**6,548**	**6,015**	**533**	**424**	**8.1%**	**6.5%**	**82,766**	**65,110**	**78.7%**	**15,440**	**15,447**
YE 31/12	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	
	Year 2008	**11,119**	**12,138**	**-1,018**	**-1,070**	**-9.2%**	**-9.6%**	**115,478**	**90,975**	**78.8%**	**24,959**	**18,718**
JAL	**Year 2004/05**	**19,905**	**19,381**	**524**	**281**	**2.6%**	**1.4%**	**151,902**	**102,354**	**67.4%**	**59,448**	53,962
YE 31/03	**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**	
	Year 2008/09	**19,512**	**20,020**	**-508**	**-632**	**-2.6%**	**-3.2%**	**128,744**	**83,487**	**64.8%**	**52,858**	
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**	**16,825**
	Year 2008	**9,498**	**9,590**	**-92**	**-1,821**	**-1.0%**	**-19.2%**	**77,139**	**55054**	**72.7%**		
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	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**
	2007	**4,464**	**4,208**	**256**	**248**	**5.7%**	**5.6%**	**56,104**	**40,096**	**71.5%**	**13,962**	
	2008	**4,671**	**4,579**	**92**	**74**	**2.0%**	**1.6%**					
Qantas	Jul-Dec 05	4,999	4,626	373	258	7.5%	5.2%	59,074	45,794	77.5%	17,260	35,158
YE 30/6	**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**
	Jul-Dec 08	6,755	6,521	234	184	3.5%	2.7%	63,853	50,889	79.7%	19,639	34,110
Singapore	**Year 2004/05**	**7,276**	**6,455**	**821**	**841**	**11.3%**	**11.6%**	**104,662**	**77,594**	**74.1%**	**15,944**	**13,572**
YE 31/03	**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**
	Year 2008/09	**11,135**	**10,506**	**629**	**798**	**5.6%**	**7.2%**	**117,789**	**90,128**	**76.5%**	**18,293**	**14,343**
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**	**19,334**
	Year 2008	**7,627**	**7,902**	**-275**	**-1,350**	**-3.6%**	**-17.7%**	**91,810**	**68,747**	**74.9%**	**34,249**	
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**	**45,000**
	Year 2008	**7,970**	**8,912**	**-942**	**-690**	**-11.8%**	**-8.7%**	**112,767**	**83,184**	**73.8%**	**58,237**	
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**	**29,301**
	Year 2006	**3,825**	**4,201**	**-376**	**-416**	**-9.8%**	**-10.9%**	**70,428**	**50,243**	**71.3%**	**35,020**	**38,392**
	Year 2007	**5,608**	**5,603**	**5**	**32**	**0.1%**	**0.6%**	**77,713**	**57,180**	**73.6%**	**39,160**	**40,477**
	Year 2008	**6,018**	**8,192**	**-2,174**	**-2,201**	**-36.1%**	**-36.6%**	**75,919**	**53,754**	**70.8%**	**27,220**	**44,153**
Air Asia	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	
	Oct-Dec 08	237	152	84	-50	35.7%	-21.1%	5,006	3,800	75.9%	3,342	
YE 31/12	**Year 2008**	**796**	**592**	**203**	**-142**	**25.5%**	**-17.9%**	**18,717**	**13,485**	**72.0%**	**11,795**	
	Jan-Mar 09	198	84	114	56	57.6%	28.4%	5,207	3,487	67.0%	3,147	

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 International		
	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 %
1990	113.4	70.9	62.5	128.8	89.7	69.6	80.5	57.6	71.6	272.6	191.7	70.3	405.8	274.9	67.7
1991	114.8	65.2	56.8	120.9	84.3	69.7	80.0	53.1	66.4	267.6	182.0	68.0	397.8	257.9	64.7
1992	129.6	73.5	56.7	134.5	95.0	70.6	89.4	61.6	68.9	296.8	207.1	69.8	445.8	293.4	65.8
1993	137.8	79.8	57.9	145.1	102.0	70.3	96.3	68.1	70.7	319.1	223.7	70.1	479.7	318.0	66.3
1994	144.7	87.7	60.6	150.3	108.8	72.4	102.8	76.1	74.0	334.0	243.6	72.9	503.7	346.7	68.8
1995	154.8	94.9	61.3	154.1	117.6	76.3	111.1	81.1	73.0	362.6	269.5	74.3	532.8	373.7	70.1
1996	165.1	100.8	61.1	163.9	126.4	77.1	121.1	88.8	73.3	391.9	292.8	74.7	583.5	410.9	70.4
1997	174.8	110.9	63.4	176.5	138.2	78.3	130.4	96.9	74.3	419.0	320.5	76.5	621.9	450.2	72.4
1998	188.3	120.3	63.9	194.2	149.7	77.1	135.4	100.6	74.3	453.6	344.2	75.9	673.2	484.8	72
1999	200.0	124.9	62.5	218.9	166.5	76.1	134.5	103.1	76.7	492.3	371.0	75.4	727.2	519.5	71.4
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
2008	354.8	241.5	68.1	244.8	199.2	81.4	191.1	153.8	80.5	634.7	512.4	80.7	955.7	735.0	76.9
May 09	28.7	19.6	68.4	20.6	16.7	81.3	15.2	11.1	73.3	50.6	38.9	76.9	78.1	57.5	73.7
Ann. change	-5.0%	-7.8%	-2.1	-8.2%	-8.8%	-0.5	-6.0%	-9.8%	-3.1	-7.1%	-9.2%	-1.8	-5.3%	-8.3%	-2.4
Jan-May 09	131.1	83.7	63.9	89.9	68.8	76.5	75.4	58.3	77.3	246.2	189.9	77.1	370.7	270.4	72.9
Ann. change	-6.1%	-9.0%	-2.0	-6.5%	-8.6%	-1.8	-4.3%	-8.0%	-3.1	-4.5%	-7.2%	-2.2	-4.1%	-7.0%	-2.3

Source: AEA.

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	30 Jun	Aerolineas Argentinas	1 x 737-700	
	16 Jun	MCAP	2 x 737-800s	
	9 Jun	American Airlines	8 x 737-800s	
	21 May	All Nippon Airways	5 x 787-8s	
Airbus	30 Jun	ILFC	1 x A330-200	
	16 Jun	Aigle Azur	1 x A319	
	16 Jun	Vietnam Airlines	16 x A321s	
	16 Jun	AirAsia X	10 x A350-900s	
	16 Jun	Cebu Pacific Air	5 x A320s	
	15 Jun	Qatar Airways	20 x A320s, 4 x A321s	

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

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