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Damage limitation

In this recession "premium" business has been particularly badly hit – and it is not just the bankers who have stopped flying in flat-beds on the Atlantic; all businesses, faced with financial uncertainty, have reassessed their travel needs. According to IATA, passenger demand in F- and J/C-classes fell off a cliff last October and the rate of decline accelerated subsequently to hit a year-on-year fall of 25% by May this year. The severest declines were experienced in intra-European and intra-Asian route sectors, each down by 35% against prior year levels; more significant for the network carriers was the 18% decline in premium traffic on the Atlantic and the 9% fall on Europe-Far-East, the two main premium revenue generating segments (note that IATA trends refer to pax numbers; premium revenue will have fallen even more precipitously). At least, however, there are the first signs that the slump may be bottoming, with modest reductions in the rate of decline on the North Atlantic since Easter.

A consequence of plummeting demand – and particularly falling business demand – is a collapse in pricing and yields in all classes of travel, exacerbated by the removal or reduction of the fuel surcharges imposed over the past few years. In each recession fears are expressed that premium travel will never recover to previous levels, and that those businesses who allow personnel to fly in the back of the bus when necessary will never again allow them to be pampered in the front. However, when the good times return, and an air ticket just has to be bought, such cost disciplines tend to disappear.

In the meantime, this resulting lack of income as yields and traffic slump (and IATA is currently forecasting a massive 15% drop in world airline revenues this year) is proving painful for Europe's network *(continued on page 2)*

JUNE QUARTER RESULTS

	Air France/KLM		British Airways		Lufthansa	
	€m	change	£m	change	€m	change
Revenue	5,169	-20.5%	1,983	-12.2%	5,211	-19.4%
EBITDAR	112	-86.2%	118	-53.4%	452	-49.0%
EBITDAR margin	2%	-10.3%	6%	-5.2%	9%	-5.0%
Cash in/(out) flow	(271)		(29)		291	
Pax unit revenue	-14.8%		-9.4%		-18.4%	
Cargo unit revenue	-30.0%		-25.0%		-27.6%	
Unit cost	-3.9%		-3.0%		-6.4%*	
Cash (end of June)	4,500		1,258		4,700	
Credit lines	1,200		130		1,500	
Cash/annual turnover	20%		15%		19%	
Current cash/ annual turnover**	20%		20%		21%	
Proportion of fleet under operating lease	33%		15%		23%***	

Note: *Cargo -12.2%. **After recent capital raising: British Airways, £350m convertible; Lufthansa, €750m bond; (Air France/KLM, €660m convertible in June).*** Estimated post consolidation of bmi.

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carriers. For them this is arguably the first real economic recession in the deregulated era, and the one that could well further accelerate consolidation and polarisation in the industry. Much has changed since the last economic downturn of 1989-1992 (when Air France had to be bailed out by its government), and the top three carriers in Europe have all developed elements of flexibility in their models to enable them to react swiftly to changes in the market.

In the lead up to this downturn BA, Air France/KLM and Lufthansa had all been able to restore balance sheets (BA's pension problem notwithstanding) and cash balances to reasonable levels – and as usual at any time in this industry, cash is king. The results from the top three carriers for the quarter to the end of June show very similar performances from all three, after allowing for the effect of sterling's weakness on BA's results. Total revenues fell by some 20%; passenger unit revenues were down by between 15%-20% and cargo unit revenues down by around 30%. Both BA and Lufthansa appeared to have achieved a slightly better unit cost performance - and Lufthansa particularly managed to reduce its cargo unit costs by over 12% - while Air France/KLM may have had some impact from the fatal loss of the A340 on the South Atlantic. EBITDAR for BA and Lufthansa halved from the prior year levels and margins fell by five points to 6% and 9% respectively. At Air France/KLM, the EBITDAR margin fell to an uncomfortable 2%.

Interestingly only Air France/KLM experienced a material operational cash outflow in the quarter; Lufthansa even managed a relatively healthy cash inflow. All three have been able to tap the markets for cash. AF/KLM issued a €660m convertible in June, while after the end of the quarter BA raised £350m in a similar issue and Lufthansa some €750m from a straight bond issuance. After allowing for these, all three carriers are now sitting with a relatively healthy cushion of cash reflecting 20% of annual turnover.

The focus for all three is damage limitation (only at BA is the word "survival" mentioned). This means: cut capacity to match demand; cut costs (particularly labour costs) to reduce losses and capex to limit cash outflow; adjust capacity and product to the weak market; and yet be in a position to benefit from the upturn when it comes. They each have a reasonable proportion of their fleets on operating leases, allowing some flexibility in medium-term capacity management, while Lufthansa has the apparent additional advantage of relatively short depreciation policies giving a higher proportion of fully depreciated equipment on its balance sheet. Each are deferring aircraft deliveries and maintaining a flexible approach to capacity as much as possible. The suspension of the 80/20 slot usage rule – at least for this summer season – helps both Lufthansa and BA (although it is unlikely to be extended for this winter season too).

On the cost side, Lufthansa had been particularly successful since 2001 in renegotiating union contracts to provide significant flexibility in working practices and allow furloughs and short-term working. BA, although helped in some way by the changes it could introduce last year from the move to Terminal 5 at Heathrow, is determined to gain long-term productivity concessions. KLM has generally tended to have pragmatic relations with its unions and, whereas Air France may have a little more difficulty under the French social environment, it has at least recently proposed a voluntary redundancy programme to fit the workforce to a planned 5% cut in passenger capacity and 15% cut in freight capacity.

Air France/KLM may still have some benefits to accrue from the 2004 merger of the two carriers, but it will be difficult meaningfully to increase the synergy savings from those already in its plans. The joint venture on the Atlantic with Delta in contrast – which started in full in April this year – should be accretive even in these difficult times. Lufthansa is benefiting strongly this year from its more recent acquisition of swiss – though it may find it harder to digest bmi, Austrian and SN Brussels, plus develop its new base in Malpensa. At the same time it has started codeshare operations with its minority-owned Jet Blue partner through JFK, to try to improve feed through New York where the Star alliance is relatively weak. As for BA, if the joint venture ATI application with American and Iberia finally gets approval, and assuming that the marriage with Iberia finally gets consummated, BA's competitive positioning should gain a significant boost to put it on a par with the other two majors. Meanwhile, BA continues to suffer the most excessive pressure from LCC competition (although in the short-term possibly helped as they move their attention away from the saturated UK market and focus on continental Europe).

Lessors tread water waiting for market recovery

In the midst of the deepest-ever aviation recession, the global leasing industry is coping as best it can as lease rates tumble and marginal airlines return aircraft or go bankrupt. In many respects the leasing industry is treading water – few assets (whether aircraft or leasing companies themselves) are changing hands as lessors preserve cash and wait for the market to improve.

The situation, however, is not uniformly bad for all lessors. Many of those who have been through downturns before are coping relatively well, and a handful of well-backed lessors are using the opportunity to snap up cheap assets. And while some in the leasing industry talk about a W shaped recession - with a second dip coming in the latter half of 2009 - most observers cautiously forecast that the industry will start recovering in the first half of 2010 (or the second half at latest) as the global economy improves.

Of course the reality is that with around 2,500 parked narrowbodies and widebodies, there is plenty of choice for airlines needing capacity. In 18 months lease rates have dropped by between 10% and 50% on almost all models, with older narrowbodies and widebodies suffering the largest falls and new narrowbodies the smallest.

The funding gap

Finding finance for new aircraft - the "funding gap" - is perhaps the greatest challenge the current downturn presents for airlines and thus lessors. Some companies (GECAS for example) believe this trend (which has arisen primarily because banks are now reluctant to provide debt) has been much exaggerated, and that manufacturers and export credit agencies are filling in much of the funding gap. Others argue that manufacturers are reluctant to provide much funding for new aircraft, and that there is a limit to the extra backing that export credit agencies such as the US's Ex-Im Bank can provide.

Whatever the truth, most lessors certainly won't step forward and provide funding to airlines themselves – first, because they can't afford to and second, because they would prefer manufacturers to cut back production instead, by anything up to 30%.

However, an investor presentation given by Aircastle in June emphasised that, while the short-term prospects for the industry are dire, the "long-term trends remain favourable" thanks to the underlying need for major European and North American airlines to upgrade their fleets. Aircastle estimates that more than 1,000 mainline aircraft in Europe and North America are more than 20 years old, while a third of the global freighter fleet will need to be retired by 2011.

The other positive is that the fall in global interest rates has helped lessors considerably; although headline lease rates have fallen, net margins have not dropped by anything near the same proportion.

How individual lessors are faring at present varies tremendously. The greatest pressure is on lessors with lots of debt and/or a less than "blue-chip" list of lessees. Some in the industry are not exactly upset by the troubles at ILFC, with one lessor commenting that both ILFC and GECAS prospered only because of access to cheap funds from their parents. Others - like BOC Aviation (backed by the deep pockets of the Bank of China) - see the downturn as an opportunity to buy cheap assets, and BOC has acquired close to 50 aircraft in the last eight months in what is an unprecedented buyers' market.

Curiously for a downturn, there is relatively little consolidation going on in the leasing industry – largely because of a scarcity of debt finance and a nervousness among the (few) potential buyers that are around. Indeed those lessors that have come onto the market have had trouble finding buyers, and those fabled white knights - the sovereign wealth funds - that were tipped by many to acquire lessors have (so far) stayed out of the fray.

Aviation Strategy's annual survey of the leasing industry (see table, pages 6-7) reveals that the overall fleet has remained virtually static year-on-year at 6,877 aircraft, but - most interestingly - lessors have 1,142 outstanding orders now compared with 1,277 12 months ago (see *Aviation Strategy,* September 2008), and the only lessor orders this year have been for a couple of Boeing aircraft and 13 Airbuses.

The "Big Two" – GECAS and ILFC – continue to dominate the lessor fleet, with a combined total of 2,825 aircraft, but again continue to have an increasingly smaller share of the outstanding order book; this year they have 23.6% of the total lessor order book, compared with 27.6% a year ago and 47.3% in September 2007.

GECAS

Based in Connecticut, GECAS is by far the world's largest lessor and, while its key rival has been struggling to find a new owner, GECAS has remained focussed on protecting its market and profitability (see *Aviation Strategy,* June 2009). From July that focus has been led by Norman Liu, who took over as CEO and president from Henry Hubschman, who moved over to become chairman at the same date. Liu insists that the lessor aims to maintain its record of never having to cancel or defer an aircraft order.

In the first six months of 2009 GECAS reported a 3.7% fall in revenue, to $2.4bn, with "segment profit" dropping 17.2% to $555m – but that's still a good result given the market environment. GECAS's assets are valued at $50.3bn (compared with $48.4bn 12 months earlier) and the fleet has increased slightly year-on-year, with 1,500 owned aircraft and another 325 aircraft managed on behalf of others (compared with 1,475 owned aircraft and 300 managed as of September 2008). GECAS's fleet has an average age of under eight years, and 55% are narrowbodies (of which 83% are A320 family aircraft and 737NGs), while 20% are widebodies (of which 90% are 767s, 777s or A330s), 16% are RJs and 9% are cargo aircraft.

The fleet is placed with approximately 250 airlines in 70 countries around the world, with just two aircraft not placed with clients as at the end of June. 34% of the fleet is placed with airlines in the US, with the next most important markets being Europe (20% of the fleet), the Asia/Pacific region (19%), Middle East/ Africa/CIS/Russia (15%), Latin America (7%) and Canada (5%).

GECAS's huge sales effort is co-ordinated via 480 employees in 24 global offices (of which the majority have been opened since 2001), and the lessor is particularly keen on building up orders in the Asia/Pacific region, where it has a presence in Tokyo, Shanghai, Hong Kong, Beijing, Singapore, Delhi and Mumbai.

All orders through to the end of 2010 have already been placed with clients, and GECAS's current order book stands at 97 Boeing aircraft (79 737s and 18 777s) and 48 Airbus aircraft (11 A319s and 37 A320s). That's significantly less than the 196 orders outstanding as of a year ago, since GECAS hasn't placed any new orders recently.

ILFC

The continuing circus regarding ILFC's sale shows no sign of ending, and as a result the world's second-largest lessor still faces an uncertain future. A subsidiary of troubled US financial services giant AIG, California-based ILFC was put up for sale late last year but the sale process has been slow and painful (see *Aviation Strategy,* May 2009). Little information is being released by ILFC or its parent, and although AIG continues to sell off other assets left, right and centre, the sale of the lessor appears elusive.

Essentially the three bidders for ILFC appear reluctant to make firm commitments without support from the US government/the Federal Reserve Bank of New York (which own 80% of AIG). The preferred bidder is a consortium led by two private equity houses: New York-based Greenbriar Equity Group and Toronto-based Onex Corp (the other two consortia are led by Terra Firma and the Carlyle Group/Thomas H. Lee Partners). But Greenbriar and Onex are believed to have bid no more than $3bn-$4bn between them, and this is also conditional on getting extra guarantees from the New York Fed on top of the $5bn of ILFC debt it has already guaranteed. ILFC has a book value of $7.5bn, but that is after $32bn of debt, $6bn of which is maturing in 2009 (including $2bn due in October), which will be very difficult to refinance and so is the biggest obstacle to finding a new owner. The situation was not helped at the end of July when Moody's downgraded ILFC's rating yet again, and placed the company on review for another potential downgrade.

What kind of owner the Greenbriar/Onex consortium would be is hard to tell at present. Onex led an unsuccessful attempt to buy Air Canada back in 1999, but neither it nor Greenbriar have revealed plans for the lessor publicly (and are no doubt concentrating first on wringing as many guarantees out of the Fed as possible).

However, AIG is now reported to have frozen the sale process as the price offered by Greenbriar/Onex is too low, and Steven Udvar-Hazy, ILFC's CEO, is rumoured to be putting together a bid to buy part of the lessor's portfolio.

The first operational decision the new owners (whoever they turn out to be) will have to make is on orders. ILFC's current order book stands at 125 aircraft, but the outstanding total has steadily fallen since a high of 360 back in 2004. Thus the most pressing problem for ILFC is that the uncertainty over its new owner means that it can't buy aircraft at the bottom of the cycle, as it traditionally does, in order to cater for the expected demand from airlines that have to retire older models over the next 12-18 months. The ILFC fleet currently stands at approximately 1,000 (compared with 947 owned and 108 managed as of a year ago), and orders for up to 50 aircraft may be placed pretty quickly once the ownership question is sorted out – although naturally that will depend on the wishes (and the finances) of those owners.

These new orders are likely to be given a boost by the capex savings from an anticipated cancellation of some or all of ILFC's order for 10 A380s. ILFC is the only lessor to have ordered A380s, but the tapering of new orders for the type combined with the high costs of converting the spec of each aircraft from one airline's requirements to another's may cause the lessor to cancel. ILFC apparently has an option to cancel the order before June 2010 without having to pay a penalty.

Boeing Capital Corporation

BCC, regarded as a financer of last resort for Boeing aircraft, currently has a portfolio of 280 owned and 49 part-owned aircraft worth some $6.4bn. BCC's operation has been steadily trimmed over the last few years, and now 160 staff operate out of four offices in the US, as well as Moscow and Hong Kong (a Brussels office was closed in the last year). In the first half of 2009 BCC reported $330m of revenue – 8.2% down on January-June 2008 – and net profit of $42m (42.5% down year-on-year).

Unsurprisingly, Renton-based BCC has "received a number of requests from both domestic and foreign airlines to reduce lease payments or to otherwise restructure obligations", and one example came in May when BCC restructured leases for nine 717s placed with Midwest Airlines, under which all the aircraft will return to BCC by the end of 2009. BCC is most heavily exposed to the 717, and particularly customers for this model in the US. Just five airlines – AirTran, American, Hawaiian, Delta and Continental – account for 52.5% of the aircraft in BCC's portfolio, with Air Tran alone accounting for a substantial 24.1% of BCC's aircraft.

Altogether 76% of BCC's portfolio by value is placed with US airlines, with 14% in Europe and the remaining 10% scattered around the rest of the world. Just over 37% of the fleet by value are 717s, with the next largest categories being 757s (15%) and 737s (9%). The reliance on 717s skews the age profile of the fleet, with just 19.6% of aircraft being less than five years old, and almost a quarter of aircraft being more than 16 years old.

CIT Aerospace

CIT Aerospace is part of the CIT Group, a NYSE-quoted commercial and consumer finance group, and has a mixed portfolio of 302 narrowbody and widebody aircraft – slightly up on a year ago.

CIT has six offices around the globe, and opened an office in Singapore in May; currently 25% of the lessor's fleet is placed in the Asia/Pacific region, and it is a target area for further orders. CIT has more than 100 aircraft on order, including 10 787s, 15 737s, 61 A320 family aircraft, 10 A330s and seven A350s.

THE LESSOR FLEET

Company	Owned*	Managed/ part-owned*	Total	Boeing orders	Airbus orders	Total orders
GECAS	1,500	325	**1,825**	97	48	**145**
ILFC			**1,000**	84	41	**125**
BCC	280	49	**329**			
CIT			**302**	25	78	**103**
AerCap			**290**		25	**25**
BBAM			**280**	20		**20**
ACG			**233**	74	68	**142**
AWAS			**214**	39	83	**122**
RBS			**205**			
Aircastle	131		**131**		11	**11**
Macquarie AirFinance	82	43	**125**			
BOC Aviation	100	23	**123**	29	38	**67**
MCAP	60	60	**120**	2		**2**
Airplanes Group			**116**			
ORIX			**115**			
Pembroke			**104**			
Aergo Capital			**103**			
Allco Finance			**66**			
Dubai Aerospace Enterprise			**61**	116	100	**216**
Jetran			**60**			
Sumisho			**60**			
Genesis			**55**			
World Star Aviation			**54**			
Al Waha Capital			**53**			
GAAM			**50**			
Compass Capital			**45**			
Guggenheim			**42**	10	6	**16**
Magellan Air		40	**40**			
RPK Capital Management			**35**			
BCI Aircraft Leasing			**33**			
AAR	7	26	**33**			
VGS			**32**			
GA Telesis			**30**			
SkyWorks Leasing			**30**			
Alafco	19	10	**29**	28	31	**59**
Aircraft Leasing and Management		27	**27**			
Aircorp			**27**			
Goal			**26**			
Jetscape			**26**			
Sojitz Aircraft Leasing			**23**			
AerVenture	23		**23**		36	**36**
GMT Global			**22**			
Vx Capital Partners			**20**			
Aircraft Financing & Trading			**20**			
Bavaria			**20**			
Novus Aviation			**18**			
Automatic			**18**			
Skytech-AIC			**18**			

THE LESSOR FLEET

Company	Owned*	Managed/ part-owned*	Total	Boeing orders	Airbus orders	Total orders
Deutsche Bank Equipment Leasing			16			
Global Aviation Leasing			15			
First Greenwich Kahala			15			
Q Aviation			15			
Itochu Airlease			14			
ICBC Leasing			14			
Doric Asset Finance			14			
Tombo Aviation			14			
Airbus Asset Management			10			
Phoenix Aircraft Leasing			10			
Deutsche Structured Finance			10			
Veling			10			
CDB Financial Leasing			9			
Intrepid Aviation					20	20
AerDragon Aviation Partners					10	10
Deucalion Capital				6		6
MatlinPatterson					6	6
Oak Hill Capital Partners				6		6
LCAL				5		5
Total	2,202	603	6,877	541	601	1,142

Note: This table includes jet lessors with at least nine owned or managed aircraft. We exclude entities set up solely to manage the leasing activities of a specific airline. *Where known.

New York-based CIT Aerospace's future is slightly uncertain given that the CIT Group has been in talks with the US government about financial support to help it avoid bankruptcy – although in July, after the government declined to provide support, the group raised $3bn in new financing. However, CIT Aerospace's assets were used as collateral for the new funding, which means that the providers of that $3bn will have to approve any new owner if it is to be sold (which has not been confirmed by the CIT Group yet).

AerCap

Thanks to the sale of older models, the portfolio of Dutch-based AerCap continues to shrink, coming down from 340 owned and managed aircraft two years ago to 314 aircraft 12 months ago and 290 at present. The fleet is placed with 95 airlines in 45 countries, the majority of which are in Europe (36 customers), followed by North and South America (18) and the Asia/Pacific region (19).

In the first six months of 2009 AerCap leased 11 aircraft and signed letters of intent for another 21, and all but two of these 33 aircraft were contracted in the second quarter of 2009, indicating that business is picking up for the lessor after a very slow start to the year. Among the second quarter activity was a deal to lease four A330-200s to Virgin Atlantic as well as the purchase and leaseback to the same airline of another six A330-300s that Virgin Atlantic has on order with Airbus.

AerCap has 15 A330-200s and 10 A330-300s on order, and all aircraft being delivered through to the end of 2011 have been placed with customers. The lessor is listed on the NYSE, and in the first half of 2008 recorded a 20% fall in revenue to $503m, with net income falling by 28% to $86.6m.

Babcock & Brown AM

BBAM has a fleet of 280 aircraft and outstanding orders for 20 737s. BBAM was part of the operating lease division of Babcock & Brown, the Australian investment bank and asset management group that went into bankruptcy in March this year. With 280 aircraft, placed with more than 70 customers in 31 countries, San Francisco-based BBAM is still looking for a new owner.

Aviation Capital Group

Aviation Capital Group (ACG) is largely a narrowbody specialist and has a portfolio of 233 owned or managed aircraft, most of which are 737s or A320 family aircraft. These are placed with 93 airlines in 40 countries around the world.

Based in Newport Beach, California, ACG is owned by insurance giant Pacific LifeCorp, and has offices in London, Santiago, Seattle, Shanghai, Singapore and Stamford. Last year ACG reported operating revenue of $609m, 2.5% up on 2007, and its portfolio was valued at $5.4bn as at the end of 2008.

The order book stands at 142 aircraft (69 737s, five 787s, 68 A320 family aircraft), compared with outstanding orders of 145 as of 12 months ago, and while 12 new aircraft arrived at the lessor in 2008 13 aircraft were disposed of, so the fleet is remaining stable in terms of numbers.

In June ACG launched a joint venture leasing company called Civil Aviation Finance and Operating Leases Co (known as CIAF-Leasing) in partnership with Civil Aviation Finance Holding, an Egyptian-based company, and Egypt's Civil Aviation Support and Development Fund. The Egyptian partners have taken a 90% equity stake in the venture, with ACG holding 10% and signing an initial five-year contract to manage the company's portfolio. The new lessor will specialise in serving airlines in the Middle East and North Africa with narrowbody equipment.

AWAS

AWAS has a portfolio of 214 aircraft, which are currently leased to 95 airlines in 49 countries around the world. The average age of the fleet is more than eight years, and having incorporated Pegasus Aviation, the AWAS fleet has what it calls a "highly distinctive strategy" with a fleet that is diversified, whether by type, age or "lessor quality". According to owner Terra Firma that diversification has made the lessor "more defensive ahead of the downward cyclical adjustment that the industry is currently experiencing".

In the 12 month period ending November 30th 2008 AWAS recorded revenue of US$781m, 32% up on 2007, with earnings before deprecation and tax rising from $283m in 2007 to $411m in 2008. Terra Firma admits that AWAS had "a very challenging year" in 2008, but that this year it sees "a number of opportunities to take advantage of the soft market to grow the business through accretive acquisitions which will develop the business strategically".

AWAS has around 100 employees and a head office in Dublin, with other offices in New York, Singapore and Miami. The lessor received three A330-300s in the first half of the year, which are now leased to Singapore Airlines, while two A330-200s are being delivered in the second half, with Oman Air contracted to take the aircraft. AWAS has 122 aircraft on order - exactly the same as a year ago.

RBS Aviation Capital

RBS Aviation Capital owns or manages 205 aircraft (with an average age of four years) that are currently placed with 53 airlines, including 18 in Europe, 17 in the Asia/Pacific region, 10 in North America, four in Latin America, two in Africa and two in the Middle East.

The lessor has 90 staff and is based in Dublin, with other offices located in London, Connecticut, Hong Kong, Shanghai, Toulouse, Dubai, Tokyo and Singapore.

After RBS turned in an operating loss of £41bn ($58bn) in 2008 and its emergency takeover by the UK government (which is now a 70% shareholder), RBS has been disposing of non-core assets, and the aircraft leasing arm was formally put into this category after a review carried out in February this year. In May RBS cancelled its order for 20 787s, which RBS admits was part of the drive to limit exposure to non-core investment. Some analysts expressed surprise at the cancellation, which one said would make it less attractive to potential buyers.

A behind-the-scenes look for a buyer has been going on for some time it is believed, but although it is formally not up for sale yet, it's clear to everyone in the industry that it is available. Chinese banks have been touted as potential buyers, (with Bank of China reportedly holding talks with RBS) and they may be one of the few sectors that might be willing to invest at present. As has happened with ILFC, however, there is likely to be a significant gap between what RBS/the government would like to receive and what buyers are prepared to pay.

Aircastle

In the first half of 2009 Aircastle recorded revenue of $269m, compared with $280m in the January-June 2008 period, and net income of $46m ($67m in H1 2008). Aircastle's portfolio has eased from 135 a year ago to 131 aircraft today, which are placed with 60 airlines in 35 countries. Almost half of the fleet (46%) is placed with European airlines, with the next largest markets being the Asia/Pacific region (23%) and North America (12%).

Connecticut-based Aircastle also has offices in Dublin and Singapore and its strategy is to concentrate on owned aircraft only and what it calls a "conservative capital structure", with a net debt to book value of 62%. The fleet has an average age of just under 11 years, with 55 new generation narrowbodies, 22 classic narrowbodies and 19 freighters. Aircastle has 11 A330s on order, and has 23 aircraft so far unplaced with clients through 2010 and 2011.

Macquarie AirFinance

Macquarie AirFinance has a fleet of 82 owned and 43 managed aircraft, placed with 55 airlines in 30 countries - predominantly in Europe, North America and the Asia/Pacific region. The majority of the owned aircraft are either 737s or A320 family aircraft, although it manages a much wider range of aircraft, including 747s, 757s, 767s, MD-80s, A330s and A340s.

It doesn't have any aircraft on order, although in April it bought two A321s (currently on lease to Thomas Cook Airlines Scandinavia) from AerCap, and in May bought and leased back a 737-800 from TUI Aviation. Macquarie AirFinance is based in Dublin, and also has offices in London and San Francisco.

BOC Aviation

BOC Aviation (formerly known as Singapore Aircraft Leasing Enterprise – SALE) has seen its fleet increase by almost 50% in the last 12 months, to 123 owned and managed aircraft. Owned 100% by the Bank of China, BOC is headquartered in Singapore and has offices in London, Washington DC, Seattle and San Diego.

The fleet is young, with an average age of four years, and the owned aircraft include 48 A320 family aircraft, 39 737NGs and 11 777s. In 2008 BOC's net profits rose by 32% to $107m, and the Bank of China has given the lessor a mandate to expand. There are 67 aircraft on order, including 29 737s, 33 A320 family aircraft and five A330-200Fs.

Interestingly, BOC sold aircraft through the first half of 2008 but became a "strategic buyer" of aircraft from the fourth quarter of the year "as competition reduced". This has continued through 2009, buying aircraft (and then leasing them back) from Air France (four 777s), Southwest Airlines (six 737-700s), Virgin Blue (three 737-800s) and Alaska Airlines (six 737-800s).

Airplanes Group

Delaware-based Airplanes Group has a portfolio of 116 aircraft worth an estimated $1bn. Most of these are Boeing narrowbodies, and the fleet includes 43 737s, 20 MD-80s and 12 A320s. 100 of the aircraft are placed with 41 airlines around the world, with most important markets being Latin America (accounting for 22% of the portfolio by value) and Europe excluding CIS countries (16%). The portfolio is relatively aged, with all aircraft being at least 16 years old.

The largest single customer for Airplanes Group is Click Mexicana, to which the lessor leases 16 aircraft. However in its report for the financial year ending March 31st 2009, Airplanes group said that Click Mexicana was "currently in arrears and is experiencing financial difficulties", and after March the existing contracts were restructured. In the 2008/09 financial year ending March 31st, Airplanes Group recorded revenue of US$242m, 1% up on the previous financial year.

ORIX Aviation

ORIX Aviation has a portfolio of 115 aircraft, worth around $3.4bn (including spare engines). Based in Dublin, the lessor is owned by the Japanese financial services group Orix Corporation. As of August it had placed all its aircraft other than a couple of 737s.

Pembroke

Pembroke has a fleet of 104 owned and managed aircraft (most of which are narrowbodies), substantially up from the 77 it had a year ago as it seeks to expand through the recession.

In April Pembroke (owned by Standard Chartered since 2007) bought 13 737-800s and an A320 from GECAS. The 14 aircraft have an average age of just over one year and are all on lease to airlines in either Africa or the Asia/Pacific region.

Aergo Capital

Aergo Capital is based in Dublin and has increased its portfolio to 103 aircraft after incorporating the fleet of South African lessor SAFAIR - which had 40 aircraft (of which 17 were 737s and five were A300-B4 freighters) - in September 2008. Aergo was previously an older model narrowbody specialist, and the most important types in its increased fleet remain MD-82s and 737-200s.

This fleet is currently leased to 23 airlines in 20 countries, including KLM, South African Airways, Jet Airways, Comair, US Airways and Transaero. Aergo also has offices in Johannesburg (where it has a large maintenance facility), Nairobi, Santiago (Chile) and Jakarta.

Dubai Aerospace Enterprise Capital

The UAE government-backed aerospace group Dubai Aerospace Enterprise (DAE) has been forging ahead with ambitious plans to build its aircraft portfolio, operated by its DAE Capital division.

The portfolio currently stands at 61 mixed narrowbodies and widebodies, but the fleet will grow rapidly once massive orders of almost US$30bn worth of aircraft (at list prices) start arriving from 2010 onwards, comprising 70 A320 family aircraft, 30 A350-900s, 70 737NGs, 15 747s, 16 777s, and 15 787s. The aircraft should arrive as the leasing industry begins a cyclical upturn, but it will be interesting to see just how lease rates to Middle Eastern airlines hold up once this new capacity starts flooding into the market.

Al Waha Capital

Abu Dhabi-based Al Waha Capital is a holding company for a variety of infrastructure and finance businesses, and its aircraft leasing operation has a portfolio of 53 aircraft valued at US$2bn, including 737 classics, A320 family aircraft, A340s and 777-200ERs. They are placed with airlines around the world, although the majority are Middle Eastern, including Etihad Airways, Emirates and Qatar Airways.

In June Al Waha Capital bought a 50% stake in lessor AerVentures from AerCap (see AerCap section on page 7) for a reported equity commitment of US$135m.

Genesis Lease

Genesis Lease's portfolio has remained virtually static year-on-year at 55 aircraft, comprising 24 A320 family aircraft, 23 737s, one A330, two 747s, three 767s and two ERJs. The fleet has an average age of just over seven years and is placed with 34 airlines, the majority of which are in Europe (13 clients, including Air Berlin, Vueling and Norwegian Air Shuttle) and the Asia/Pacific region (11 customers, including Air China, China Southern and JAL).

The lessor is listed on the NYSE (with an 11% stake held by General Electric Company) and based in Shannon, Ireland, although all its aircraft are managed on its behalf by GECAS. In the first six months of 2009 revenue remained flat at $108m, with net profits falling 24% to $14.3m.

Global Aviation Asset Management

Australian lessor Global Aviation Asset Management (GAAM) operates out of Sydney, London and Dublin with a fleet of 50 aircraft - 23 A320 family aircraft, three A340s, six 717s and 18 737s. They are placed with 25 airlines including BA, Air France, Air China and Virgin Blue.

Guggenheim Aviation Partners

US lessor GAP opened an office in Singapore late last year and has a fleet of approximately 42 aircraft. GAP is owned by Guggenheim Partners, a diversified financial services company that has 15 offices around the world. GAP has 16 aircraft on order, including four 747s, six 777s and six A330s.

Alafco

Kuwait lessor Alafco is majority-owned by the Kuwait Finance House and for the first half of the 2008/09 financial year (the six months ending March 31st 2009) reported a net profit of US$22m. Its fleet consist of 29 owned and managed aircraft, including nine 737-800s, two 737-900ERS, six A320 family aircraft and four 777s.

Alafco currently has 13 customers, most of which are in the Middle East and Asia/Pacific regions. Its largest single customer is Turkish Airlines, where five 737-800s have been placed. The lessor also manages 10 aircraft for Millennium Aircraft Leasing, an aviation fund launched by the Kuwait Finance House. Alafco has 59 outstanding orders (19 A320s, 12 A350-800s, six 737s and 22 787s).

Other lessors

Tokyo-based **MCAP** - owned by the Mitsubishi Corp - has a portfolio of 60 aircraft worth an estimated $2bn, and manages another 60 aircraft. It ordered two 737-800s this June.

Sydney-based **Allco Finance** has a portfolio of 66 aircraft leased primarily with Asia/Pacific airlines, including Qantas and SIA, but went into administration at the end of 2008. It is still a going concern, and is provisionally being sold to HN Group and Bravia Capital, although this is subject to agreement by Allco's creditors.

Texan lessor **Jetran International** has an estimated fleet of 60 aircraft, all of which are 737s, DC-9s and MD80s, while **Sumisho Aircraft Asset Management** is a subsidiary of Japan's Sumitomo Corporation and operates out of Amsterdam with a fleet of 60 owned and managed aircraft, ranging from A320 family aircraft and 737NGs to A330s, A340s, and 767s. In June this year Shogo Ishimaru was appointed as the lessor's president and managing director with a mandate to grow the company's business and asset base.

Three San Francisco-based lessors are **World Star Aviation,** which manages 54 cargo and late-model narrowbody aircraft for 30 airlines in 20 countries; **Compass Capital,** an asset finance and management company with a portfolio of 45 owned or managed aircraft; and **Vx Capital Partners,** which has 20 aircraft, including 737s, 747s, DC-10s, and A320s.

Shannon-based **Magellan Air** manages a fleet of 40 aircraft, leased to airlines in Europe, South America and the Asia/Pacific region, and Chicago's **RPK Capital Management** has approximately 35 aircraft in its portfolio. Another Chicago-based lessor is **BCI Aircraft Leasing,** which has a 33-strong portfolio, the majority of which are 737 classics. The fleet is leased to 11 airlines around the world, with the single largest customer being US Airways, which operates 13 of BCI's 737s.

Illinois-based **AAR** is an aviation support group with seven owned and 26 part-owned aircraft, more than half of which are 737-400s. However, it now wants to "de-emphasize" its aircraft leasing business, and is looking to sell its aircraft as the opportunity arises.

Dublin-based **VGS** was formed in 2007 by combining the former aviation assets of Volito Aviation and Goldman Sachs Special Situations Group, and has a portfolio of 32 aircraft. Florida-based **GA Telesis** also has offices in Singapore and London and is an aerospace support and maintenance company with a portfolio of approximately 30 aircraft, including Boeing, Airbus, MD, Bombardier and Embraer types.

SkyWorks Leasing is based in Connecticut and manages 30 aircraft for clients, while **Aircraft Leasing and Management** is based at London's Gatwick airport and manages 27 aircraft for clients, including six A320 family aircraft, three 737s, two 747-400Fs and three 767s. **Aircorp** is based in Dallas and has a fleet of 27 727s and 737s, while Munich-based **Goal** - owned by Lufthansa (40%) and KG Allgemeine Leasing (60%) - has 26 jet aircraft, including seven 737s and four A310s.

Fort Lauderdale-based **Jetscape** was launched in 2000 and today owns or manages 26 aircraft, including eight 737s and six E190s, which are currently placed with 18 airlines in 13 countries. Amsterdam-based **Sojitz Aircraft Leasing** has 23 Boeing aircraft, while in June AerCap sold a 50% stake in Irish-based subsidiary **AerVenture** to Abu-Dhabi-based Al Waha Capital. AerVentures was launched in 2006 and specialises in A320 family aircraft, with a fleet of 23 aircraft and outstanding orders for another 36.

GMT Global Republic Aviation (GMT Global) is based in Dublin and also has offices in Denver and Virginia in the US. It has 22 aircraft (most of which are widebodies) that are leased to seven airlines, and in April it bought four A320-200s from ORIX Aviation.

Amsterdam lessor **Aircraft Financing & Trading** has an estimated fleet of 20 jets, and **Bavaria International Aircraft Leasing,** owned by German corporate group Schorghuber, is based in Munich and has a fleet of 20 narrowbody aircraft.

Novus Aviation is a Swiss-based lessor with an estimated 18-strong portfolio, having sold a couple of 767-200s at the end of 2008, while Orlando-based **Automatic** has 18 aircraft after selling a couple of 737-200s earlier this year.

The UK-based **Skytech-AIC** owns or manages a fleet of 18 aircraft, and New York-based **Deutsche Bank Equipment Leasing** has approximately 16 older model 737 and A320 aircraft in its portfolio, compared with 30 aircraft a year ago.

Global Aviation Leasing is a Gibraltarian lessor that has a fleet of 15 DC-9/10s and MD-80s, leased out to airlines in Europe, Africa and the Middle East.

US lessor **First Greenwich Kahala** has an estimated 15 aircraft while Texan lessor **Q Aviation** also has a fleet of 15 aircraft (down from 23 a year ago). Though based in Seattle, **Itochu Airlease** is owned by Japan's Itochu Corporation and has 14 aircraft, and among a wave of new Chinese lessors is **ICBC Leasing** (with 14 aircraft), which is known to be actively increasing its portfolio.

Frankfurt-based **Doric Asset Finance** also has offices in London and New York, and has a portfolio of 14 aircraft, most of which are widebodies, while **Tombo Aviation** is based in California and is owned by Japan's Matsui & Co. It has a portfolio of 14 narrowbody and widebody aircraft, 11 of which are 737s.

Airbus Asset Management has an estimated 10 aircraft in its portfolio, as has Mauritius-based **Veling,** Singapore's **Phoenix Aircraft Leasing** and Frankfurt-based **Deutsche Structured Finance,** which is owned by Aareal Bank. China's **CDB Financial Leasing** has an estimated portfolio of nine 737s, all placed with Chinese airlines.

Earlier this year Dubai-based **LCAL (Low-Cost Aircraft Leasing)** cancelled 16 of 21 787-8s and 787-9s it had previously ordered, thanks to the global recession. But so far this has been the only cancellation of orders by other existing or new lessors - US freighter leasing specialist **Intrepid Aviation** has outstanding orders for 20 A330-200 freighters, with delivery from 2010 onwards, while Shannon-based **AerDragon Aviation Partners** (a joint venture company owned 50% by the China Aviation Supplies Import & Export Group Corporation, 25% by AerCap and 25% by Calyon AirFinance) has received three aircraft from an order for 13 A320s.

Deucalion Capital, part of Germany's DVB Bank group, has ordered eight 777Fs, of which two have been delivered to date, while two US private equity companies – **MatlinPatterson** and **Oak Hill Capital Partners** – have respectively six A330-200Fs and six 777s on order.

At the Paris air show it was announced that a new lessor called **Greenstone Aviation** was being set up by John Slattery, who previously worked at RBS Aviation Capital until 2007. Based in Dublin, Greenstone aims to raise $0.5bn in equity funding, to be spent on securing 737s and A320s at the bottom of the cycle. Slattery says he wants to open offices in New York, Beijing, Singapore and Dubai, with 30 employees.

Not included in the table is **Aircraft Purchase Fleet Limited (APFL),** a new Ireland-based lessor started at the end of 2008 by Italy's Toto Group, which formerly owned Air One. APFL has taken on the aircraft previously on order for Air One, which includes 48 A320s, 12 A330-200s and 12 A350-800s.

Korean Air: short-term problems; long-term promise?

Following a massive loss in 2008, Korean Air recently announced a 10-year strategic plan designed to double revenue and grow its fleet by more than 50% over the same period. But can Korean Air deliver such ambitious growth, particularly given the problems it faces in the short-term?

Korean Air's 10-year plan came about following a period in which the airline's revenue increased from Korean Won (KRW) 7.2 trillion (US$5.5bn) in 2004 to KRW 10.2 trillion (US$7.8bn) in 2008, yet its profitability declined steadily from a 7.2% net margin in 2004 to -19% in 2008 (and with passengers carried by Korean Air in 2008 falling 4% to 21.9m).

There are many factors behind this fall in profitability, but key among them are fuel prices and foreign exchange rates. Korean Air's fuel bill has increased from KRW 1.58 trillion (US$1.2bn) - accounting for 28.6% of total operating costs - in 2004 to KRW 4.19 trillion (US$3.2bn) - or 47.6% of costs - in 2008. With only 15% of fuel consumption hedged in 2008, the airline inevitably suffered heavily from the fuel price rise, reporting a massive loss of KRW 1.96 trillion (US$1.5bn) in 2008.

However, foreign exchange rates - and specifically the KRW/US dollar rate - play a more fundamental role in the company's profitability than even fuel prices do. The majority of the carrier's revenue is generated inside South Korea and thus is paid in KRW, but Korean Air's fuel bill, aircraft rental, insurance and some financing expenses are all paid in US dollars. The first three expenses account for nearly 52% cent of total operating costs, and so when the fuel price soars and the KRW depreciates - which happened in 2008 - Korean Air is hit twice over.

On the other hand, Korean Air benefits when fuel prices fall and the KRW stays relatively stable and strong – which happened in the fourth quarter of 2008, when the carrier made an operating profit of KRW 22.6bn (US$17.2m). Since then the carrier has experienced both fuel price and KRW exchange rate falls, and in the first half of 2009 Korean Air's fuel expenses fell by 40.1% - though the airline still recorded an operating loss of KRW 127.3bn (US$96.7m).

Korean Air is also affected by the impact of the KRW/US dollar rate when translating its foreign currency transactions and reserves onto its financial results. While the airline reported a 163% increase in non-operating gains in 2008, the effect of foreign currency translations lost the airline a staggering KRW 2.4 trillion (US$1.8bn). Conversely, the carrier's net profit of KRW 78.5m (US$0.1m) in the second quarter of 2009 was derived from foreign currency benefits totalling KRW 477.8bn (US$363.1m) that offset an operating loss of KRW 127.3bn (US$96.7m) as well as other non-operating losses.

Profitability question

This fluctuation of exchange rates and non-operating results makes it very difficult to judge Korean Air's financial health merely by profitability, and a more accurate assessment can be drawn from the airline's debt-to-equity ratio. Over the past five years this has risen from 261% at the end of 2004 to 534% in June 2009. Before 2008 the ratio stayed stable at around 240% - which allowed the airline to raise considerable debt in times of distress - but increasing fuel bills and investment activities in 2008 resulted in a cash outflow of KRW 688.7bn (US$523m) that year, and this had to be financed by increased debt, thus pushing up the debt-to-equity ratio.

Ordinarily this wouldn't be too much of a problem since South Korea is renowned for close ties between corporations, government and banks. Despite the global credit crunch, the carrier secured US$196m in short-term loans and US$53.8m in long-term

KOREAN AIR FLEET	Fleet	Orders	Options
A300-600R	8		
A330-200	3	6	
A330-300	16		1
A380-800		10	
737-800	15		2
737-900/900ER	16	4	2
747-200/400	38		
747-8F		7	2
777-200	18	6	
777-300/300ER	5	10	3
787-8		10	10
Total	119	53	20

loans from Korean banks in 2008, and in the same year the airline also issued US$858.9m in bonds at annual interest rates of at least 5%, the majority of which will mature in 2011. However, the Korean financial markets were hit hard by the global financial crisis in the second half of 2008, and Korean Air has recently had to turn to foreign financial institutions for further liquidity, such as mandating Naxitis for a 777-200ER refinancing and using Export-Import Bank financing for a 777-300ER delivery in mid-2009.

The deterioration of the carrier's financial position raises questions about its ambitious new 10-year plan, which aims to double its annual revenue to KRW 25 trillion (US$19bn) and grow the fleet by 50% to more than 180 aircraft.

The fleet currently stands at 119 aircraft (see table, above), of which 44 are long-haul passenger aircraft and 17 are dedicated cargo aircraft. This reflects the geography of the country, because by being based in the southern half of the Korean peninsula and bordering the sea of Japan, the Yellow Sea and North Korea, South Korea is in effect isolated from continental Asia – which means that medium-and long-haul air transport is vital for the country.

An added natural advantage for Korea's airlines is the country's position to the east of the continent, which means that it is closer to the US west coast than almost all major rivals. This has encouraged Korean Air to develop a hub-and-spoke network connecting the East Asia market via Incheon airport to routes onto North America, and despite ongoing global recession the number of international passengers transferring at Korean airports increased from 6.9m in 2007 to 7.1m in 2008, demonstrating the resilience of the Korean transfer market. In 2008 the country recorded 36.5m international air passengers (including origin & destination and transfer passengers), 38% of whom were transported by Korean Air. This compares with 16.8m domestic passengers in South Korea (in 2007, the last year for which figures are available).

Korean Air has also been helped by the sustained industrialisation and modernisation carried out by South Korean governments over the past four decades, which have focused on export-oriented and high-tech and high value-adding industries such as electronics, telecommunications, automobile production and shipbuilding. However, South Korea's export reliance also has a downside for Korean Air, leaving it relatively exposed to global economic volatilities - as evidenced by the carrier's fall in international passenger revenue of 17.7% and in cargo revenue of 28.7% in the first half of 2009.

Korean Air's dependence on international markets is at least helped by an increasing number of liberalised air service agreements signed between South Korea and other countries. By the summer of 2009 the government had signed passenger ASAs with 19 countries and cargo ASAs with 31 countries. The passenger agreements are mainly with countries in the Asia/Pacific region and the Americas, while the cargo agreements include these regions plus selected EU member countries.

Given this background, Korean Air is focusing on building up its medium- and long-haul fleet and has outstanding orders for six A330-200s, 10 A380-800s, 10 777-300ERs and 10 787-8s. The A380-800s will be deployed on hub-to-hub routes such as Seoul to New York, while the 787-8s are for long, thin routes and the 777-300ERs will fill in routes between these categories. Given Incheon's hub position, the large medium- and long-haul fleet and the myriad of open skies agreements, it's not surprising that Korean Air serves more destinations in America and Asia than any other airline, resulting in 30.2% cent and 12.9% respectively of its passenger revenue coming from the North America and Southeast Asia routes.

On routes to Europe and the Middle East, however, given its eastern Asian location Korean Air is at a disadvantage to its continental Asian rivals, and so the airline concentrates on direct routes to secondary cities - such as Munich and Milan - which attract some transfer traffic throughout Asia.

Korean Air appears to be retreating from the domestic market, whose revenue contribution has decreased steadily from 17% of total passenger revenue in 2004 to 10.5% in 2008. That's due partly to the emergence of Korean LCCs (such as Air Busan), which had a 28% domestic market share by mid-2009, up from 2.2% in 2006, and partly to a contraction in the domestic market, which has fallen from 22.5m passengers in 2000 to 16.8m passengers in 2007.

To defend its domestic position Korean Air established LCC Jin Air in July 2008, offering premium service at low fares via four leased 737-800s and a Cessna 208 Caravan. Together with route restructuring efforts, this move helped Korean Air record a 2.7% increase in domestic passenger revenue in 2008 even though passengers carried fell 6.1%.

Much more of a priority for Korean Air than the domestic market is its cargo business, where it traditionally has high volumes and load factors - 9bn ton kilometres and 74% respectively in 2008. The airline has seven 747-8Fs and six 777-200LRFs on order, and is also committed to converting 10 of its 747-400s to freighters. While the single most important market is North America (accounting for 40.7% of cargo revenue), Korean Air has been trying to strengthen business in China and Southeast Asia, and in late 2007 it launched Tianjin-based Grandstar Cargo International Airlines in co-operation with China's Sinotrans Air Transportation Development Co and Korean investors.

Perhaps even more important is Korean Air's plan to take advantage of South Korea's open skies agreement with Uzbekistan by developing the country's Navoia airport as a central Asian cargo hub by 2018, where it will connect cargo flights from Korea, China and Southeast Asia through to the Middle East and Europe. If successful, this would reduce Korean Air's reliance on the North American cargo routes, and thus this will be a key focus for the airline over the next decade.

The future

Despite a net income of KRW 78.5bn (US$59.7m) for the first-half of the 2009 financial year, there's little doubt that Korean Air is fighting for survival through the current recession. Its cash and cash equivalents of KRW 494.5 billion (US$375.8m) as at the end of 2008 will hardly sustain it through the next two years, particularly as there is KRW 1.94 trillion (US$1.5bn) of short-term borrowings and bonds to pay off in the same period. However, Korean Air will struggle to secure refinancing at anything other than high interest rates, which will pile up further problems for the future.

However, if the carrier can somehow refinance at reasonable terms then its long-term expansion plans do make strategic sense. Though its cargo business faces strong competition created by the merger of All Nippon Cargo and Japan Airlines' cargo divisions as well as the tie-up of Air China and Cathay Pacific in cargo, it is being pro-active via expansion in China and the new hub in Uzbekistan. The impending "Free Trade Agreement" between South Korea and US - which is awaiting US congressional approval - may also be crucial to its cargo fortunes, and the US government estimates the deal will add around $10bn in annual exports to South Korea.

But perhaps it is the long-haul passenger business that will be the key to the airline's long-term success, and Korean Air will need to place new capacity carefully as markets are opened up by ASAs signed by the government. The airline's revenue generated from first and business class services only accounted for 19.5% of total passenger revenue in 2008 (a percentage far below its Western peers) and so if Korean Air can add capacity and increases its premium traffic a few percentage points as well, then its future may well be bright – always assuming it can get through the difficult next 18 months or so.

By Yong Qiu
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Gol: "Back to basics" strategy helps Brazilian LCC back to profits

Gol Linhas Aereas Inteligentes, Latin America's leading LCC, is staging a promising turnaround, amid signs that the April 2007 Varig acquisition is at last paying dividends. But much work remains to be done in terms of rebuilding profit margins and repairing the balance sheet. Gol wants to "get back to basics" of being an LCC, while capitalising on the competitive strengths gained through the merger.

Although Gol incurred heavy losses only for a couple of quarters last year (and much of it was due to exchange rate developments), the Varig acquisition, which caused greater problems than the management ever anticipated, took a heavy toll on the company. It damaged the proven, simple, low-cost business model, which had facilitated rapid growth and superior profit margins. It forced Gol temporarily into a contraction mode. And it brought Gol close to a liquidity crunch, with unrestricted cash reserves amounting to only 6% of annual revenues at the end of March 2009.

Until very recently, many in the financial community feared that Gol would not be able to recover from the stresses of the Varig integration. So it is very heartening that Gol has seen a reversal of its fortunes in recent months. Thanks to a combination of smart management actions, hard work and some luck, and perhaps the right strategies, Gol now looks like a long-term survivor.

Most importantly, Gol averted a liquidity crisis with timely fund-raising. The company has raised a total of R$856m ($465m) through equity, debt and other transactions since March. In late August Gol announced plans to raise another R$550-650m ($300-353m) through a global share offering. Who would have thought six months ago that a large public equity offering would be possible?

Gol's second-quarter earnings call in mid-August provided much tangible evidence that the carrier is on the mend and that its earnings outlook is quite promising.

First of all, Gol has put the Varig problems behind it. Operating synergies from the GOL/VRG integration were apparently fully realised in the second quarter. Of course, some thorny issues remain – notably, being stuck with Varig's remaining six 767-300s, which are grounded and are costing the company a fortune in lease payments.

Second, Gol is making good progress with restoring its pre-Varig cost structure. The management stressed that the aim is to "again achieve the lowest costs per ASK in the world".

Third, Gol is seeing promising benefits from the Varig assets. The acquisition has enhanced Gol's competitive position domestically and within South America. It has also given the carrier new tools to tap the high-yield segment – notably Smiles, Latin America's largest FFP.

Fourth, like other Brazilian carriers, Gol is benefiting from its home country's resilient economy. Brazil entered the global recession late, escaped the worst of its effects and now looks likely to be among the first to recover.

Fifth - although this may only be a short-term benefit - currency movements are again going in Brazilian carriers' favour and are expected to boost profits in the short-term.

Gol's amazing R$354m net profit in the second quarter (25% of revenues) was the result of a massive non-cash gain related to the Real's appreciation, but it was great news for shareholders who by law are entitled to dividend payouts of at least 25%. On an operating basis, Gol had an R$89.9m profit (6.5% of revenues) in the second quarter, which is seasonally its weakest, up from a R$295m loss in the year-earlier period.

However, the 6.5% margin in the second quarter was much lower than those achieved by many North American LCCs (though similar to Southwest's and WestJet's 7%), indicating that Gol has some way to go in its recovery efforts.

Also, Gol's liquidity position is still very weak compared to the industry norm. The massive fund-raising effort in the spring boosted cash reserves to only 9.8% of annual revenues on June 30th, when most airlines these days have 15-20% or more.

Post-2006 struggles

The Sao Paulo-based airline, which began flying in January 2001, is Latin America's first (and so far the only) true LCC. As a pioneer of low fares in

Brazil, Gol has had tremendous positive social impact. Because of its ability to stimulate traffic and the dismal financial state of the other (high-cost) airlines in Brazil at that time, Gol captured a 22% domestic market share in just three years. Now, with most of the other airlines gone, Gol and TAM have a domestic duopoly with virtually identical (43%) domestic market shares in July.

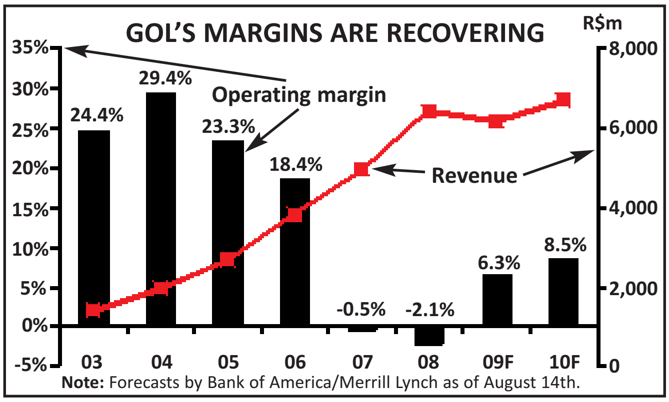
Up to and including 2006, Gol was one of the world's most profitable and rapidly growing airlines. It achieved annual operating margins in the 19-29% range and net margins in the 13-20% range in 2003-2006 – a period during which its ASMs almost tripled.

Gol's preferred shares have been listed on the NYSE and Sao Paulo's Bovespa stock exchange since 2004. However, the free float is only 25% of all shares. The company's founders, the Oliveira family, hold a controlling 75% stake.

But the good times ended in late 2006, when the Brazilian airline industry faced a structural crisis that lasted through the first quarter of 2008. Continued double-digit traffic growth, problems with air traffic control, lack of government investment in aviation infrastructure over several decades and airline strategies that sought to maximise market share all contributed to the crisis. ATC slowdowns and worsening airport bottlenecks led to a sharp increase in flight delays and cancellations, making travel a hassle and increasing costs for airlines.

The situation was aggravated by two fatal crashes: the September 2006 collision of a Gol 737 with a Legacy executive jet over the Amazon, which killed 154 people, and the July 2007 crash of a TAM A320 while trying to land in heavy rain at Congonhas airport in Sao Paulo, which killed 199. After the crashes the government imposed ATC and airport restrictions, which had a severe financial impact on the airlines over an 18-month period.

In the middle of that turbulence, Gol acquired bankrupt Varig, Brazil's flag carrier and one of the oldest brands in Latin America. Varig was in a sorry state after years of mismanagement and had already shrunk significantly in efforts to stay afloat. The R$562m acquisition turned out to be very problematic, partly because of the delay in getting government approval to combine the companies. The approval was finally obtained in September 2008, meaning no synergies for 18 months. Varig was also unable to execute its growth plans because of the Sao Paulo airport restrictions.



Note: Forecasts by Bank of America/Merrill Lynch as of August 14th.

With losses mounting, Gol was not able to stick to its original plan of gaining a presence in long-haul international markets through Varig. In the spring and summer of 2008, Gol shut down Varig's remaining long-haul operation (Frankfurt, London, Rome, Madrid, Mexico City and Paris) in favour of focusing on serving markets within South America.

To add insult to injury, this gave Gol's main competitor TAM a unique opportunity to expand to Europe and the US. TAM took full advantage of it, quickly becoming Brazil's only flag carrier on intercontinental routes (see *Aviation Strategy*, December 2008).

The shutdown of Varig's long-haul operations left Gol with seven grounded 767-300s, each of which was costing it $0.5m per month in lease payments. Gol was able to swap one 767-300 for a 737-800, but is still stuck with the remaining six aircraft.

2008 was a tough year for Gol also because of the extraordinary surge in oil prices and the sharp depreciation of the Real (after many years of appreciation). The Brazilian currency lost nearly one third of its value against the US dollar over some six months after the start of the global financial crisis in late-summer 2008, resulting in steep foreign exchange losses on Gol's dollar-denominated debt.

On the positive side, the aviation sector's structural crisis and the new macroeconomic challenges led to changes in attitudes that have benefited both Gol and TAM. The government is now fully committed to improving aviation infrastructure. The airlines are now more cautious about adding capacity and focus more on profitability than market share. One analyst noted at the time that Gol and TAM had "finally learned how to price as a duopoly".

Last year's October 19th was an important date on the Varig front: Gol was then finally able to integrate the two carriers' networks. That quarter marked the beginning of Gol's financial turnaround. Having completed the integration in January, Gol realised some synergies in this year's first quarter. More substantial savings, especially in sales, advertising and maintenance, were realised in the second quarter. Earlier this year Gol estimated that annual revenue and cost synergies from the integration would eventually add up to R$180m ($98m).

The GOL/VRG strategy

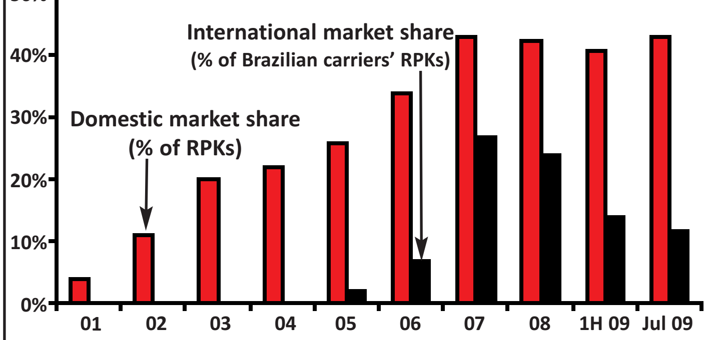
Gol wants to "remain true to its identity as a low-cost, low price airline with high quality standards" (as expressed in the latest annual report). Therefore, while integrating the two companies and introducing a unified 737-700/800 fleet, Gol has maintained two airline brands. Varig continues to offer a business class (recently revamped "Comfort Class"), while Gol remains single-class.

Gol is also sticking to its original mission, which is to "democratize air travel in Brazil and throughout South America". The airline has made it clear that it is not considering a return to long-haul markets in the foreseeable future.

Varig's new role is to operate medium-haul international service to major destinations in South America (currently four: Bogotá, Caracas, Santiago and Buenos Aires), while Gol focuses on domestic service and short-haul international (currently 49 and nine destinations, respectively).

The two most valuable things that Varig has brought to Gol are the Smiles FFP and additional slots at key airports such as Sao Paulo's Congonhas. These assets are all the more valuable because they help strengthen Gol's position in the high-yield market.

GOL'S MARKET SHARES



Note: Gol/Varig consolidated from 2007 onwards. **Source:** Gol and ANAC.

The extra slots at Congonhas, Brazil's most important business hub, have given the Gol/Varig combination an unbeatable 48% market share at that airport. After eliminating overlapping routes and services and optimising slots, Gol has been able to offer shuttle flights departing every 30 minutes on the Rio-Sao Paulo route. The airline has introduced a special on-board dining service on the route called "Bistroda Ponte" (Shuttle Bistro).

As well as being able to offer a more consistent, high-frequency service in the key domestic markets, the Varig integration has enabled Gol to open new routes, such as Sao Paulo-Londrina and Sao Paulo-Caxias do Sur.

The Smiles FFP, which has over 6.2m members and which Gol has extended to the unified company, is an important competitive advantage. It will help Gol capture additional business traffic and retain existing customers. Some 65% of Gol's traffic is business-oriented (because Brazil's leisure air travel segment is still relatively undeveloped).

Gol remains committed to providing for low-income leisure passengers – the emerging middle class in Brazil that is the fastest-growing passenger segment. Key programmes include VoeFacil ("Fly Easy"), which lets Gol customers finance their tickets in up to 36 monthly payments at a relatively low interest rate.

Gol's management noted in the second-quarter call that the company is now able to explore all segments of the domestic market. Its offerings have expanded to five brands: Gol, Varig, Smiles, VoeFacil and Gollog (cargo subsidiary).

To obtain feed to its services and to generate more value for Smiles members, Gol is seeking to forge codeshare partnerships with "the most important airlines in the long-haul segment". Recent months have seen new deals with Air France-KLM and American Airlines.

Of course, Gol is not the only airline in Brazil aggressively implementing these types of new strategies. However, one early encouraging sign (other than the improving financials) is that Gol's domestic market share stopped declining in the spring and has increased steadily in recent months. So Gol is probably on the right path with its post-Varig strategy. That said, bearing in mind the financial damage caused by the acquisition, many in the financial community still feel that Gol might have been better off without the Varig adventure.

Back to basics

The recent "back to basics of being an LCC" message was exactly what many people wanted to hear. It means that the focus now is on restoring productivity, efficiency and the former advantageous unit cost structure.

Gol's cost structure was damaged by the capacity cuts at Varig, a sharp reduction in aircraft utilisation resulting from the shedding of unprofitable routes and long-haul service, and costs associated with aircraft returns. But the second quarter saw positive trends. Total operating costs were down by 26%, due to operating synergies from the merger and the decline in fuel prices. CASK was down by 18%, despite a 10% capacity reduction.

Aircraft utilisation is seen as the key to reducing unit costs. The target is believed to be 14 hours daily. To aid the process, in the second quarter Gol deferred the deliveries of 20 737NGs from 2010-2011 to 2014-2015 (reportedly without penalties). Gol's cost structure will benefit from the phasing out of its remaining 737-300s by the end of this year. The fleet will then be all-737NGs, totalling 108 (40 -700s, 16 -800s and 52 -800SFPs). The management is also working hard on getting rid of the six remaining 767-300s.

Gol's updated cost guidance in mid-August envisaged ex-fuel CASK of R$9.3 cents in 2009, which would be a modest decline from last year's R$9.4 cents. But further reductions are expected in 2010. Of course, currency developments are the wildcard. The 2009 CASK forecast is based on an average exchange rate of R$2.09 to the dollar. But if the exchange rate stays at the current (early September) level of around 1.84 in 2010, Gol's unit costs could fall to the 8-something range next year. Some 96% of Gol's debt and about 60% of its costs are in US dollars, while nearly all of its revenues are in Reals.

Rebuilding liquidity

Gol made promising progress on the cash-raising front in the spring and early summer. First, the controlling shareholders provided R$203.5m through a rights offering to avoid a liquidity crunch. After that Gol issued R$400m of two-year debentures. And in June there was the co-branded credit card deal, which provided R$104m of cash immediately and R$151m to be paid over five years.

But the R$613.7m ($334m) unrestricted cash position at the end of June, at 9.8% of annual revenues, was far from adequate, so building up cash is an urgent priority. Gol is now hoping to raise up to R$650m ($353m) through a global share offering, which would involve the issuance of new common and preferred shares. The Oliveiras plan to sell preferred shares in the offering and use the proceeds to buy Gol's common stock in the primary offering.

Demand and profit outlook

It has been a difficult winter in Latin America generally, because countries such as Argentina and Chile had severe outbreaks of the H1N1 flu and many countries in the hemisphere have been hit hard by recession. Gol had to rearrange its international network quite a bit, suspending or reducing services, particularly to Argentina and Chile after sharp declines in travel in those markets, and transferring the capacity to the Caribbean or the sun destinations in Brazil's Northeast.

However, the Brazilian domestic market, where Gol generates 90% of its revenues, has been a rare bright spot. There was a strong demand surge in July, when industry RPKs increased by 25.7% (following modest growth in June and a decline in May), and early reports indicate that August was also strong. Yields held up in both months.

All of this, in combination with the tentative signs in recent weeks that Brazil is emerging from recession, bodes well for the country's carriers. It may even mean that Gol's current earnings forecasts are underestimates. As of mid-August, analysts were expecting Gol to achieve operating margins in the region of 6-8% in 2009 and 9-10% in 2010, following marginal operating losses of 1-2% of revenues in the past two years.

The key question is: Will domestic capacity restraint prevail? Some analysts are concerned about potential significant capacity addition, which could have detrimental impact on yields. Gol, for one, is under pressure to refill its network and get its unit costs down. Then there are the new entrants – Azul, Webjet, OceanAir, TRIP and others – that are growing rapidly and pricing aggressively; those carriers are far too small to be a real threat to Gol or TAM, but they could inflict serious damage to the pricing environment.

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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/	Oct-Dec 07	8,678	8,202	476	207	5.5%	2.4%	62,615	49,591	79.2%	17,868	104,482
KLM Group	Jan-Mar 08	8,543	8,612	-69	-810	-0.8%	-9.5%	62,948	49,060	77.9%	17,154	
YE 31/03	**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**
	Apr-Jun 09	7,042	7,717	-676	-580	-9.6%	-8.2%	63,578	50,467	79.4%	18,703	106,800
BA	Jul-Sep 07	4,729	4,118	611	458	12.9%	9.7%	38,191	30,500	79.9%	9,206	42,024
YE 31/03	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**
	Apr-Jun 09	3,070	3,216	-146	-164	-4.7%	-5.3%	36,645	28,446	77.6%	8,446	
Iberia	Oct-Dec 07	1,963	1,681	279	140	14.2%	7.1%	16,773	13,471	80.3%	6,463	22,168
YE 31/12	**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
	Apr-Jun 09	1,455	1,632	-177	-99	-12.1%	-6.8%	15,668	12,733	81.3%		20,760
Lufthansa	Jul-Sep 07	8,960	8,004	956	843	10.7%	9.4%	48,662	39,112	80.4%	18,836	
YE 31/12	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
	Apr-Jun 09	7,098	7,027	71	54	1.0%	0.8%	49,939	38,076	76.2%	18,142	105,499
SAS	Jul-Sep 07	2,612	2,518	94	109	3.6%	4.2%	10,452	8,228	78.7%	7,523	27,447
YE 31/12	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
	Apr-Jun 09	1,546	1,665	-119	-132	-7.7%	-8.6%	9,584	7,055	73.6%	6,850	18,676
Ryanair	Jul-Sep 07	1,229	795	434	384	35.3%	31.2%			86.0%	13,952	
YE 31/03	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**	
	Apr-Jun 09	1,055	844	211	168	20.0%	15.9%			83.0%	16,600	
easyJet	**Year 2005/06**	**2,917**	**2,705**	**212**	**170**	**7.3%**	**5.8%**	**37,088**	**31,621**	**84.8%**	**33,000**	**4,859**
YE 30/09	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	
	Apr-Jun 09	1,116						15,600	13,400	84.7%	11,900	

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	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
	Apr-Jun 09	844	777	67	29	7.9%	3.4%	9,418	7,428	78.9%	3,983	8,937
American	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
	Apr-Jun 09	4,889	5,115	-226	-390	-4.6%	-8.0%	62,064	50,796	81.8%	22,092	79,200
Continental	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
	Apr-Jun 09	3,126	3,280	-154	-213	-4.9%	-6.8%	45,072	37,281	82.7%	16,348	43,000
Delta	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
	Apr-Jun 09	7,000	6,999	1	-257	0.0%	-3.7%	94,995	78,941	83.1%	42,050	82,968
Northwest	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
	Apr-Jun 09	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Southwest	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	5,499
	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
	Apr-Jun 09	2,616	2,493	123	54	4.7%	2.1%	41,122	31,676	77.0%	26,505	35,296
United	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
	Apr-Jun 09	4,018	3,911	107	28	2.7%	0.7%	57,901	47,476	82.0%	21,064	43,800
US Airways Grp.	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
	Apr-Jun 09	2,658	2,536	122	58	4.6%	2.2%	35,382	29,507	83.4%	20,491	32,393
JetBlue	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
	Apr-Jun 09	807	731	76	20	9.4%	2.5%	13,256	10,533	79.5%	5,691	10,235

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	Jan-Jun 06	3,473	3,201	272	225	7.8%	6.5%	43,814	34,657	79.1%	8,144	
YE 31/12	**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**
	Jan-Jun 09	3,988	3,725	263	119	6.6%	3.0%	55,750	43,758	78.5%	11,938	18,800
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	**Year 2005/06**	**10,186**	**8,711**	**1,475**	**542**	**14.5%**	**5.3%**	**118,070**	**90,899**	**77.0%**	**34,080**	**34,832**
YE 30/6	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
	Year 2008/09	**10,855**	**10,733**	**152**	**92**	**1.4%**	**0.8%**	**124,595**	**99,176**	**79.6%**	**38,348**	**33,966**
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	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	
	Apr-Jun 09	186	94	91	39	49.1%	21.1%	5,520	4,056	73.5%	3,519	

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
Jun 09	28.6	20.4	71.3	21.2	18.2	85.8	14.8	11.4	76.8	51.1	41.5	81.3	78.5	60.8	77.5
Ann. change	-5.5%	-6.3%	-0.6	-7.3%	-7.0%	0.2	-6.9%	-10.7%	-3.2	-6.3%	-7.4%	-1.0	-4.8%	-6.5%	-1.4
Jan-Jun 09	159.6	104.1	65.2	111.1	87.0	78.3	90.3	69.7	77.2	297.2	231.4	77.9	449.2	331.3	73.7
Ann. change	-6.0%	-8.5%	-1.7	-6.6%	-8.3%	-1.4	-4.7%	-8.5%	-3.2	-4.8%	-7.2%	-2.0	-4.3%	-6.9%	-2.1

Source: AEA.

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	27 Jul	Ethiopian Airlines	5 x 777-200LRs	
	23 Jul	Turkish Airlines	7 x 777-300ERs	
	17 Jul	COPA Airlines	13 x 737-800s	
	13 Jul	Egyptair	8 x 737-800s	
Airbus	1 Jul	Wizz AIr	50 x A320s	

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

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