

Japan Airlines: At last, a radical restructuring

A combination of political change, recalcitrant banks and a steep recession is giving Japan Airlines (JAL), Asia's largest carrier, a unique opportunity to get its house in order. Plans currently being drafted with the help of a government-appointed expert panel suggest a drastic restructuring in the coming months that will also fix balance sheet issues. But will the creditor banks co-operate, or will JAL have to restructure in bankruptcy?

In mid-October the Tokyo banking scene was in a flux as analysts and bankers were trying to figure out the implications of a massive Y600bn (\$6.6bn) financial aid package that JAL was planning to seek from its creditor banks. According to the leaked reports, JAL is looking for Y300bn in debt-for-equity swaps and loan waivers, plus Y300bn in new loans from the banks. In addition, the airline reportedly wants a capital boost of Y150bn from private investors and the government.

A rescue package of that size would be costly for the banks, which will be deciding in the coming weeks whether or not to co-operate. If discussions with the banks fail, reorganisation under bankruptcy is a possible scenario for JAL.

This is clearly a very low point for the airline, which has seen its share price collapse in recent weeks, giving it a market value of just Y276bn. In mid-October both Moody's and Standard & Poor's lowered JAL's credit ratings, amid growing alarm about the scale of the rescue effort needed and doubts about the airline's ability to recover.

A time for hope

However, the situation also offers new hope for the established carrier, which was fully privatised in 1987 but never really shook off the flag carrier mentality and other ills associated with government ownership. One way or another, JAL is now going to get an opportunity to restructure thoroughly.

Before the recession, JAL had a decade of persistently weak annual results – either small losses or modest profits. A series of restructuring efforts failed to solve the basic problems: high labour costs, a less efficient fleet than its rivals, uncompetitive route structure, a bureaucratic corporate structure, militant unions and poor morale. In 2007/08 JAL staged a promising recovery, but that was short-lived because of the fuel price hike and subsequent economic downturn.

JAL has been devastated by the global recession because of its heavy exposure to international routes and (*continued on page 2*)

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business traffic. In the June quarter, its international passenger revenues plummeted by 46% and total revenues by 32%. It had a negative 26% operating margin and posted its largest-ever quarterly net loss, Y99bn (\$1.1bn). JAL is now headed for its second consecutive annual net loss – currently forecast to be \$63bn in fiscal 2009/10, following last year's Y63.2bn loss.

In June JAL received a Y100bn (\$1.1bn) "emergency" loan through the state-owned Development Bank of Japan (DBJ) – the third time it had sought government assistance since 2001. But it was clear all along that JAL would need significant further liquidity this year.

The key problem has been that the banks have balked at providing JAL with more funds unless the carrier comes up with a solid and achievable turnaround plan and the government makes a firm commitment to support JAL.

August saw a new development that fundamentally changed the funding climate for JAL and gave the banks new worries: the Democratic Party of Japan (DPJ) swept to power in a landslide election victory, ending five decades of nearly unbroken rule by the Liberal Democratic Party (LDP). Somewhat confusingly, the more left-wing DPJ vowed to place greater scrutiny on the use of state funds, which the LDP had distributed quite freely to companies like JAL.

Conflicting signals

The new administration has stressed that it will not allow JAL to fail and that Japan needs to maintain its two major airlines. However, the financial community has been a little spooked by the conflicting signals sent by the DPJ. The party wants to support ailing firms, while also reigning in wasteful government spending. Its policy stance is to provide for local needs and preserve jobs; yet it is now pushing for a restructuring at JAL that requires cutting unprofitable domestic service and drastically reducing staff numbers. In late September S&P noted the "need to closely monitor the future framework and direction of government support under the new Democratic Party of Japan administration".

In late September, as part of its state aid application, JAL submitted a new turnaround plan that proposed cutting costs by 30% over three years, reducing the workforce by 14% (6,800 jobs) and eliminating 50 unprofitable routes.

But the lenders and the government dismissed JAL's proposals as inadequate. Transport minister Seiji Maehara then appointed a new five-member "task force" to draw up a more radical restructuring plan. The draft of the plan is due by the end of October.

At that point a decision was also taken to shelve the alliance talks that JAL had hoped to conclude with either American or Delta by mid-October. JAL needed to focus all its attention on restructuring, and the possible Y30-50bn (\$330-550m) investment by the winning bidder would not have made much difference. (The main immediate benefit would have been to improve the fund-raising climate for JAL.)

The task force is mostly made up of restructuring experts from the former Industrial Revitalisation Corporation of Japan (IRCJ), a government agency that assisted banks and struggling companies in 2003-2007. The team sent experts to JAL to study its accounts and internal situation.

There have been reports of some truly outlandish options being considered, such as breaking JAL into "good" and "bad" parts for a General Motors-type restructuring, or merging its international operations with ANA's and dedicating it to domestic/short haul operations.

But as details of the draft turnaround plan began to trickle out in mid-October, it was evident that the task force is just going for deeper restructuring measures to try to get the banks to co-operate. The job cuts have been increased to more than 9,000, or nearly 20% of the workforce, and JAL's president Haruka Nishimatsu is to step down and be replaced by someone from outside the company.

But the reports indicate that the route cuts may not be as sharp as what JAL proposed in September. The airline apparently wants to keep five of the 21 international routes it proposed cutting because it now

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believes that they could be made profitable. (Could this be a sign of tentative demand recovery? IATA reported in mid-October that Asian airlines are starting to sell more premium seats.)

It is also believed that the draft plan proposes reducing JAL's pension obligations from the current Y330bn (\$3.6bn) to Y100bn (\$1.1bn) by substantially slashing pension benefits – something that JAL has already been working on since earlier this year. It will not be easy because the plan will be fiercely opposed by JAL's retirees.

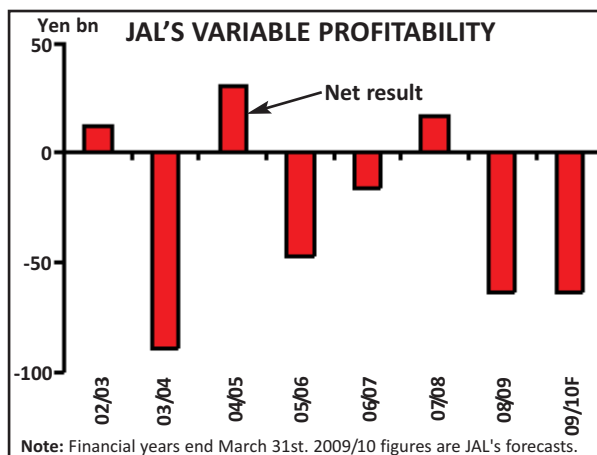
Balance sheet restructuring

But the most promising aspect of the plan is the likely balance sheet restructuring. JAL is nowhere near insolvent, but it has a weak balance sheet, extremely weak cash reserves and heavy upcoming debt maturities. At the end of June, JAL had total assets of Y1,696.7bn, total liabilities of Y1,517.9bn, long-term debt of Y881m and stockholders' equity of Y279m. Its lease-adjusted debt-to-capital ratio is in the low-90s – higher than the leverage ratios of other major Asian and European carriers but lower than the US legacy carriers'. Its June cash position was a pitiful Y109.8bn, or around 6% of annual revenues – the norm for global airlines these days is 15-20%, and in the US less than 10% is considered bankruptcy-level.

JAL's cash reserves have historically been poor, which has meant that the airline has repeatedly had to go begging for funds. The only exception was in March 2008 when, following a strong year, the cash position temporarily improved to 15.9% of annual revenues.

A substantial balance sheet restructuring now will hopefully improve JAL's financial flexibility significantly. The airline should have the reserves to ride out tough periods that inevitably occur in the aviation business, be able to borrow through normal commercial channels and be able to tap the capital markets for funds.

It is possible that the impact of the restructuring on the banks could be softened, for example, by raising funds through



asset sales. Even after a significant shedding of assets in recent years, JAL still has numerous wholly or partly owned subsidiaries that could be monetised.

But the government has also acknowledged that public funds may be necessary to accomplish the restructuring. One possibility would be to inject funds through the DBJ under an emergency aid programme set by the LDP administration for non-financial companies hit by the global recession.

Another possibility would be to apply for assistance by the Enterprise Turnaround Initiative Corporation of Japan (ETIC), a new government-backed institution that opened for business on October 16th with the ability to procure up to Y1,600bn (\$18bn) in funding in the current fiscal year. The ETIC is similar to the former IRCJ (where the JAL task force members came from). It will operate like an investment fund, investing in and buying debt of companies with weak balance sheets and assisting them in restructuring. ETIC could also help companies that have filed for court protection from creditors.

As a last resort, JAL could file for bankruptcy. Japanese bankruptcy law is similar to US laws and has a fast-track process called "civil rehabilitation". The government would be loathe to see that happen, but many argue that is not necessarily a bad option for an airline in JAL's complicated situation, with legacy costs, labour and pension cost problems and eight militant in-house unions.

By Heini Nuutinen
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US airlines focus on liquidity

In recent weeks US airlines have raised at least \$8.4bn in new liquidity and financings, even though the legacy sector continues to post losses, economic recovery seems tentative at best and there is no tangible evidence of any recovery in business travel. Why the success in fund-raising and what are the implications?

September was a month that had been anticipated with great trepidation in the US. After Labor Day, which marks the end of the peak summer travel season that is characterised by strong leisure demand, airlines rely heavily on business traffic. But business travel had collapsed earlier this year due to the global recession. Would it be back after Labor Day? If not, the airlines would be in trouble.

Since most economic forecasts anticipated a painfully slow recovery, back in July there was much pessimism about airlines' prospects this winter. There were fears that United, and possibly American and US Airways, could have serious liquidity issues and even end up in bankruptcy.

Capital markets reopen

Labor Day passed, with no tangible evidence of recovery in business travel. But, to everyone's surprise, in mid-September the bank and capital markets suddenly swung open to airlines. The markets were liquid and

bankers and strategic partners were keen to do deals. The airlines jumped at the opportunity, with American and Delta leading the way.

The massive capital-raising spree that followed was unique not just because of the volume raised but because of the enormous variety of the transactions. "Equity, converts, refinancings, EETCs, mileage forward sales ... you name it, it probably occurred in September", quipped one Wall Street analyst.

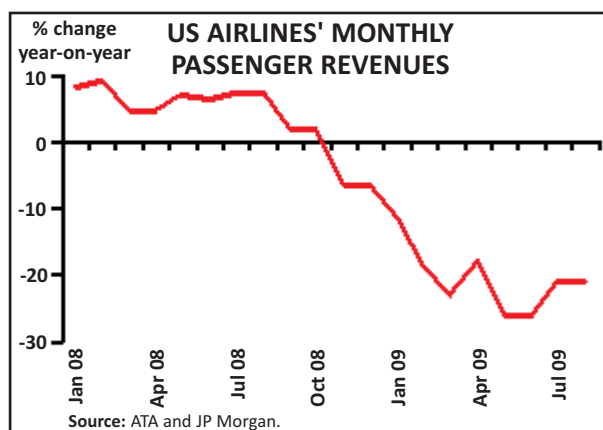
AMR raised \$4.2bn in additional cash and financings in the second half of September through multiple transactions, including a public stock offering, a public convertible debt offering, a private bond offering, a new secured loan, sale-leaseback commitments and an advance sale of frequent-flyer miles.

Delta completed \$2.1bn of financings on September 28th that included a two-tranche private bond offering, a revolving credit facility and a term loan. The transactions refinanced Northwest's bankruptcy exit facility and other near-term debt maturities and bolstered liquidity by \$600m.

UAL followed at the end of the month with public stock and convertible note offerings that raised \$424m in net proceeds. After that the airline launched a \$659m public EETC offering that primarily refinanced its outstanding 2001 EETC debt but also raised a little extra to boost cash reserves. US Airways successfully completed a public share offering in late September that raised \$137m in net proceeds. Low-cost carrier AirTran raised around \$173m from public share and convertible note offerings that were due to close on October 14. The airline also refinanced its \$90m revolver and upsized it to \$125m.

And Southwest found it an opportune time to negotiate a replacement for its currently unused \$600m revolving credit facility that was set to expire in August 2010 (the new facility is available for three years).

JP Morgan analysts estimated in an October 9th report that US airlines had raised \$3.9bn in "incremental liquidity"



(excluding refinancings) since mid-September, against a roughly \$15bn equity capitalisation of the participating carriers.

Standard & Poor's suggested in its October 9th industry credit outlook report that the capital markets became much more receptive to airlines because of a combination of "more hopeful economic news, somewhat improved prospects for airlines and a strong overall corporate debt market".

Early September saw some tentative positive economic indicators. In mid-September Federal Reserve chief Ben Bernanke noted that technically the recession was "very likely over", though he did warn of ongoing pain in the labour market.

There was also a perception that airlines were, as one analyst put it, "in the process of turning a financial corner". US Airways reported seeing more close-in bookings, which is a possible sign of increased business travel. Several legacy carriers issued improved third-quarter earnings guidance in mid-September.

American was able to raise such a significant amount of new funding because it relied partly on its long-time strategic business partners, GE and Citibank. The post-2001 era has seen many similar instances of symbiotic relationships at work, often involving GE. But this was the conglomerate's largest aviation finance deal in a decade. It involved American obtaining from GECAS a new \$280m secured loan and \$1.6bn of sale-leaseback financing commitments for previously ordered 737s; in return, American selected GE engines for its future 787-9 order. GE said that while the deals were complementary, each had to stand by itself.

The deal with Citibank was an advance sale of frequent-flyer miles, which gave AMR \$1bn cash while Citibank secured an extension of the co-branded credit card programme. It had been in the works for a long time, resulting in American becoming the last of the US legacy carriers to raise cash through that method. The delay probably had much to do with Citibank's earlier precarious financial situation.

US airlines needed the additional liquidity because losses since mid-2008 and heavy debt payments had eroded their cash balances. Many of the carriers have substantial near-term debt and capital lease obligations. The

industry is now entering the weaker winter season and economic recovery may be slow.

Cash boost

The past month's transactions have dramatically improved cash positions. In JP Morgan's estimates, at year-end 2009 each US airline will now have total cash reserves accounting for at least 18% of annual revenues. Unrestricted cash positions should be in the healthy 15-20% range. The consensus is that, barring unforeseen fuel or demand shocks, there will not be any bankruptcies this winter.

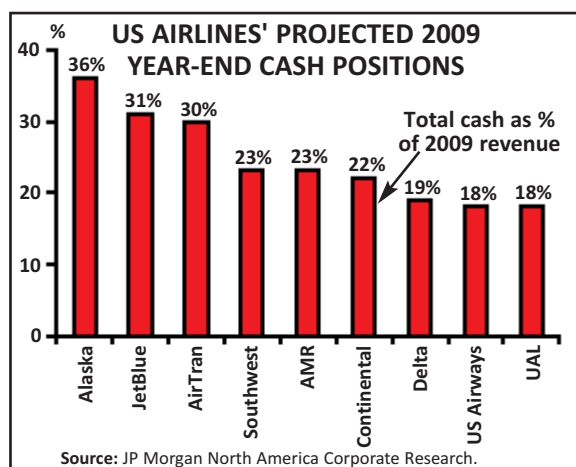
Some of the balance sheets have been modestly strengthened by the secondary share issuances (AMR, UAL, US Airways and AirTran), which may help those carriers improve their credit ratings. The downside, of course, has been dilution to shareholders, but averting bankruptcy risk was clearly more important.

As to whether the US legacies are in a position to start investing in foreign carriers, the answer is: probably yes, if they have to. American and Delta were earlier in separate alliance talks with JAL, which could require the winner to make an investment of reportedly several hundred million dollars; the talks have been postponed as JAL focuses on restructuring. The US carriers would undoubtedly prefer not to have to invest, but they will do what it takes to retain and improve access to that important market.

BofA Merrill Lynch is forecasting an aggregate net loss of \$550m for the eight largest US carriers in the third quarter, down from an \$825m net loss a year ago. Operating result is expected to be positive to the tune of \$475m, up from \$50m a year ago. All of the large carriers except Continental will be posting losses (including Southwest). Continental is expected to break even, while the smaller LCCs will be profitable.

For the full year 2009, all of the network carriers are likely to post losses, Southwest will hover around breakeven and the smaller carriers will be profitable.

As of October 9th, consensus estimates for 2010 still anticipated losses for AMR, UAL and US Airways. However, estimates are likely to start inching upward as the third-quarter reports (in the second-half of October)



may include evidence of business travel finally picking up. BofA Merrill Lynch's newly revised estimates expect all of the US carriers to be profitable in 2010.

The key question is when business travel will return. Some analysts believe that there is already evidence of a modest upturn, particularly domestically. But many remain convinced that international business travel will not start recovering until the year-end or in early 2010.

How the top five US network carriers are now positioned

Delta is one of the best-positioned US legacies, having successfully implemented the merger with Northwest (after both restructured in Chapter 11). First, the airline has financially outperformed its peers in recent quarters and is expected to post a narrower loss than the other large carriers for 2009. This reflects the extensive cost cuts in bankruptcy as well as the merger synergies, which are expected to boost this year's results by \$500m.

Second, Delta has had ample cash reserves – the result of the opportunities to raise significant liquidity as part of the Chapter 11 exits and the merger. At the end of June the company had \$5.4bn in unrestricted cash and available credit facilities, or 16% of trailing 12-month revenues.

But Delta also has an extremely heavy burden of debt and lease obligations. Fitch

US carriers will continue to benefit from domestic capacity discipline. The past year's sharp cuts have brought domestic industry capacity back to levels not seen since the late 1990s. BofA Merrill Lynch analysts suggested that economic recovery was not likely to result in meaningful capacity additions given other forces at play, including permanently higher energy costs, higher capital costs, higher environmental costs and higher regulatory costs.

Many people feel that the ability to raise capital so easily has been a mixed blessing for US airlines. The latest JP Morgan report noted: "Meaningful upheaval seems to have been averted again, with the industry apparently no closer to generating what we consider to be acceptable returns on capital". By upheaval, the analysts were referring to structural changes such as bankruptcies, liquidations, consolidation and sizable capacity cuts.

But some of that may well come in the next round – when the airlines need more liquidity but have fewer traditional options available. Many of them are running out of unencumbered assets and will have to become ever-more creative.

Ratings noted in June that the airline had \$5bn in debt coming due through the end of 2011. The agency downgraded Delta's credit ratings, citing a steady erosion of cash balances that "threatens Delta's ability to comfortably meet heavy fixed obligations".

So in September Delta understandably grabbed the opportunity to refinance. The airline originally intended to issue \$1.5bn of first-lien bank and capital market debt to take care of Northwest's Chapter 11 exit facility and other 2010 debt maturities. But investor demand was so strong that Delta was able to boost the first-lien offering by \$250m and add a \$600m second-lien tranche on the same collateral.

The total of \$2.1bn raised consisted of \$750m of 9.5% senior secured first-lien notes due 2014, \$600m of 11.75% senior secured

second-lien notes due 2015, a \$500m revolving credit facility and a \$250m term loan.

The transactions took care of more than 40% of Delta's 2010 debt maturities and generated \$600m in incremental cash. As a result, Delta expected to have \$5.6bn in unrestricted liquidity, or 17.7% of trailing 12-month revenues, at the end of September.

In addition to having more manageable debt maturities in 2010, Delta also benefits from having relatively light aircraft commitments next year and from having committed financing in place for all near-term deliveries.

On the negative side, Delta still has a heavy overall debt burden and few unencumbered assets remaining to support additional borrowing. But its longer-term prospects are generally regarded as promising, because the combined network will make it well positioned to benefit from global economic recovery.

AMR needed to raise funds because its liquidity position deteriorated sharply last winter. Its unrestricted cash reserves were only \$2.8bn at the end of June – 13% of trailing 12-month revenues. This was the lowest amount since the airline's 2003 reorganisation and brush with bankruptcy.

The main problem has been significant near-term debt and capital lease maturities, even though AMR has significantly reduced its debt since 2002. Current maturities of debt and capital leases were \$1.2bn as of June 30th. Also, AMR has an onerous pension burden (because it avoided Chapter 11), one of the highest labour costs in the industry and higher costs associated with a very mature fleet.

American kicked off the September liquidity-raising with the massive GE and Citibank deals. The \$1bn FF-mile sale will be treated as a loan for accounting purposes (8.3% interest rate). AMR will "repay" the loan using FF-miles in equal monthly instalments in 2012-2016. A week later, AMR raised \$830m in aggregate net proceeds from public stock and convertible senior note offerings (each contributing \$400m-plus). Both offerings were significantly increased in size, reflecting strong demand from investors.

And finally, AMR launched a \$450m private bond offering to refinance \$432m of its bank debt. The three-year notes have a 10.5% interest rate and are secured by the

same 141 aircraft that backed the bank facility (757s, 767s and MD-80s).

The \$4.2bn in new liquidity and financings raised in the past month was in addition to some \$1.3bn in secured aircraft financings AMR completed earlier this year.

The latest fund-raising has dramatically improved AMR's liquidity position. In JP Morgan's estimates, the airline will end the year with unrestricted cash of \$4.1bn – a very healthy 20.8% of revenues. And, having pre-funded a substantial portion of upcoming debt maturities, next year's debt and capital lease payments will be a relatively modest \$867m, compared to this year's \$2.3bn.

Unlike its peers, American still has significant unencumbered assets that could be used to raise additional funds. The airline estimates those assets at \$2bn, down from \$3.7bn in June, though it is not clear if all of them are easily marketable.

In conjunction with the liquidity moves, American announced a modest new network restructuring for next summer, aimed at eliminating unprofitable flying. And of course, American is maintaining a disciplined approach to capacity addition. Next year its mainline capacity is slated to inch up by only 1%.

The latest transactions and network plans are all the more beneficial because there should be minimal overall negative impact on costs. One analyst noted that the network retooling efforts would offset the additional interest expense. Of course, not all of the transactions added to debt, and the share offering strengthened the company's balance sheet. AMR has already averted a potential ratings downgrade from Moody's, which in late September changed the ratings outlook from "negative" to "stable".

In recent months, there has been much speculation that **United**, in particular, could face liquidity pressures this winter. UAL is expected to incur the legacy sector's steepest loss this year, reflecting its extensive global route system and greatest exposure to the premium sector. UAL also has heavy debt and capital lease obligations that add up to \$1.7bn between April 2009 and the end of 2010.

UAL's current liquidity position is actually not that bad. The airline was expected to maintain its unrestricted cash balance at

around \$2.6bn (15.4% of trailing 12-month revenues) at the end of September, thanks to \$300m of financings, asset sales and other liquidity initiatives completed in the third quarter. The cash raised included \$154m proceeds from the sale of senior notes backed by aircraft spare parts in late June. UAL was also in full compliance with its credit facility covenants on September 30th.

But the key concern with UAL is the potentially large amount of additional cash that needs to be raised to meet the substantial upcoming debt and capital lease payments if the recession lingers on.

The \$1.1bn of new financings in early October represented a very significant first step in giving UAL more breathing room this winter. The \$659m proceeds from the EETC offering will repay at par the \$568m debt in the 2001 EETC and provide \$90m to boost the cash position. The deal will reduce UAL's 2010 debt repayments by \$215m and 2011 payments by \$100m.

The EETC financing has an interest rate of 10.4% and a final distribution date of November 2016. S&P described the 31-aircraft collateral as "mixed in attractiveness", but the deal was structured in such a way to increase the likelihood that United would continue to pay on the certificates in bankruptcy.

The public stock and convertible note offerings, which raised \$424m in net proceeds, were evidently well received. The convertible note offering was increased in size from \$175m to \$300m. In JP Morgan's estimates, UAL will now end the year with cash reserves of an adequate 16.1% of annual revenues.

United's CEO Glenn Tilton said recently that the airline could decide by year-end whether to make the major new aircraft order it began considering in the spring. In part because of its ageing fleet, the airline is handicapped by one of the highest operating costs in the industry.

When global economic recovery gets under way, United could be the biggest beneficiary among the US airlines. It could stage an amazing transformation from the likeliest bankruptcy candidate to an over-performer.

US Airways had a difficult 2008 and saw its unrestricted cash position dwindle to just 10.2% of annual revenues at year-end.

However, the airline has been performing better financially than its legacy peers this year and has relatively light debt maturities in the near term, so there are no real liquidity concerns. In May US Airways raised \$234m from common stock and convertible debt offerings, which helped to boost unrestricted cash to \$1.7bn (15.2% of annual revenues) at the end of June.

On the negative side, US Airways has few unencumbered assets it could borrow against, so it relies heavily on equity offerings. It was quick to take advantage of last month's favourable market conditions, raising \$137.3m in net proceeds through a common share offering that closed on September 28th.

Separately, US Airways also amended its credit card agreement with Barclays to temporarily lower the minimum unrestricted cash requirement from \$1.5bn to \$1.35bn.

So US Airways is not in danger, but it needs to juggle a bit to avoid violating covenants and could benefit from further cash infusions. The airline is performing better than its legacy peers mainly because of its domestic focus (better pricing environment, more opportunity to collect ancillary revenues, Southwest's historic capacity cuts, etc).

Continental is one of the healthiest US carriers. Its unrestricted cash balance has remained remarkably stable over the years and through the turmoil in recent quarters, fluctuating only in the \$2.5 to \$2.8bn range (17-20% of annual revenues). Its June 30th unrestricted cash balance was \$2.8bn (20.2% of annual revenues), and year-end reserves are again expected to exceed 20% of revenues.

Continental was not active in the bank or capital markets in September. It raised about \$158m from equity issuance in July. Earlier that month, it completed a \$390m EETC (with an attractive 9% coupon compared to the 12-13% others were paying) and obtained new bank loans to finance 737-900ER deliveries.

The airline does have a substantial debt and lease burden stemming from fleet modernisation since the mid-1990s. But exemplary cash management, consistently superior operating margins and a nicely balanced global network inspire confidence. It is currently focused on staging a smooth transition from SkyTeam to Star alliance in the last week of October.

By Heini Nuutinen
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Aeroflot: ready for life without Siberian fees?

Under a new CEO, Aeroflot is preparing for the loss of Siberian overflight fees through fleet modernisation, a large reduction in its workforce and the restructuring of loss-making subsidiaries. But can Russia's flag carrier succeed in preparing itself for an era without substantial indirect state subsidies?

At first sight Aeroflot - which operates to almost 100 destinations around the world - appears to be one of Europe's most profitable airlines, with rising revenue and profits through the 2000s until last year (see chart, right). And even in 2008 it still managed to achieve a substantial operating profit equivalent to \$339m, though this was 41.3% down on 2007.

Indeed the Aeroflot group carried 11.6m passengers in 2008, 13.7% up year-on-year, with the mainline carrying 9.3m passengers, 13.5% up on 2007 (at a load factor of 70.9%, 0.6 percentage points up on 2007), of which 5.7m were international passengers.

However, the full-year results for 2008 (not released until July this year) also reveal deep underlying problems at the airline. While revenue reached \$4.6bn - 21.2% up on 2007 - costs rose at a faster rate (with fuel costs rising 51% to \$1.5bn), leading to the fall in operating profit, while net profits plunged to \$37m, compared with \$313m a year earlier.

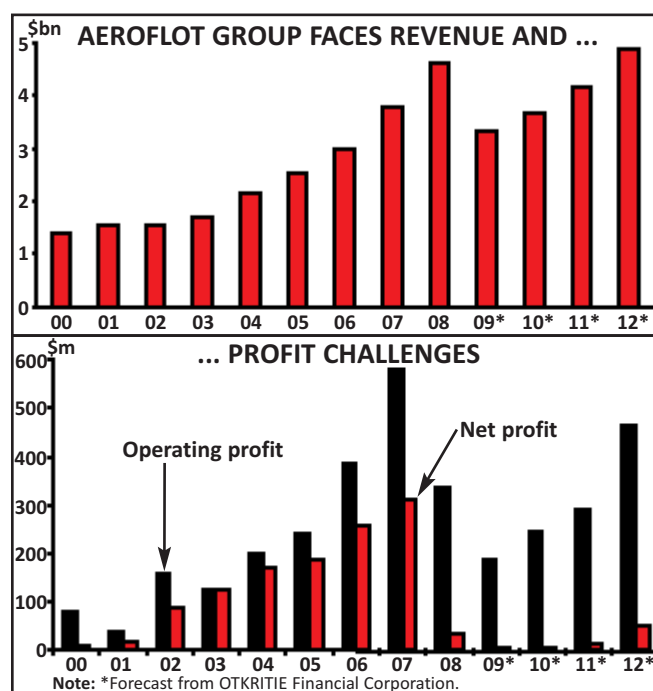
And it's this net figure that is particularly worrying, since it reflected: ongoing losses at Aeroflot's three main subsidiaries - Aeroflot-Cargo (which recorded a \$105.3m loss in 2008), Aeroflot-Nord (\$25m) and Aeroflot-Don (\$32.3m) - as well as at other subsidiaries (\$62m), the rise in fuel prices, foreign exchange losses and losses associated with a revaluation in US\$ of loans for the new terminal at Sheremetyevo (\$45.5m) due to the depreciation of the Russian rouble.

Crucially, 2008's poor net result was achieved despite the huge boost given tradi-

tionally by fees paid by European airlines overflying Siberia on long-haul routes to the Asia-Pacific region (which are on top of standard air navigation charges). A legacy of the former Soviet Union, these fees are handed straight to Aeroflot (although the airline does then have to pay various taxes and charges to the Russian aviation authorities from this pot of money).

End to the windfall

This huge windfall has underpinned Aeroflot's results for decades, but an agreement between the European Union and Russia means that these overflight fees will be completely abolished by the end of 2013. Other Russian airlines have also lobbied to share in these royalties, but it is understood that a deal has been done with the government that ensures that Aeroflot will continue to be the sole recipient of these overflight fees until the end of 2013.



AEROFLOT GROUP FLEET			
	Fleet	Orders	Options
Aeroflot Russian Airlines			
A319	14	1	
A320	31	9	
A321	10	16	
A330	3	7	
A350		22	
737-300	1		
767-300ER	11		
787-8		22	
MD-11F	3		
IL-96-300	6		
Tu-154M	23		
Superjet 100-95		30	15
Total	102	107	15
Aeroflot-Nord			
737-300	1		
737-500	16		
An-24/26	7		
Tu-134	10		
Total	34	0	0
Aeroflot-Don			
737-400	3		
737-500	7		
IL-86	4		
Tu-134	1		
Tu-154	4		
Total	19	0	0
Group total	155	113	15

Nevertheless, the imminent loss of this windfall is a huge blow to Aeroflot. The royalties are hidden within Aeroflot's accounts, but analysts estimate that Aeroflot received around \$400m in 2008 at a gross level, although one analyst calculates that a hefty proportion of this was passed on to state aviation bodies, leaving around 30% to go to the bottom line of Aeroflot. Even if this is accurate (and other analysts think that the percentage that remains with Aeroflot is much higher than 30%), that was still a hefty \$120m boost in 2008, without which the airline would have recorded an \$83m net loss.

Under an interim agreement signed between Aeroflot and the Russian air transport ministry earlier this year, the fees at a gross level will be reduced this year by as much as 50% (though the impact at a net level is as yet unclear), though they will remain substantial all the way to the end of 2013.

That presents a huge challenge for Aeroflot, and that may be why Valery Okulov, the long-serving CEO of the airline (and son-in-law of Russian ex-president Boris Yeltsin), was in effect fired after not being "nominated" to the company's board earlier this year for the first time since 1997 (although he then became a Russian government deputy minister, in charge of civil aviation).

His replacement in April was Vitaly Savelyev, who was previously a vice president of AFK Sistema, a Moscow-based conglomerate, where he was in charge of a telecoms business unit. He was also a Russian deputy minister for economic development between 2004 and 2007 and has wide experience in banking and finance.

He has been charged with preparing Aeroflot for the loss of these overflight fees, and unsurprisingly Savelyev's first move in his five-year tenure was to signal that everything that Aeroflot did was up for review. A full strategic review of every part of the group will be completed before the end of 2009 (and will, for example, examine whether to outsource major parts of the group, such as ground handling and maintenance), but in June Savelyev announced a number of actions that are being implemented immediately - a halt to fleet renewal, plus cuts in staff.

Freezing fleet renewal

The group has a fleet of 155 aircraft, of which 102 are at the mainline (see table, left). However, the Aeroflot mainline has 107 aircraft on order, which Savelyev says is "more than enough". Through the summer Aeroflot re-examined its capacity requirements, and this led to the postponement of deliveries for five A320 family aircraft, including two A320s from the first quarter of 2010 to early 2011 and early 2012, and three A321s from the third quarter of 2010 to 2012. However, all the deliveries planned for this year (18 A320s and six A330s) will be delivered as scheduled, since Aeroflot is committed to disposing of all its Tupolev aircraft by the end of 2009 as part of a drive to attract

more business passengers and to become more fuel-efficient.

Once the Tu-134s and Tu-154s go, the average age of the fleet will come down from 10 to five years, although six IL-96s will stay until 2016, when they (and Aeroflot's A330s and 767s) will be replaced by the first deliveries of 22 A350s and 22 787s on order. Until then the IL-96s will be used domestically and on a handful of international routes (such as to Havana and Hanoi), and some of these aircraft may be transferred to a new charter subsidiary, as the charter market is still an important part of the Russian aviation sector.

From 2016 Aeroflot will have just four models - 787/A350s for long-haul, A320 family aircraft for medium-haul and Sukhoi Superjet 100s for short-haul. Aeroflot has orders for 30 Superjets (plus 15 options), although the first of these regional aircraft will now not be delivered to Aeroflot until 2010; the first aircraft was previously due this year, and Aeroflot is already selling tickets for the first routes that will use the Superjet (from Moscow Sheremetyevo to Chelyabinsk and Astrakhan).

Despite the delay a cancellation of this order is unthinkable politically, as the 75-90 seat aircraft is seen as being crucial to the future of aircraft manufacturing in Russia. The first 10 aircraft will be leased to Aeroflot from VEB Leasing and financed by a \$250m credit line provided by the Vnesheconombank (known as VEB), the Russian state-controlled development bank, on 12-year contracts. This same bank is also financing the Superjet manufacturing programme after Vladimir Putin, the controversial Russian prime minister, promised \$200m in further state funding earlier this year, without which Sukhoi said it would not be able to complete the programme given the current economic environment. However, whether the Superjet will receive significant (or indeed any) orders against its Embraer and Bombardier rivals outside of the former Soviet Union countries remains to be seen.

In terms of finance, capex for the new aircraft appears affordable, thanks to the final few years of the Siberian fees, more

than generous financing from state-owned Russian banks and reasonably good cash flow at the airline. But Savelyev is now making an important statement that all further fleet development is now frozen, at least for the foreseeable future.

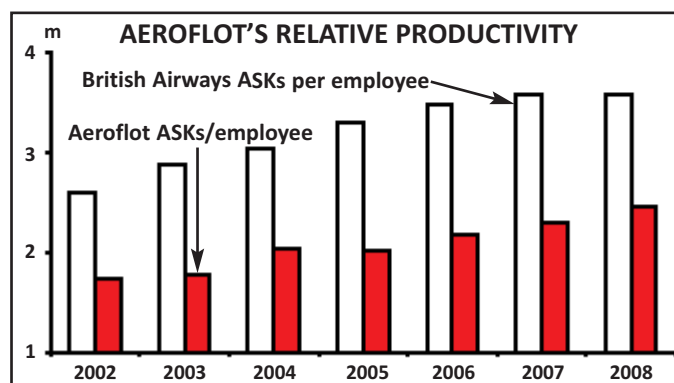
Staff reduction

Aeroflot is to reduce its workforce from 15,000 to 9,000 (a cut of 40%) within the next two or three years, in order to bring its productivity more into line with European competitors. As a productivity measure Savelyev uses the informal 1,000 employees per 1m passengers per year aimed for by European airlines, and under this measure Aeroflot is substantially overmanned. Under a more conventional productivity measure, ASKs per employee, the airline has a long way to catch up with British Airways, for example (see chart, below).

This process has already started, with 2,000 positions due to go by early 2010. In the summer Aeroflot also reduced its senior management by cutting deputy CEO positions from 13 to nine, and in addition introduced a pay freeze for all staff.

Altogether Aeroflot expects to cut its costs by a massive 25% in 2009, ahead of an anticipated fall in revenue this year of around 20% thanks to falling passenger traffic to/from and within Russia.

That drop in demand is the second major challenge that Aeroflot faces (on top of the loss of overflight fees). A long period of passenger growth through the 2000s in the Russian domestic and international markets (Russian airlines were



barely affected by September 11) peaked in 2008, when Russian airlines carried 49.8m passengers, but that has come crashing to a halt this year thanks to the global economic crisis. RPKs at Russia's airlines are expected to fall by between 10-15% this year, and according to Russia's Federal Air Transport Agency (FATA), domestic and international passenger traffic fell 17.5% in the first-half of 2009, although the fall at Aeroflot was less than this. In the January-June period mainline Aeroflot carried 3.9m passengers, 12.1% down on the first-half of 2008, at a load factor of 63.5%, with the total group carrying 4.8m passengers, an 11.5% fall year-on-year.

However this passenger downturn is expected to be a temporary blip, as Russia is still one of the least developed aviation markets in continental Europe. The fall in traffic is expected to stop in the third quarter of this year, with analysts predicting growth again in the fourth quarter. That is the best possible scenario for Aeroflot as the fall in traffic through the first-half of 2009 gave the newly-appointed Savelyev the ammunition to radically cut back costs at an airline that has never really had to tighten its belt before.

But the underlying long-term passenger trends for Russia look positive. According to the latest Airbus Global Market Forecast, the annual average growth rate for passenger traffic over 2009-2028 is forecast at 4.9% in the Russian domestic market, the same rate as in the Russia-Western Europe sector. And there are much higher rates for Russia-Asia (6.2%) and Russia-US (7.3%).

Aeroflot currently has a 39% share of traffic to/from the country and 11% of

domestic Russian traffic, but a worrying statistic for Savelyev is that Aeroflot makes losses on approximately 40% of the routes it currently operates.

That percentage will fall once the staff cuts and fleet renewal kick in, but another key factor in bringing this percentage down is outside of Aeroflot's control – the number of competitors that Aeroflot has to face within Russia. There are at least 250 commercial airlines operating in the ex-USSR, of which 170 are in Russia, although a large proportion of these carriers are small and/or in dire financial straits.

Indeed Gazprombank says that Aeroflot will be the "the key beneficiary of the ongoing consolidation" in Russian airlines, and that "small regional airlines overburdened with debt and limited access to financing won't survive in the current market environment, with substantial decreases in passenger and cargo volumes".

That will be a welcome development for Aeroflot, but probably will not diminish the need for it to severely restructure its route network at some time in the not-too-distant future.

Of course Aeroflot will hold on to as many of its profitable internal routes as possible, although here it is coming under pressure from the Russian competition regulator, which ruled recently that Aeroflot abused its dominant position on a domestic route between Krasnoyarsk and Norilsk by charging fares of \$1,100 (when the maximum authorised fare was \$250). The regulator fined Aeroflot the amount of all the excess revenue over \$250 per flight on this route, although it's unclear just what the total amount comes to.



Sheremetyevo boost

A priority for Aeroflot is to ensure better feed into its long-haul flights at its main base, Moscow's Sheremetyevo airport, which has been a continuing problem for Aeroflot.

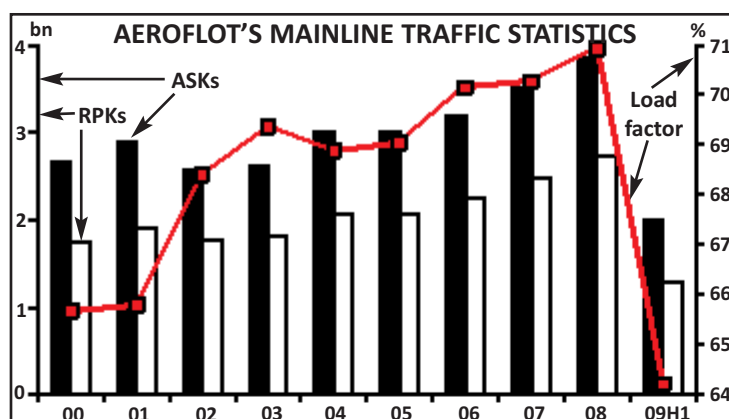
The situation should be improved greatly when the new terminal 3 (S3) at Sheremetyevo opens in the fourth quarter of this year. This will double capacity

at the airport, with the new terminal initially adding capacity of 8m passengers a year, extendable to 12m. All Aeroflot's and SkyTeam's international flights (other than to the US and a handful of Asia/Pacific destinations) will move to S3, and the airport (and Aeroflot) hopes that these new links will help Sheremetyevo regain leadership of the domestic market, which it lost to Domodedovo in 2005.

Aeroflot owns 53% of S3, although this is costing the group many hundreds of millions of dollars in capex. Indeed Aeroflot's long term-debt rose by 5.3% in 2008, to \$1.3bn, with more than a third of that debt being finance lease obligations and \$575m being long-term loans for the construction of S3. However, the airline says the development of S3 will generate \$200m of additional revenue in 2010, rising to \$300m a year afterwards.

Expanding flights at Sheremetyevo also gives the airline another benefit - reduced fuel costs. Aeroflot has not carried out fuel hedging in recent years, and although it buys 25% of its fuel abroad (at prices that are cheaper than available in Russia), within Russia it purchases as much fuel as possible at Sheremetyevo. Bulk agreements with Russian fuel companies at the airport mean that, on average, fuel purchased there is 16% cheaper than the cost of fuel bought anywhere else in Russia, according to statistics provided by FATA.

But while S3 will be a major boost to Aeroflot, there are many other problems that have to be tackled. Among the priorities is sorting out the mess at the group's subsidiaries. Both Aeroflot Don (set up in 2000) and Aeroflot Nord (launched in 2004) racked up large losses in 2008, and to make matters worse the Russian authorities imposed operating restrictions on Aeroflot-Nord this summer following an investigation into the crash of a 737-500 last year, which a report said had partly been caused by inadequate training and a series of maintenance problems at the airline. Both airlines have an eclectic mix of models, and like the mainline these subsidiaries will



reduce this variety over the next few years.

While Aeroflot is hopeful that both Aeroflot-Don and Aeroflot-Nord can return to profit in 2009 another subsidiary - Aeroflot-Cargo - has even greater problems. Aeroflot spun off its cargo operation as an independent subsidiary in 2006, and it now specialises in routes between Europe and the Asia/Pacific region using MD-11Fs and 737s. But its performance has been dire, and it has come close to being declared bankrupt. Aeroflot now wants to reabsorb Aeroflot-Cargo back into its mainline operation, where it's hoped that direct control will help turn around the freight operation.

Short-term pain, long-term gain?

In August Aeroflot released figures for the first-half of 2009, saying that operating profit rose 28.2% to \$74.3m and net profit rose 48.1% to \$103.5m, even though revenue fell 5% to \$1.3bn. However, these are prepared under Russian accounting standards and so must be treated with caution until IAS results are released in September. Aeroflot still expects to post a profit for 2009 (helped by the depreciation of the rouble, since most costs are rouble based while revenues are largely received as Euros), although analysts are predicting that it may be very close to reporting a net loss (see chart, page 9).

Regardless of the 2009 result, it's clear that Savelyev's focus is on sorting out Aeroflot's immediate problems, given the

drop in traffic this year and the imminent loss of the Siberian overflight fees. The new CEO is also looking to make significant service changes - as well as new in-flight catering, in July the airline announced a major re-branding effort, which includes retraining of its flight attendants (some of which have been sent to Singapore to receive training from SIA) and a new colour scheme to replace the current blue and orange, which Savelyev says (perhaps a bit too honestly) "evokes revulsion in passengers".

This is not the first rebranding that Aeroflot has gone through in recent times, but this time around Savelyev appears determined to change the airline's image for good.

More importantly perhaps, Aeroflot's dabbling in western Europe has come to an end for the moment, with Savelyev saying that he "didn't see prospects in Europe" for mergers and acquisitions, given that it faces substantial problems in being a non-EU airline (which restricts it to a 49% stake in any EU airline). And while Aeroflot has other priorities closer to home, it just cannot afford to invest in a European airline (from both a financial and managerial resource point of view) anyway, even at the bottom of the aviation cycle.

European failure

Aeroflot has had an abysmal track record in Europe. After a failed bid for Alitalia in 2007, Aeroflot was part of the Darofan consortium that bid unsuccessfully to buy CSA Czech Airlines earlier this year (after the Czech government put its 91% stake up for privatisation) – Aeroflot then stated that "following a thorough examination of CSA's financial and operational situation, Aeroflot detected considerable risks in the bid, which would have entailed serious financial obligations at a time of a global financial crisis".

Although the right decision, that was a complete about turn from what Okulov, the previous CEO, said only a few months previously (when he stated that extending the long-term co-operation between

the two airlines into a merger would enable both airlines to become more profitable).

Another near miss was with Malev, which Aeroflot came close to managing on a contract basis at the start of 2009 under a restructuring plan put together by its new owner, AirBridge, following the Hungarian carrier's privatisation. In April, Aeroflot was also put forward to buy part of Blue Wings, after the Dusseldorf-based airline (which operated primarily to Turkey) was grounded temporarily by the German authorities due to concerns about its finances. But this deal was largely political, due to 48% of the airline being owned by Russia's National Reserve Corporation, which also holds 30% of Aeroflot (the Russian government owns another 51.2%). Aeroflot's management apparently objected to the acquisition, saying it would give little benefit to the Russian airline, and the deal eventually came to nothing.

While in the longer run a merger or acquisition of a major European airline might make strategic sense for Aeroflot, the short- and medium-term imperative is to sort out Aeroflot's cost base. The only justifiable merger or acquisition might be within Russia, as part of an attempt to strengthen Aeroflot's position domestically as smaller players go under or consolidate.

Last December Aeroflot said it would bid for the 25.5% stake in S7 that the Russian government was selling, although this led to anti-competitive concerns by the state anti-monopoly regulator, and appears even more of a non-starter now that S7 is joining the oneworld alliance (incidentally Star does not yet have a member in Russia).

There are plenty of other potential targets in Russia, although Savelyev will need to pick his acquisitions carefully, because as one analyst puts it, there will be "a second wave of bankruptcies among local air carriers on the back of their limited access to cheap fuel and a substantial decrease in passenger and cargo turnover".

Ryanair's hollow threat to cancel orders and shrink?

Like other airlines, Ryanair has been hit hard by the global recession, although not as severely as many other carriers. Surprisingly, however, the LCC is now threatening to cancel orders and purposely manage its decline into a "cash cow". Is this a serious option, or is the world's largest LCC playing a dangerous game of brinkmanship with Boeing?

At the beginning of October Michael O'Leary, Ryanair's CEO, started off proceedings at the airline's annual investor day by saying that the bad news was that there was no new good news, but that the good news was that there was no new bad news. He reiterated the company earnings' guidance of doubling underlying profits to the lower end of a range of €200m-€300m for the year to the end of March 2010 – albeit from the very low level of the last financial year (and ignoring the €218m accelerated depreciation and mark-to-market of the Aer Lingus stake, which pushed the company into a published net loss of €169m).

O'Leary also reinforced the company's aim to double passenger numbers and profits over the five years to the end of March 2012 – targeting total annual passenger numbers in that year of more than 80m (against a current 12 month rolling figure of 67m) and profits of more than €800m.

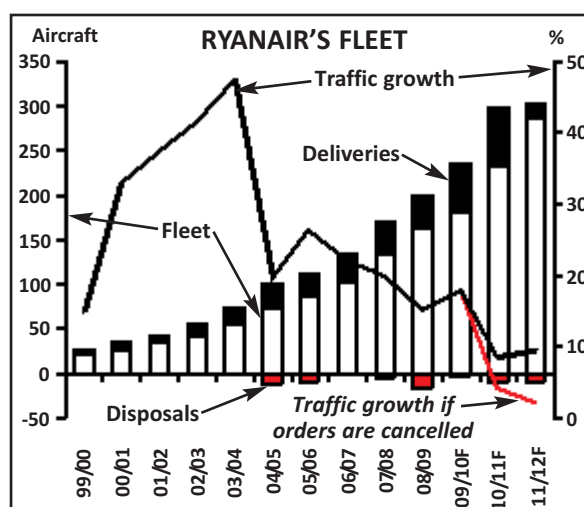
A public "bust-up"...

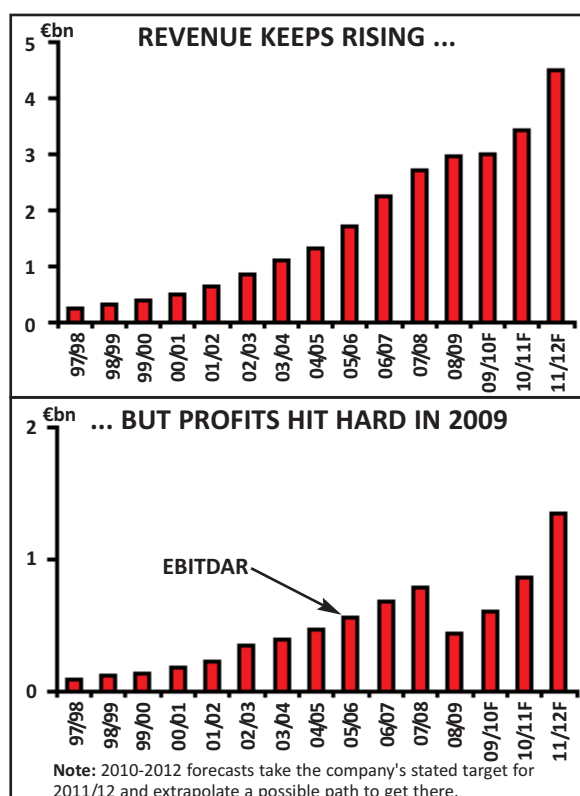
Having said all this, he then warned investors that the company was encountering some problems in its attempts to negotiate the next batch of 737 orders for delivery from 2013. O'Leary had been hoping to better the extraordinary deal he made in the last downturn, but he now implied that there was a very real possibility of a public "bust up" with the Seattle manufacturer. In light of this, he then suggested that if an

agreement could not be reached he might cancel remaining orders and options and rein back growth significantly from 2011, instead running the airline "for cash".

Ryanair currently has a fleet of 202 737-800 aircraft, with an average age of just under three years. It has orders in place for a further 110 aircraft and 102 options for delivery up to 2012 (see chart, below); the next 59 aircraft due to be delivered by October 2010 have already been fully financed, all but four (to be taken on operating lease) financed through Exim Bank facilities. As plans stand at the moment, it has a further 51 aircraft for delivery between October 2010 and March 2012 still to be financed; and the plans are predicated on continuing to push an increase of capacity of around 10% a year into the market. Part of the rationale of the Ryanair fleet plan has been to dispose of some of the older equipment – acquired at higher initial costs and lower €/US\$ exchange rates – to minimise ownership costs and therefore the unit costs of operation.

Ryanair currently operates from 36 bases throughout the EU, with more than 1,300 daily flights on 900 routes between 151 airports. This gives it the largest coverage of





Europe of any European airline (albeit not with meaningful frequency on many routes). It can boast that it is the second largest passenger carrier within and into/out of the UK, Italy, Spain and Belgium, with market shares of between 12% and 19%, and the third-largest in France and Germany, with market shares of 7-8% (see table, right). It is of course the largest carrier in Ireland, with a near 50% share of the market.

Ryanair is proud to claim the accolade of providing the lowest average fare in Europe, at €37 one-way, or some 13% below the average fare of easyJet, its nearest competitor. It also boasts the best customer service, in that it has the best punctuality, reliability, the fewest misplaced bags (it does help not to operate a hub sometimes, and apparently Ryanair fines its airports and handlers for mishandled bags) as well as the fewest cancellations (see table, page 18).

If Ryanair does slam on the brakes to its growth path it could start to become even more indecently profitable. One of the prime tenets of the Ryanair business plan is to operate "load factor active, yield pas-

sive". Indeed it is one of the basic principles in air transport economics that the more capacity you put into the market the more you have to encourage traffic, and with high rates of growth the introduction of marginal new routes and marginal capacity on existing routes can act as a dilution to pricing power and achieving high yields.

By stopping growth – or at least minimising it towards the "natural" growth characteristics of the market – Ryanair would be able to achieve strong yield improvements. As the lowest cost provider in what is essentially a commodity market it would still remain exceedingly competitive, while its very low cost base ensures that it will still be able to operate routes totally uneconomic to other airlines.

It will, however, probably find it more difficult to achieve unit operating cost savings (its operating costs per passenger excluding fuel are expected to have fallen by 5% year-on-year in the current financial year ending March 2010, and have fallen by 42% since 2000); particularly since as the fleet ages it will start to encounter operational delays as well as increasing maintenance costs. To achieve those cost savings it is likely to intensify its negotiations with suppliers even more and concentrate on the low cost options.

Even more cash ...

Financially, if it stops growth plans completely it is therefore likely to find cash pouring out of its ears: with some €250m annual depreciation and in the absence of its €1bn annual aircraft capex, cash balances even at break-even profitability could continue to grow at well over €1bn a year (or some 30% of revenues). At the end of June it had €2.5bn in cash on its balance sheet (an enviable 85% of annual revenues) while net debt stood at €105m, without taking account of the €400m cash tied up in its 29% stake in Aer Lingus (written down to €80m on the balance sheet and currently worth €113m).

In addition there is a substantial amount of cash included in the fixed asset schedule as deposits for future aircraft deliveries –

more than €400m at the end of March 2009. Not entirely jokingly perhaps, and no doubt in light of the current political arguments against bankers' pay scales and bonuses, O'Leary suggested that management would first put in place a really good management bonus scheme before paying surplus cash to shareholders as "special" dividends (although of course he is also a major shareholder).

On the other hand, this threat has potential downsides. The company has so far successfully avoided attempts at forced union recognition, and particularly pilot union recognition. In part, it claims, this is because it offers pilots a highly attractive package: no "overnights"; no "through the nights"; no time zone problems; fixed and predictable roster patterns; guaranteed one month's annual leave plus two lots of 13 day breaks – with pilots therefore sleeping in their own beds each night.

In addition, some 50% of all its pilots (and also the cabin crew) are on a contract basis – paid by the hour – providing a substantial flexibility in seasonal rostering. Indeed BALPA tried to force recognition for Ryanair's UK pilots this year, but backed down apparently through lack of necessary support. In the past year the company has been at pains to negotiate long-term four-year pay contracts with pilots at each of its bases, and at the investor day was able to boast that it had achieved this throughout the network.

It is important that Ryanair's pilots are employed on the more flexible (for the employer) UK or Eire employment contracts – although there are no doubt dangers that the French in particular (and other EU countries perhaps too) will try to enforce local country contract requirements, and perhaps require union recognition. It appears fairly clear that faced with such an imposition Ryanair would close down operations in such bases affected.

However, should Ryanair be seen to be making significant profits and distributing the returns to shareholders, it appears entirely possible that it may encounter increasing belligerence from the pilot

RYANAIR'S CAPACITY

	International & domestic capacity (m seats)	Market share	Market rank
UK	1.9	17%	2
Italy	1.3	16%	2
Ireland	0.7	49%	1
Spain	1.3	12%	2
Belgium	0.2	19%	2
France	0.5	8%	3
Germany	0.7	7%	3

Source: Ryanair.

workforce for a share of the pot. It is, however, very unlikely that the Ryanair management have not considered the implications.

A chance for Airbus?

Having said all this, a break-down in negotiations with Boeing could well open up the possibility of real negotiations with Airbus – which up to now may have felt its negotiating position was hopeless (and which apparently earlier this year declined to participate in talks with Ryanair on the basis that the discount to list prices being requested was far too high) – and pave the way for Ryanair to start building an Airbus fleet and possibly put it in an even better position for future negotiations with the aircraft manufacturing duopoly.

This could suggest that public statements of an abandonment of growth plans will be short-lived (and if it had been able to acquire Aer Lingus, with its Airbus fleet, it would already perhaps be in that position). There is therefore the possibility that a potential public break up with Seattle realistically allows Ryanair to acquire the low cost lift to generate the growth it feels it needs from Toulouse. Given Ryanair's increasing market presence it seems unlikely that either manufacturer would regard this as ideal, although in the end both will want to secure orders even in the downturn, and will have to put a price on an order for up to 400 new aircraft from one of the few airlines that has the ability to pay – but only a price acceptable to Ryanair.

This approach to negotiations seems to permeate the ethos at the company.

EUROPEAN AIRLINES' PUNCTUALITY, LOST BAGGAGE AND DISPATCH RELIABILITY			
	Punctuality	Missed bags per 1,000	
		pax	Reliability
Ryanair	93.0%	0.4	99.6%
Luxair	90.3%	7.6	85.4%
KLM	89.9%	14.4	98.6%
Austrian	89.3%	10.1	99.4%
LOT	87.9%	9.8	97.7%
bmi	86.5%	17.2	98.5%
SAS	86.4%	9.1	99.0%
Tarom	85.7%	9.8	99.2%
Finnair	85.2%	11.4	99.5%
TAP	85.0%	17.3	99.2%
Brussels	84.9%	9.1	98.6%
Lufthansa	84.7%	10.9	98.4%
Icelandair	84.3%	7.6	100.0%
AeroSvit	84.1%	5.2	99.2%
Adria Airways	83.7%	7.0	99.7%
swiss	83.4%	9.0	98.5%
Air France	83.3%	18.9	97.0%
Malev	82.9%	8.6	97.7%
BA	82.6%	15.6	98.0%
CSA Czech Airlines	81.1%	9.1	99.0%
Croatia Airlines	81.1%	7.7	97.5%
Air Malta	80.3%	4.6	99.8%
Olympic Airlines	80.0%	n.a.	96.7%
JAT Airways	76.3%	n.a.	98.0%
Alitalia	73.8%	19.6	98.8%
THY	70.4%	4.5	n.a.
Iberia	70.2%	19.2	97.0%
Cyprus Airways	69.3%	8.0	99.4%

Source: Ryanair for its figures, comprising rolling 12 months to August 2009; AEA for all other figures, for winter 2008/09.

Earlier this year, Ryanair closed down most of its routes (except for the lucrative one to Dublin - the fourth most important route in its network) from Manchester, seemingly because it did not like the airport imposing increases in charges. It was happy to secede to easyJet the higher yielding (but high cost) routes out of that airport (e.g. to Spain) in favour of routes from airports that would offer lower costs and hopefully longer term deals.

Similarly, it had tried to negotiate with Milan's Malpensa airport last year to gain a long-term charging formula, but walked away - to retain its base at Orio al Serio - allowing easyJet (and to a lesser extent Lufthansa) to move into the Milanese air-

port as a replacement for the retrenching Alitalia. O'Leary commented in one of the sessions at the investor day that he was quite happy to wait until easyJet's growth out of Milan slowed and SEA decided that it needed another source of growth, and then would return to the negotiating table - but only on his terms. Apparently in these difficult economic times, other "major" airports have initiated talks with Ryanair to attempt to persuade it to set up a base (other airline failures are helping this trend) and Ryanair stated that it had enough airport opportunities to build towards carrying more than 100m passengers a year.

Airport anger

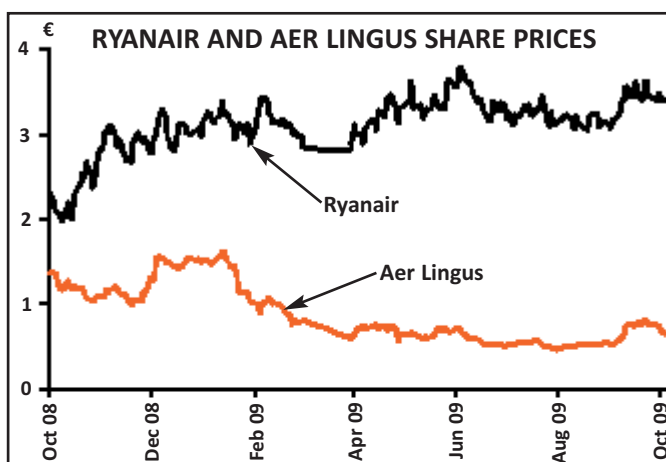
Meanwhile, the company has been very vociferous publicly over the operations and charges at its two largest bases, at London Stansted and Dublin, and very publicly critical of the expansion plans at both (and the regulators' acquiescence in allowing landing charges to rise to pay for them). In London, (BAA's appeal notwithstanding), Ryanair appears to have won a prime negotiating position after the competition authorities in the UK declared a requirement for BAA to sell London's third airport. However, whoever looks to acquire the airport from the Ferrovial consortium will have to negotiate with Ryanair; and the airline would be able to promise growth of services and guarantees of income - but only on its own terms and with exceedingly low landing charges.

In Dublin meanwhile, it appears that other airlines (also at the moment incidentally suffering badly from the recession) are starting to raise real concerns about the need to operate the new terminal - or more specifically to pay for it - while Aer Lingus, itself in a desperate financial state, can hardly be looking forward to substantial increases in costs at its home base. Meanwhile, partly as a result of the deep recession in both countries, and partly because of the UK APD and the Irish tourist tax, Ryanair has announced deep cuts in winter capacity at both airports (although not as deep a set of cuts as the public releases may suggest).

At the same time, Ryanair has imposed internet-only check-in – and, in a manner of what many may see as hubris, is imposing a €5/£5 charge for doing so (and a penalty of €40 for failure to do so). This may take the idea of unbundling fares to an unwarranted extreme (and indeed may backfire, although O’Leary talks of “educating and disciplining the passenger”), but removes the need for the use of check-in desks (for which the airline gets charged at the airport) and incidentally frees up some elements of terminal capacity for the airports concerned, making - from Ryanair's point of view - their arguments for terminal expansion specious.

Ryanair is also sitting on an unproductive 29% stake in Aer Lingus: full takeover uniquely blocked (no doubt at the Irish government's request) by Brussels. It appears very unlikely now that Ryanair will initiate a third public bid for its local rival; but it may very well be willing to sit and wait. The Irish “flag” carrier is suffering more than most in this downturn – mainly because it is having to compete head-on with Ryanair. It has recently announced another major restructuring plan to cut costs by nearly €100m by 2011 (around 12% of non-fuel costs) – with a major redundancy plan, deferral of aircraft deliveries, and reassessment of pension provisions – which may just produce returns before its cash balances (€1bn gross cash at the end of June, net cash €440m down from €800m a year earlier) become uncomfortable.

Unfortunately, having slimmed down its operations so far in its restructuring in the early 2000s, it may have little real further opportunity to dream of approaching Ryanair's cost base – even by moving operations to London Gatwick. Aer Lingus does not necessarily have the leeway to raise the much-needed cash that was enjoyed by BA, Lufthansa or Air France earlier this year, or the major US carriers recently – unless it were able to persuade the Irish Government to allow it to sell its valuable slots at London Heathrow. Any attempt to raise cash from shareholders would probably require Ryanair's agreement, while the government and the employee pension funds may find a request to put up funds uncomfortable.



O’Leary appears quite happy to wait for the humiliating call to rescue Aer Lingus – and his recent comments suggesting using it as a vehicle to bid for bmi may not be too far off the wall, and could allow Ryanair legitimate access into the more mainstream airports.

The airline industry is quite good at generating high profile maverick players, and working out quite where a maverick will next jump is almost impossible. Ryanair's mantra to double passengers, revenues and profits between 2007 and 2012 may not quite yet be believed by the financial markets, but under current plans could be achieved (after the declines of last year and this) by a 5% annual growth in revenues per passenger over the next two years – to bring it back to the €52/pax generated in 2007.

If it does have a breakdown in negotiations with Boeing and cuts back its growth plans significantly, it may have to generate an annual growth in revenues per passenger of more than 10%. However, by following a low or static growth path from 2012 onwards this may ironically give it an additional cost advantage over other LCCs – among other things in not having to buy quite so many emissions allowances as the aviation industry enters the European Emissions Trading Scheme as would otherwise be the case – but would create more problems in the longer term over how to deal with an ageing fleet.

Meanwhile, in deciding where Ryanair goes from here, O’Leary may just be faced with an embarrassing number of strategic options for Ryanair.

By James Halstead

Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Air France/ KLM Group YE 31/03	Oct-Dec 07	8,678	8,202	476	207	5.5%	2.4%	62,615	49,591	79.2%	17,868	104,482
	Jan-Mar 08	8,543	8,612	-69	-810	-0.8%	-9.5%	62,948	49,060	77.9%	17,154	
	Year 2007/08	34,173	32,182	1,991	1,087	5.8%	3.2%	256,314	207,227	80.8%	74,795	104,659
	Apr-Jun 08	9,830	9,464	366	266	3.7%	2.7%	66,610	53,472	80.3%	19,744	106,700
	Jul-Sep 08	10,071	9,462	609	44	6.0%	0.4%	69,930	58,041	83.0%	20,439	107,364
	Oct-Dec 08	7,880	8,136	-256	-666	-3.2%	-8.5%	64,457	51,255	79.5%	17,934	106,773
	Jan-Mar 09	6,560	7,310	-751	-661	-11.4%	-10.1%	61,235	46,214	75.5%	15,727	106,895
	Year 2008/09	34,152	34,335	-184	-1,160	-0.5%	-3.4%	262,359	209,060	79.7%	73,844	106,933
	Apr-Jun 09	7,042	7,717	-676	-580	-9.6%	-8.2%	63,578	50,467	79.4%	18,703	106,800
	BA YE 31/03	Jul-Sep 07	4,729	4,118	611	458	12.9%	9.7%	38,191	30,500	79.9%	9,206
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 YE 31/12	Oct-Dec 07	1,963	1,681	279	140	14.2%	7.1%	16,773	13,471	80.3%	6,463	22,168
	Year 2007	7,617	7,049	568	450	7.5%	5.9%	66,454	54,229	81.6%	26,860	22,515
	Jan-Mar 08	1,948	1,990	-42	-661	-2.2%	-33.9%	16,360	12,990	79.4%	21,574	
	Apr-Jun 08	2,142	2,148	-6	33	-0.3%	1.5%	16,771	13,372	79.7%	21,793	
	Jul-Sep 08	2,181	2,156	25	45	1.1%	2.1%	17,093	14,220	83.2%	21,988	
	Oct-Dec 08	1,753	1,836	-83	-25	-4.7%	-1.4%	15,875	12,302	77.5%	20,956	
	Year 2008	8,019	8,135	-116	47	-1.4%	0.6%	66,098	52,885	80.0%	21,578	
	Jan-Mar 09	1,436	1,629	-193	-121	-13.4%	-8.4%	15,369	11,752	76.5%	20,715	
	Apr-Jun 09	1,455	1,632	-177	-99	-12.1%	-6.8%	15,668	12,733	81.3%	20,760	
	Lufthansa YE 31/12	Jul-Sep 07	8,960	8,004	956	843	10.7%	9.4%	48,662	39,112	80.4%	18,836
Oct-Dec 07		8,197	8,103	94	165	1.1%	2.0%	45,845	35,128	76.6%	17,106	
Year 2007		30,682	28,797	1,885	2,264	6.1%	7.4%	169,108	130,893	77.4%	62,900	100,779
Jan-Mar 08		8,368	8,086	282	85	3.4%	1.0%	45,131	34,828	77.2%	15,992	106,307
Apr-Jun 08		10,113	9,285	829	541	8.2%	5.3%	50,738	40,258	79.3%	18,488	108,073
Jul-Sep 08		9,835	9,542	293	230	3.0%	2.3%	52,487	42,437	80.9%	18,913	109,401
Oct-Dec 08		8,274	7,693	582	70	7.0%	0.8%	47,075	36,632	77.8%	17,107	108,711
Year 2008		36,592	34,600	1,992	896	5.4%	2.4%	195,431	154,155	78.9%	70,500	108,123
Jan-Mar 09		6,560	6,617	-58	-335	-0.9%	-5.1%	44,179	32,681	74.0%	15,033	106,840
Apr-Jun 09		7,098	7,027	71	54	1.0%	0.8%	49,939	38,076	76.2%	18,142	105,499
SAS YE 31/12	Jul-Sep 07	2,612	2,518	94	109	3.6%	4.2%	10,452	8,228	78.7%	7,523	27,447
	Oct-Dec 07	2,041	2,039	2	-96	0.1%	-4.7%	9,985	7,034	70.4%	7,195	25,651
	Year 2007	5,969	5,676	293	259	4.9%	4.3%	40,030	29,365	73.4%	29,164	26,538
	Jan-Mar 08	2,046	2,185	-139	-181	-6.8%	-8.8%	9,696	6,700	69.1%	6,803	25,477
	Apr-Jun 08	2,959	2,968	-9	-69	-0.3%	-2.3%	11,564	11,851	102.5%	8,260	26,916
	Jul-Sep 08	2,604	2,869	-265	-319	-10.2%	-12.3%	10,984	10,879	99.0%	7,325	24,298
	Oct-Dec 08	1,665	1,706	-42	-357	-2.5%	-21.4%	9,750	6,559	67.3%	6,612	23,082
	Year 2008	8,170	8,288	-117	-971	-1.4%	-11.9%	41,994	29,928	71.3%	29,000	24,635
	Jan-Mar 09	1,359	1,482	-123	-90	-9.0%	-6.6%	8,870	5,541	62.5%	5,748	22,133
	Apr-Jun 09	1,546	1,665	-119	-132	-7.7%	-8.6%	9,584	7,055	73.6%	6,850	18,676
Ryanair YE 31/03	Jul-Sep 07	1,229	795	434	384	35.3%	31.2%			86.0%	13,952	
	Oct-Dec 07	824	760	64	68	7.7%	8.3%					
	Jan-Mar 08	859	792	67	-85	7.8%	-9.9%					
	Year 2007/08	3,846	3,070	777	554	20.2%	14.4%			82.0%	50,900	
	Apr-Jun 08	1,215	1,202	13	-141	1.0%	-11.6%			81.0%	15,000	
	Jul-Sep 08	1,555	1,250	305	280	19.6%	18.0%			88.0%	16,600	
	Oct-Dec 08	798	942	-144	-157	-18.0%	-19.7%			71.3%	12,400	6,298
	Jan-Mar 09	623	592	31	-223	5.0%	-35.8%			74.6%	14,500	
	Year 2008/09	4,191	3,986	205	-241	4.9%	-5.7%			81.0%	58,500	
	Apr-Jun 09	1,055	844	211	168	20.0%	15.9%			83.0%	16,600	
easyJet YE 30/09	Year 2005/06	2,917	2,705	212	170	7.3%	5.8%	37,088	31,621	84.8%	33,000	4,859
	Oct 06-Mar 07	1,411	1,333	-47	-25	-3.3%	-1.8%	19,108	15,790	81.2%	16,400	
	Year 2006/07	3,679	3,069	610	311	16.6%	8.5%	43,501	36,976	83.7%	37,200	5,674
	Oct 07-Mar 08	1,795	1,772	22	-87	1.2%	-4.8%	23,442	19,300	82.3%	18,900	
	Apr-Sep 08	2,867	2,710	157	251	5.5%	8.7%	32,245	28,390	88.0%	24,800	
	Oct 08-Mar 09	1,557	1,731	-174	-130	-11.2%	-8.3%	24,754	21,017	84.9%	19,400	
	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.

Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
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.

Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
ANA YE 31/03	Year 2004/05	12,024	11,301	723	251	6.0%	2.1%	85,838	55,807	65.0%	48,860	29,098
	Year 2005/06	12,040	11,259	781	235	6.5%	2.0%	86,933	58,949	67.8%	49,920	30,322
	Year 2006/07	12,763	11,973	790	280	6.2%	2.2%	85,728	58,456	68.2%	49,500	32,460
	Year 2007/08	13,063	12,322	740	563	5.7%	4.3%	90,936	61,219	67.3%	50,384	
	Year 2008/09	13,925	13,849	75	-42	0.5%	-0.3%	87,127	56,957	65.4%	47,185	
Cathay Pacific YE 31/12	Jan-Jun 06	3,473	3,201	272	225	7.8%	6.5%	43,814	34,657	79.1%	8,144	
	Year 2006	7,824	7,274	550	526	7.0%	6.7%	89,117	71,171	79.9%	16,730	
	Jan-Jun 07	4,440	4,031	409	341	9.2%	7.7%	49,836	38,938	79.6%	8,474	19,207
	Year 2007	9,661	8,670	991	900	10.3%	9.3%	102,462	81,101	79.8%	23,250	19,840
	Jan-Jun 08	5,443	5,461	-18	-71	-0.3%	-1.3%	56,949	45,559	80.0%	12,463	
	Year 2008	11,119	12,138	-1,018	-1,070	-9.2%	-9.6%	115,478	90,975	78.8%	24,959	18,718
	Jan-Jun 09	3,988	3,725	263	119	6.6%	3.0%	55,750	43,758	78.5%	11,938	18,800
JAL YE 31/03	Year 2004/05	19,905	19,381	524	281	2.6%	1.4%	151,902	102,354	67.4%	59,448	53,962
	Year 2005/06	19,346	19,582	-236	-416	-1.2%	-2.2%	148,591	100,345	67.5%	58,040	53,010
	Year 2006/07	19,723	19,527	196	-139	1.0%	-0.7%	139,851	95,786	68.5%	57,510	
	Year 2007/08	19,583	18,793	790	148	4.0%	0.8%	134,214	92,173	68.7%	55,273	
	Year 2008/09	19,512	20,020	-508	-632	-2.6%	-3.2%	128,744	83,487	64.8%	52,858	
Korean Air YE 31/12	Year 2004	6,332	5,994	338	414	5.3%	6.5%	64,533	45,879	71.1%	21,280	14,994
	Year 2005	7,439	7,016	423	198	5.7%	2.7%	66,658	49,046	71.4%	21,710	17,573
	Year 2006	8,498	7,975	523	363	6.2%	4.3%	71,895	52,178	72.6%	22,140	16,623
	Year 2007	9,496	8,809	687	12	7.2%	0.1%	76,181	55,354	72.7%	22,830	16,825
	Year 2008	9,498	9,590	-92	-1,821	-1.0%	-19.2%	77,139	55,054	72.7%		
Malaysian YE 31/03	Year 2003/04	3,061	3,012	49	86	1.6%	2.8%	55,692	37,659	67.6%		20,789
	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 YE 30/6	Year 2005/06	10,186	8,711	1,475	542	14.5%	5.3%	118,070	90,899	77.0%	34,080	34,832
	Jul-Dec 06	6,099	5,588	511	283	8.4%	4.6%	61,272	49,160	80.2%	18,538	33,725
	Year 2006/07	11,975	11,106	869	568	7.3%	4.7%	122,119	97,622	79.9%	36,450	34,267
	Jul-Dec 07	7,061	6,323	738	537	10.5%	7.6%	63,627	52,261	82.1%	19,783	33,342
	Year 2007/08	14,515	13,283	1,232	869	8.5%	6.0%	127,019	102,466	80.7%	38,621	33,670
	Jul-Dec 08	6,755	6,521	234	184	3.5%	2.7%	63,853	50,889	79.7%	19,639	34,110
	Year 2008/09	10,855	10,733	152	92	1.4%	0.8%	124,595	99,176	79.6%	38,348	33,966
Singapore YE 31/03	Year 2004/05	7,276	6,455	821	841	11.3%	11.6%	104,662	77,594	74.1%	15,944	13,572
	Year 2005/06	6,201	5,809	392	449	6.3%	7.2%	109,484	82,742	75.6%	17,000	13,729
	Year 2006/07	9,555	8,688	866	1,403	9.1%	14.7%	112,544	89,149	79.2%	18,346	13,847
	Year 2007/08	10,831	9,390	1,441	1,449	13.3%	13.4%	113,919	91,485	80.3%	19,120	14,071
	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 YE 31/12	Year 2004	4,050	3,508	542	288	13.4%	7.1%	64,894	46,644	71.9%	24,500	29,133
	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 YE 31/12	Year 2004	2,897	2,787	110	19	3.8%	0.7%	53,769	37,196	69.2%	28,210	18,221
	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 YE 31/12	Year 2004	2,584	2,524	60	39	2.3%	1.5%	41,599	27,581	66.3%	17,710	20,817
	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 YE 31/12	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	
	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.

Aviation Strategy

Databases

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
Aug 09	29.0	22.0	75.6	22.3	19.9	89.0	16.0	13.6	85.2	55.5	47.6	85.8	83.8	69.3	82.7
Ann. change	-5.8%	-3.6%	1.8	-5.4%	-2.8%	2.3	-4.8%	-2.4%	2.1	-3.1%	-2.0%	0.9	-2.9%	-1.8%	0.9
Jan-Aug 09	218.1	148.3	68.0	155.8	126.5	81.2	122.0	96.5	79.1	407.8	326.2	80.0	616.7	469.6	76.2
Ann. change	-5.9%	-7.0%	-0.8	-6.4%	-6.9%	-0.4	-4.9%	-7.1%	-1.9	-4.5%	-5.9%	-1.3	-3.9%	-5.5%	-1.3

Source: AEA.

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	11 Sep	India Navy	8 x 737-800s	
	28 Aug	Turkmenistan Airlines	3 x 737-700s	
	12 Aug	Westjet	14 x 737-700s	
Airbus	25 Sep	MNG Airlines Cargo	2 x A330-200Fs	
	18 Aug	Turkish Airlines	7 x A330-300s	

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

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