Aviation Strategy

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British Airways/Iberia: Quest for synergies

Last month British Airways held its annual Investor Day – unusually at the same time as publishing its annual results. With memories of volcanic ash hanging in the atmosphere over Heathrow and under the cloud of industrial action by one of the cabin crew unions the announcement that the company had achieved a slightly better than expected net loss of only £425m for the year to March 2010 (against a net loss of £358m in the previous year) may have been relatively good news. The main focus of the day however was on the two strategic developments that BA hopes to effect this year to put it once again in a comparatively competitive position with long term rivals Air France-KLM and Lufthansa: the planned merger with Iberia; and the likelihood of finally achieving Anti Trust Immunity (ATI) with long term partner American on the Atlantic.

BA + IB = IAG + ?

In December's issue of *Aviation Strategy* we highlighted the strategic and organisational elements of the proposed merger. Following the formal signing of the agreement between the two in April, little has changed from our exposition then, save that the two have decided on the name of “International Airlines Group” as the controlling entity (slightly more imaginative than the original TopCo). Having been leapfrogged by its main competitors' strategic moves in recent years, this deal will put the combined group in position as the fifth largest global airline group by revenues – albeit still some two thirds the size of Air France-KLM or Lufthansa and a little way behind the new United and Continental combine and Delta after its absorption of Northwest. The two networks are basically complementary: BA's strength on the North

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Atlantic, being based at the prime European gateway to North America at Heathrow; Iberia's strength in the Latin markets in South and Central America with flows over Madrid Barajas.

The company made the usual expected statements, reiterating its comments made at the end of last year; the deal would

- give them a strong strategic position in the global airline sector
- provide complementary networks and hubs
- provide enhanced customer benefits
- maintain existing leading brands
- generate significant synergy savings (estimated at €400m annually by the fifth year – an estimate unchanged in the past six months)
- encompass effective governance and management

Synergies

In the two years of negotiations the two have had a little more time than usual to work out the potential synergistic benefits of the merger – and have at least had the opportunity to benchmark their operations against the results particularly, presumably, of the Air France-KLM merger in 2003. They estimate that by the end of five years they should be able to generate an annual run-rate of benefits approaching €400m – or 2% of revenues – incremental to that already achieved through the long standing UK-Spain JV and oneworld alliance coordination. Of this total around one third, €150m (less than 1% of combined revenues), would come from revenue enhancements, and of this 78% from passenger revenue improvements; the remainder from cost savings.

Is this realistic? In comparison with the gains achieved by Air France and KLM the revenue estimates may appear conservative – their revenue synergies are currently possibly running at over 3.5% of combined revenues, some 50% higher than their own estimates at the time of the merger. Despite this, Air France/KLM's operating loss for 2009/10 was €1.3bn, a -6.1% margin on revenue, compared to British Airways' -2.9%.

No doubt in the analysis of synergy calculations BA and Iberia (or their consultants) relied heavily on the benefits of examples of multiple hub operations in Europe at AF-KL through CDG and Amsterdam, or the slightly less visible example of Lufthansa/SWISS through Frankfurt, Munich and Zurich: the ability to redirect traffic, coordinate schedules to widen market attractiveness, and offer joint fare structures (what used to be known as interlining?).

There is one major difference of course – both KLM and Air France relied heavily on their hub operations and were competing aggressively for the same transfer traffic; their hubs being only 400km apart. Air France had used the capacity available through the four runways at Roissy CDG to grow into the cost savings it needed a decade ago through developing a strong wave system in order to create an attractive transfer hub to add to its relatively strong O&D markets into and out of Paris (being the only other destination in Europe after London with a good sized catchment area to generate good levels of point-to-point demand). KLM in contrast, lacking the strength of good point-to-point demand into and out of Amsterdam had grown through the regulated era from creating and relying on the network transfer capability provided through sixth freedom operations.

In contrast British Airways is based at a severely constrained airport. It does have the advantage of being at the best O&D market in Europe – and the principal European gateway to North America - and has spent the last decade concentrating more on the higher yielding point-to-point demand and premium transfer traffic while de-emphasising Economy transfers; although there is a significant amount of transfer traffic through Heathrow, and the company can switch its sales focus relatively easily - as it has done in the last two years (helped importantly by its move into the new Terminal 5).

Iberia also had a relatively constrained airport until the opening of the two new runways and fourth terminal in 2006; and while concentrating on its natural "niche"

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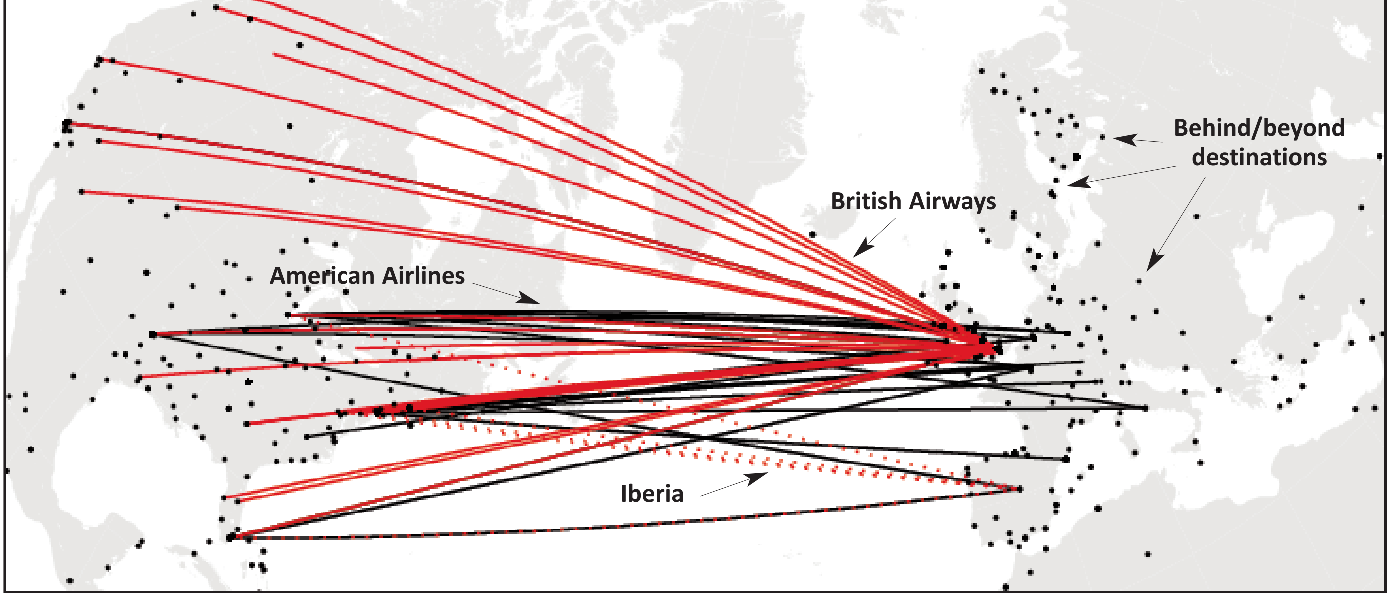
BRITISH AIRWAYS, AMERICAN AIRLINES AND IBERIA TRANSATLANTIC ROUTES



into the Latin American markets (with relatively strong point to point demand) has only since then really been able to develop Barajas as a transfer hub. There is also very little overlap in the respective route networks: of the 100 long haul destinations served in 2009 they only have twelve (or 12%) in common. This compares with a 33% duplication for Air France and KLM in 2003 of their then 102 long haul destinations (and a near 60% duplication on Asia/Pacific routes); intriguingly, by 2009, Air France and KLM had rationalised their offerings by hub so that this overlap had been reduced to nearer 24% overall (and 35% on the Far East).

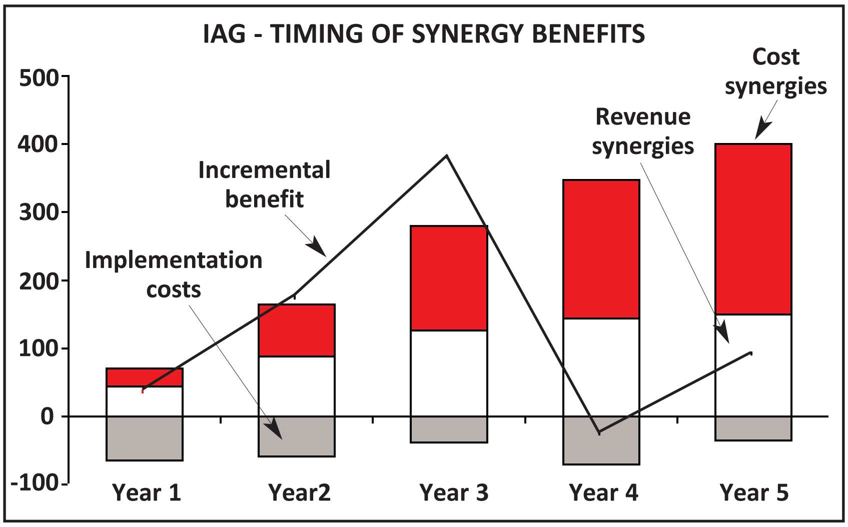
So perhaps this consolidation move is unusual in Europe – it may be that it bring together more opportunities for access into new markets for each carrier than the competition that it removes; although there are natural reasons for the existence of the relative lack of destination overlap – consider the world map had the 1588 Spanish attempt to topple an undesirable heretical regime succeeded. For BA in particular – now with the likelihood of any further runway capacity expansion scotched at Heathrow for the foreseeable future (even though there may now be increasing pressure to move to mixed-mode runway usage to get some increase in capacity of the two runways) – there may be some rationale in expecting that Madrid could provide long run growth potential; one of the corollaries following on from the long term constraints at Heathrow may well be an increasing and perhaps accelerating shift away from short haul European operations and a gradual dismantling of the hub system.

The main passenger revenue benefits are expected to come from:

• **Combining point of sale strength** Apart from the natural positions in their home markets, British Airways' strengths lie particularly in North America and Iberia's in Latin America. Combining sales activities in either region is expected to generate enhanced market access. Where neither are

IAG ROUTE OVERLAP – NUMBER OF DESTINATIONS SERVED 2009

Region	Unique to BA	Unique to IB	Jointly served
Asia/Pacific	15	0	0
C. America/Caribbean	12	7	1
Europe	40	46	45
Middle East	8	0	1
North America	19	0	5
Northern Africa	3	4	2
South America	0	8	3
Sub-Sahara Africa	17	2	2



strong (such as France and Germany) it may be possible, as they claim, to create a credible alternative to the home carrier.

• **Cross-selling to each other's customer base** As distribution moves increasingly to own-site on-line internet booking the ability and incentive to present the other's schedules should be incrementally beneficial. At the same time the ability to combine corporate accounts and account management should help redirect new forms of “captive” demand.

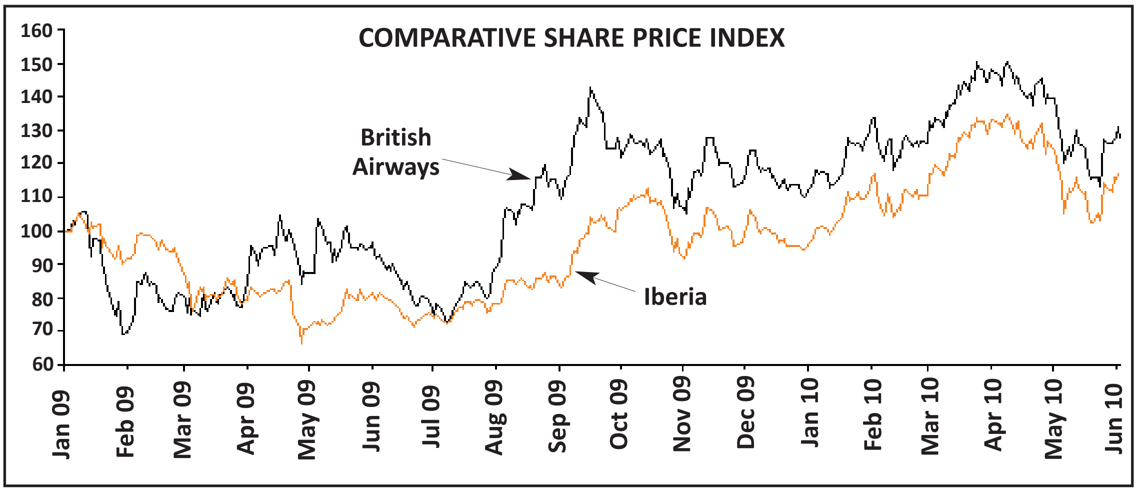
• **Increased connectivity and optimised scheduling** The alignment of schedules to optimise spread of flight timings naturally should increase attraction of demand flows. At the same time there may be opportunities to use the double hub to improve customer choice and flexibility – an example given was that there could be a mere 2% difference in trip timing for a flight from Rome to New York via Madrid compared with one through London (even though the premium passenger would probably want to fly direct - perhaps even on American?).

• **Best practice in revenue management and selling processes** Undoubtably the group will aim to move the revenue and capacity management systems to a core group back office function – the integration of IT systems will no doubt take time – and there should be some reasonable opportunities to align pricing, inventory management, revenue integrity, corporate and agency dealings and direct channels.

• **Enhanced FFP proposition** The combined 10m membership of BA's Executive Club and Iberia's Iberia Plus frequent flyer plans fall well short of the those of either Air France-KLM's 13m Flying Blue or Lufthansa's 15m Miles & More members – although there are a further 11m signed up to BA's UK-based Airmiles programme. As the FFPs move increasingly towards ancillary revenue generation programme membership size becomes increasingly important. In addition the attractiveness to the members should increase as the earn-and-burn potential on either carrier becomes more transparent.

By far the lion's share of anticipated synergy benefits come from cost savings – but as usual it may be that they will take longer to achieve (and cost more to implement) than the anticipated revenue benefits. The group expects that almost a third (€70m) will come from IT integration: joint procurement of hardware and maintenance; elimination of duplication of infrastructure and development projects; move to common business processes and single best applications for key functions; and reduction of IT overhead through common IT strategy, simplification of processes and administrative tasks.

This may be somewhat more advanced thinking than that approached by AF-KL in 2004 (when both were concentrating on their independent post 2001 cost savings programmes) – but also probably one of the more difficult to implement well. The next largest element is expected to come from maintenance. There is at least some element of fleet commonality and there should be the opportunity for joint inventory control giving significant reductions in working capital requirements. At the same time benefits are expected to accrue from the sharing of best practices; coordination of engineering, planning and control better to absorb fixed costs; joint procurement of materials and components; and optimisation of common capabilities. A new group corporate centre is planned in order to take on the duplicated common back office functions – such as finance and commercial activities. Increase in size usually brings



improvement in supplier bargaining power and the two expect to generate some €28m from savings in data and distribution costs, flight related costs such as on-board services, catering, HOTAC expenses; fuel purchasing at joint stations; aircraft insurance costs. Other costs synergies are anticipated from the integration of operations at common out stations – particularly sales and call centres, ground handling and ground operations, CIP lounges (what they have not yet done under oneworld?) - as well as coordination of cargo operations, handling and trucking contracts. Longer term there could be significant benefits from fleet acquisition and combination of the fleet renewal plans.

The merger agreement may have been signed but there is still quite some time before it is delivered. BA has to come to an agreement with its pension trustees over the deficit – with a deadline for the end of June – and Iberia still has an option to withdraw (on the basis of the pension) until the end of September. The regulatory approval process is likely to continue to the end of September, and on the basis that Brussels will not impose unbearable restrictions (and so far the only deal that the EU has meaningfully blocked was Ryanair's attempted acquisition of Aer Lingus) shareholders' meetings to approve the merger are anticipated for November with a planned completion date in December. This deal has been long in gestation – some at British Airways have been working on it for the past eighteen years – but by the emergence of 2011 the new International Airlines Group SA should be a reality. It is ever a danger signal for a company, let alone an airline, to change its corporate name – witness United's attempt to emerge as Allegis in the 1980s or Swissair's attempt to reinvent itself as SAirGoup – but this one may well be a pattern for survival and growth, and one as a base for further cross border deals to foster the long held dreams of consolidation in the industry.

ATI+BA+IB+AA=?

The second plank of strategic developments highlighted at last month's Investor Day was a discussion of the long-awaited transatlantic joint venture. On the basis that Anti Trust Immunity will be granted at the end of July – tentative approval was granted by the US DoT in February subject to the modest disposal of four slot pairs at Heathrow (which the group will no doubt recover quite quickly) – British Airways,

COST SYNERGY BREAKDOWN

	€m	%
IT	70	28%
Maintenance	58	23%
Corporate Centre	35	14%
Purchasing	28	11%
Fleet	18	7%
Sales	15	6%
Other	25	10%
TOTAL	250	100%

COMBINED FLEET

	In Service BA	In Service IB	On Order BA	On Order IB	On Option BA	On Option IB
A318	2					
A319	33	23		1		
A320	39	36	11	9	31	63
A321	11	19				
A340		33		1		2
A380	-		12		7	
B737	19					
B747	49					
B747-F	3					
B757	8					
B767	21					
B777	46		4		4	
B787	0		24		28	
Avro RJ	3					
Emb 170/190	9		2		18	
Total	**243**	**111**	**53**	**11**	**88**	**65**

Iberia, American (along with Finnair and Royal Jordanian as members of the oneworld alliance) will finally be able to coordinate on the Atlantic (AA already had been able to coordinate with Finnair under existing ATI agreements). The group plans to move quickly to a full contractual “Joint Business” covering all services between North America/Mexico and Europe, with deeper coordination on beyond and behind routings. BA and American have argued that they have been competitively disadvantaged by the inability to combine forces in face of the ATI granted to the other major European players – and particularly in light of the creation of the four-way joint venture by Air France, KLM Delta (and Northwest) established in 2008 and the expanded Star Alliance ATI in 2009 – and have been trying to gain approval with minimal concessions on and off since 1997. Of course it was the final dismantling of “Fortress Heathrow” - or at least the raising of the portcullis from EU-US open skies two years ago – that allowed the DoT to reconsider in their favour.

Since the opening of the skies over Heathrow, BA has seen a shift of competitor action from London Gatwick into its home base, and the oneworld share (aka BA and AA services) of Heathrow-US capacity decline from 61% to 58% in the period. Between Summer 2007 and Summer 2009, the number of daily services between Heathrow and the US has grown by 15% overall – with a 33% jump in services from operators other than BA or American (who combined increased serviced by 6%): equivalent to the growth in the number of operators on the route, as Continental, USAir, Delta and Northwest have gained access (mostly through acquiring or leasing slots at vast expense from their alliance partners). This has changed the competitive landscape sufficiently perhaps to allow the regulators to accept the BA-AA arguments in favour of greater coordination.

The deal is described as a contractual joint venture and referred to as a “Joint Business”. The initial deal is for ten years with declining penalties over time for withdrawal. It is apparently a capacity-based revenue share agreement (rather than a full profit share agreement as with the AF-DL agreement, or BA's agreement with Qantas on the Kangaroo route) with some excessively complicated agreements for the share of capacity, relative capacity growth and allocation of revenues. Total revenues for the join operations are estimated at $7bn (£7bn or €7bn?) and account for a third of BA's total revenues, while accounting for some 20% of the Europe-US market. As with the other two joint ventures on the Atlantic the principles involve:

- Metal neutrality – who cares (apart from the customer) what flag is painted on the tail?
- Balanced growth – we can't upset the exacting unions can we?
- Coordination of key functions – sales, marketing, scheduling and pricing. Neither unions nor passengers will see this – although potential passengers may be glad to see more schedule choices on the website booking engine, while ruing (without knowing) the restrictions on pricing that consolidation should bring.
- Expanded code sharing. 100 transatlantic daily flights, 500 destinations daily in 100 countries, an extensive network developed through the key base hubs of Heathrow, Gatwick, Madrid, New York, Miami, Dallas and Chicago. Departure boards working overtime?
- Customer benefits from an expanded network and enhanced service offerings. But

perhaps customer confusion from product differences – seat pitch, on-board F&B charges, blanket colours?

Alliance hopes

Intriguingly, the preliminary approval from the DoT in February may have been significantly positive for the future existence of the oneworld alliance: JAL, in the process of administration, was debating whether to switch alliance partners (which would have destroyed the strategic entry into North Asia) and being actively courted by Delta to join SkyTeam. American successfully put up a strong fight to retain the Japanese flag carrier – and under the potential of the impending open skies agreement between Japan and the USA should now be able to achieve ATI on the Pacific and create a similar joint venture agreement for traffic between North America and Asia. As with Air France-KLM and KLM's long standing JV with Northwest, BA can claim significant experience from its decade-long agreement with Qantas on the Kangaroo route, and bring this experience to bear. With ATI it will no doubt be able to share the experience with its North American partner.

One of the key elements of the JV on the Atlantic will be the hub coordination between the networks. At Heathrow the oneworld operations will be concentrated on a combination of Terminals 5 (BA only) and Terminal 3 (BA “not so important” + partners). The new T5C satellite (geographically situated between T5 and T3) should open next year along with a baggage transfer tunnel to facilitate network transfers between T5 and T3.

In New York, where American appears to be driving significant growth at Kennedy to compete against Delta's expansion there (and Continental's at Newark) there is the potential for BA and IB to co-locate at Terminal 8 – with BA relinquishing its long held terminal 7 at JFK (which it still shares with United after the abortive 1988 link) – to create a single oneworld terminal operation, seamless transfer proposition and “leading edge” lounge and premium services. They also say that they should be able to “adopt the very best of (LHR)T5 at JFK”. In the longer term – something not mentioned by the other alliances (yet at least) – is the opportunity for further “optimisation”: selective common procurement (aircraft, fuel, airport charges, GDS and credit card fees); lower per passenger costs through use of larger aircraft on major routes; harmonisation of product; extended collaboration to “include best practices across the groups”.

The hope naturally is to be able to generate combined improved earnings – but not having ATI has precluded them from yet being able to give any hard numbers of the potential. As with all these joint ventures however it will be exceedingly difficult to see in the published figures where the real financial benefits lie – as by their very nature there will only appear a balancing cash movement in the accounts. It may well be that having the three major alliance groupings operating joint ventures on the Atlantic and controlling in excess of 60% of the market will remove sufficient competition to allow each to improve returns; it may be that with all three operating in a “level playing field” that it becomes a zero sum game. In any case, these joint ventures are a poor substitute for full capital mergers – but in the absence of any real political willingness to abandon ownership restrictions it is the only game in town.

US airlines: Optimism about 2010 profits

As the US airline industry heads into the peak summer travel season, all the indicators point to the sector returning to solid profitability in 2010. What are the key trends facilitating financial recovery? This year will also see some international growth as the US legacies and their global partners seek to strengthen their presence in high-growth markets. Where do the expansion efforts focus?

As of early June, all the key trends are positive for US airlines. Except for a dip in April due to the volcanic ash-related closures of European airspace, air travel demand has been rebounding steadily. Business travellers are returning. Capacity remains extremely tight. As a result, load factors are at record levels and the industry is regaining some pricing power.

The latest revenue trends are encouraging. Continental's consolidated RASM surged by 23-24% in May, far exceeding expectations. US Airways, which reported 19% RASM growth for the month, described the revenue environment as "robust, with continued strength in close-in bookings and overall yields".

The airlines are also benefiting from lower fuel prices. The past month's jitters about the global economy have resulted in crude oil prices falling from over $80 per barrel to the $70-75 range.

US legacies may not suffer any ill-effects from the sovereign-debt crisis in Europe because of their relatively limited exposure to the transatlantic market (12-24% of system revenue) and predominance of the US point of sale (75%). A recent report from JP Morgan noted that the "increased affordability of Europe may actually cause total demand for US legacies to rise, while the opposite may occur to their European peers". Of course, should the crisis seriously hurt European banks and hence transatlantic travel by the financial services sector, the impact would likely be felt by US operators.

US airlines continue to benefit from incremental revenue streams. New bag and other fees and a la carte activities are boosting industry revenues by an estimated $4-5bn this year.

On the domestic front, the biggest positive is that LCCs are maintaining capacity discipline. Southwest has stopped growing for the first time in its history.

And, as an unexpected bonus, more industry consolidation is under way in the form of a proposed United-Continental merger, which can only help keep a lid on industry capacity in the longer term.

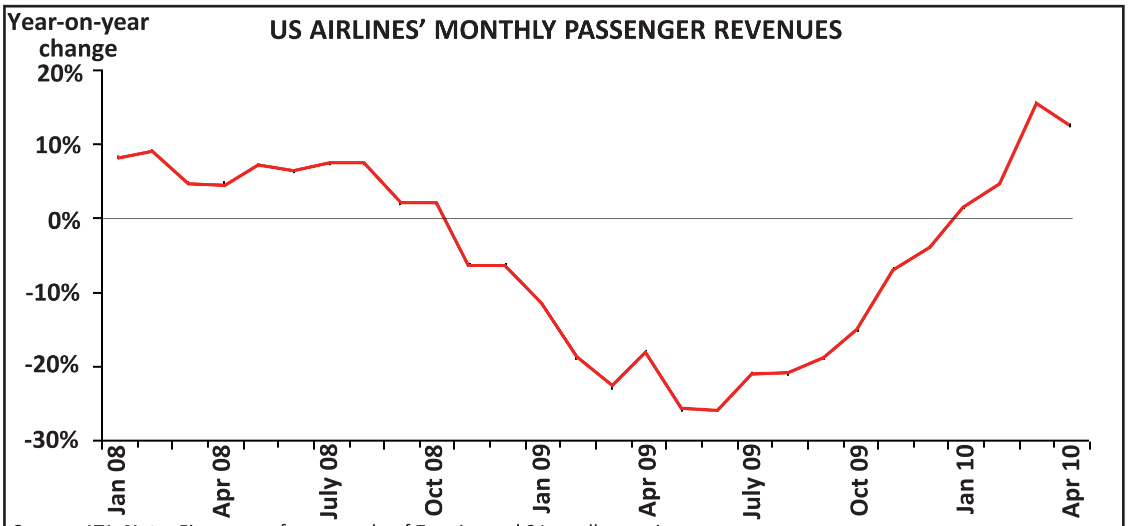
Back to profitability

As a result of all those positives, US airlines are poised for what JP Morgan analysts call a "multi-year profit run". In recent months the consensus estimate has been an industry operating profit of around $9bn in 2010 and $10-11bn in 2011, but those figures are likely to go up in the coming weeks as the forecasts are revised for the lower fuel prices.

On May 25 JP Morgan raised its 2011 industry operating profit forecast to an all-time record $13.4bn, reflecting $5.5bn in annualised savings from lower fuel prices and slightly softer revenue (2011 GDP growth falling from 3% to 2%). The analysts noted that improvement in 2010 was not as material, because the changes affect largely the second half of the year and near-term fuel hedges diminish some of the benefit.

As of early June, all of the US carriers except American were expected to be profitable in 2010. American is mainly suffering the consequences of avoiding Chapter 11 in the last decade (high labour costs).

With no significant aircraft deliveries scheduled in the near-term, US airlines could generate significant free cash flow in the next couple of years. This would enable them to modestly pay down debt, facilitating a gradual improvement in credit ratings (these processes are already under way).



Source: ATA **Note:** Figures are for a sample of 7 major and 21 smaller carriers.

As a result of last autumn's significant liquidity-raising (see *Aviation Strategy* October 2009), US legacies' cash reserves are at an all-time high, with unrestricted liquidity in some cases even exceeding 25% of annual revenues.

Of course, there are tough longer-term challenges, including significant labour cost pressures now that virtually all of the past decade's concessionary contracts are open. US airlines will need more than a couple of profitable years to repair their balance sheets. They are a long way from earning acceptable returns on capital.

Manageable fuel prices

In mid-to-late April, when the price of crude oil was approaching the mid-80s, it looked like fuel prices could impede airline recovery. But fears about Europe's fiscal woes and the global economy sent the price of crude tumbling by 20% during May, to the $70-level (as of early June). This is significantly below the mid-2008 peaks though much higher than the low points in early 2009.

Perhaps the biggest positive is that there is now an even greater sense than before that oil prices have reached relative stability. Insofar as it affects oil prices, the European fiscal crisis will not be solved anytime soon. Crude oil seems certain to stay in the below-$100 range, which US airlines regard as manageable these days.

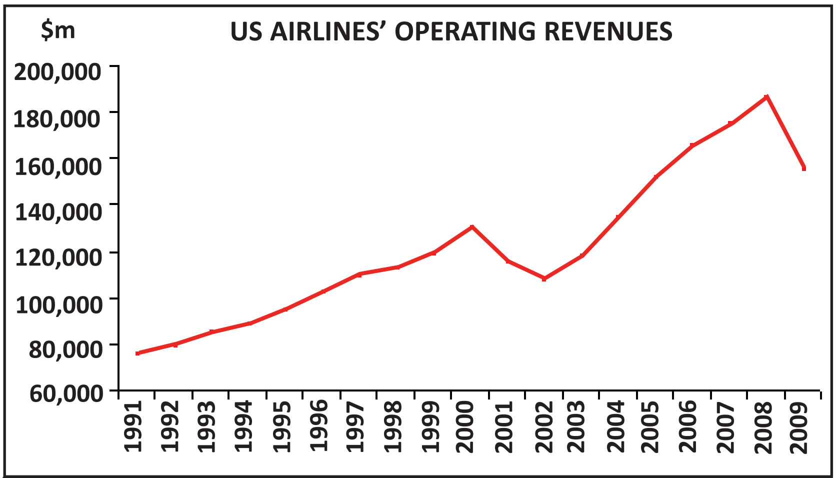
A recent communiqué from IATA suggested that oil prices are unlikely to break out of the $80-100 per-barrel range, because ample inventories would outweigh any resurgence in economic optimism.

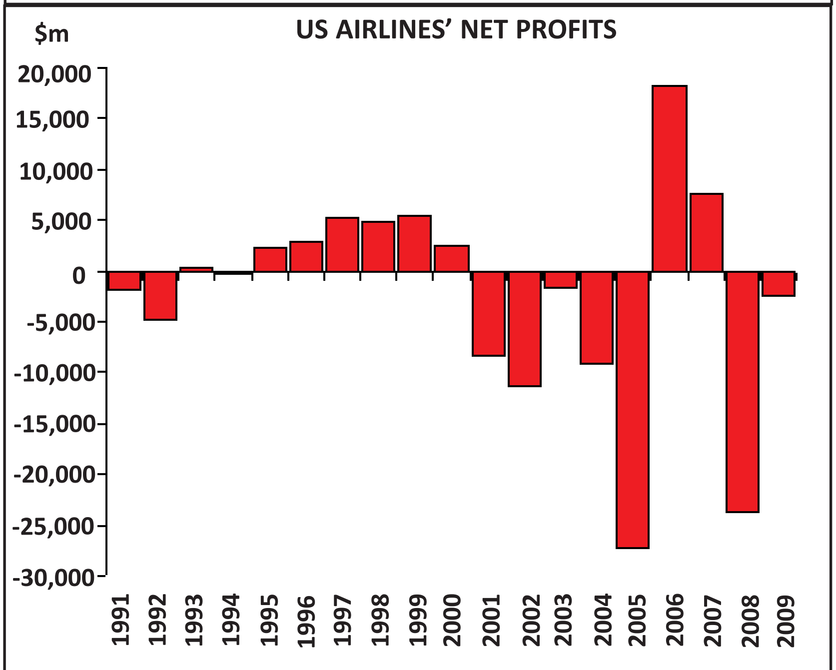
US airlines also currently benefit from reasonable fuel hedge positions. Their hedges cover 25-50% of their 2010 fuel needs and lesser portions of their 2011 needs, providing protection at oil prices somewhat above current levels. A notable exception is US Airways, which has no hedges in place.

Demand and revenue recovery

While US economic signals continue to be mixed – or basically suggest a long, slow road to recovery – there is little doubt that US airlines' traffic, yields and unit revenues are recovering strongly from the extremely depressed 2009 levels. In recent months demand has been picking up across the board, including business and international traffic.

US airlines' monthly passenger revenues turned positive in January, after 14 months of decline, as the average fare per mile inched up by 0.6% - the first increase since November 2008. Since then the trends have improved sharply. In March passenger revenues were up by 15.4% and ticket prices by 11.7%. April passenger revenues (up 12.5%) were negatively impacted by the volcanic ash-related cancella-





Source: *ATA*
Note: The figures are for all US passenger and cargo airlines and include bankruptcy/restructuring and other special charges

tions, but international passenger revenues still rose by 15%, helped by a 37% surge in transpacific markets.

This year's monthly revenue and RASM figures have benefited from progressively easier year-on-year comparisons, but a recent analysis by S&P, which compared the latest data to the average for the same month of the previous three years, found that the RASM upturn is real.

The spectacular 18-24% RASM surges reported by several carriers for May reflected not just easy comparisons but recovery of business traffic, higher than expected fares and surcharges introduced for peak travel days.

In their first-quarter earnings calls, the US carriers reported surges in corporate contract revenues as high as 30-50% in March and April. But the levels were still well below 2008's. With many companies clearly remaining nervous about spending in light of economic uncertainty, there is a long way to go to full recovery to pre-recession levels (if it ever happens).

New revenue streams

In the spring and summer of 2008 the US legacies moved en masse to increase existing ticketing, change and excess-baggage fees, create new revenue streams by charging for a la carte service such as checked bags and introduce new travel enhancement products such as cabin upgrades. These activities have only limited associated costs, are not particularly sensitive to the economy (rather, they are correlated to load factors) and are turning out to be a lucrative revenue source.

At United, ancillary revenues added up to more than $14 per passenger in the March quarter and more than offset a reduction in third-party maintenance work. At JetBlue, ancillary revenues were $18 per passenger, compared to an average fare of $142.

Continental, the last US legacy to serve free meals in economy class on longer domestic flights, is now falling in line with the rest of the industry: the airline will start charging for meals on many North American and some Latin American routes this autumn. The move is expected to save $35m annually, assuming that the food sales simply break even.

In March Continental also began offering economy class passengers the option to purchase roomier exit-row seats for a fee. This is not a branded product like United's EconomyPlus but merely a quick way to generate extra revenues.

Most of the US airlines are working to offer additional unbundled products and services in the future. JetBlue, in particular, has promising prospects in this area because of the unique opportunities offered by its new Sabre platform when it is fully developed.

Southwest is benefiting enormously from the premium-type products introduced since late 2007. In the March quarter, its "other" revenues were up by 40% to $105m, which included a $21m contribution from the new "Business Select" product. As the largest domestic carrier, Southwest is uniquely well positioned to develop ancillary revenues and capitalise on southwest.com. The airline is working on enhancements to its FFP, web site and revenue management systems.

However, Southwest is sticking to what it calls a "no hidden fees" policy (meaning no fees on items that were previously included in the ticket price) and believes that it is gaining market share with its "Bags Fly Free" campaign. It is a lone holdout in the US in that respect. To reinforce the message this summer, 50 Southwest aircraft have been painted with the slogan "Free Bags Fly Here" on their fuselage, with an arrow pointing to the cargo bin.

At the opposite extreme, Spirit Airlines, which earned 21% of its total revenues from extra fees last year, has become the first US airline to decide to start charging for carry-on luggage. The privately held Florida-based LCC will charge up to $45 for a carry-on bag that is placed in the overhead bin from August. This move will be closely watched by the rest of the industry for any customer backlash, but some politicians feel that Spirit has crossed a line. The latest fees have prompted new legislative moves to protect customers, close tax loopholes and suchlike.

Continued capacity discipline

The massive domestic capacity cuts in 2008 and 2009 helped the US airline industry through the mid-2008 oil price surge and the 2009 recession and are now fuelling a strong recovery. The cuts have been all the more beneficial because the airlines succeeded in removing many of the associated costs – easier because the fleets included large numbers of older, fully-depreciated aircraft. In some instances, whole domestic fleet types were retired.

According to ATA, US carriers' scheduled domestic ASMs fell by 10.4% between 2007 and 2009, reaching a level that was below 1999's. It was the result of a sharp 14.5% contraction by the five largest network carriers and the main LCCs essentially keeping their capacity flat (Southwest's declined by 1.6%, JetBlue's and AirTran's was up by 2-3%). In the same two-year period, US carriers' international ASMs were roughly unchanged (up 4.5% in 2008 and down 4.8% in 2009).

Capacity growth is expected to remain extremely constrained this year and in 2011, which bodes well for the pricing environment and financial recovery. In 2010 domestic ASMs are likely to be flattish and international ASMs will see growth in the low-to-mid single digits.

However, 2010 will have two very different halves: industry capacity was still down in the first six months but begins to return in the second half of the year. According to a late-May ATA report, in the September quarter US airlines' ASMs per week will be up by 3.4% domestically and almost 6% internationally.

American's CEO Gerard Arpey made the point recently that US airlines are currently in a "wait and see" mode, trying to ascertain what the new level of demand is. American expects its mainline capacity to inch up by only 1% this year, including a slight domestic reduction and 3% growth internationally. Virtually all of the international growth will be made up of flying that was either cancelled due to H1N1 or deferred for economic reasons (Chicago-Beijing) last year.

American's fleet renewal programme is picking up speed; there are as many as 45 737-800s arriving this year. But the aircraft are for MD-80 replacement and will not add to capacity. The main impact will be the financial pain of having to fund $2.1bn capex this year.

Delta expects to fly essentially the same amount of capacity in 2010 as last year, even though it is reducing its fleet by 71 aircraft in an effort to rationalise following the merger with Northwest. The idea is to maintain last year's ASM level through increased utilisation. The airline has 15 deliveries scheduled for this year (including two 777LRs and 11 used MD-90s) and is retiring 36 mainline aircraft (DC-9s and 757s) and 50 regional aircraft.

The 787 orders inherited from Northwest are expected to be deferred or cancelled. While continuing to negotiate the matter with

Boeing, Delta has extended the leases of its 747-400s by typically five years (having secured significant lease rate reductions) and is going through the process of installing flatbeds and new seating to those aircraft. The management commented recently that with 180 trans-ocean aircraft and a fairly young average fleet age of 8-10 years, the airline is in good shape from the fleet perspective.

Despite having downsized more than the other legacies since 2007 (ASMs down 17.5%), United remains firmly committed to capacity discipline. Its mainline ASMs are expected to be flattish in 2010 (anywhere from a 1.1% reduction to 2.1% growth).

While United has very limited fixed obligations in the next few years, the airline recently finalised agreements for 25 787s and 25 A350XWBs (plus 50 purchase rights for each type), which will start arriving in 2016 to replace 747s and 767s. In late April, despite the impending merger announcement, United also said that it was still on track to finalise a narrowbody order by year-end, justifying it on a replacement basis and because it offered significant opportunity to down-gauge.

Continental, which in the past always grew a little faster than the other legacies, has finally fallen in line. After recently again trimming its 2010 ASM forecast, the airline now expects its domestic mainline ASMs to fall by 0.5-1.5% and international ASMs to increase by 2-3%. While 757-300 and 737NG deliveries continue, Continental is due to start receiving its 25 ordered 787s in August 2011.

US Airways is projecting 1% ASM growth in 2010, comprised of a 1-2% domestic reduction and 8-9% growth internationally. The airline has a much smaller international exposure than the other network carriers and therefore justifies the higher growth rate. However, some of this year's growth is restoration of Mexico service that was cancelled due to H1N1. Having received two A320s and two A330s in the first quarter, US Airways has no further aircraft deliveries scheduled until the third quarter of 2011. With the continued removal of older 737s and 757s, the airline's mainline fleet will actually contract by ten aircraft this year.

Most importantly, the main US LCCs have indicated that they will continue to keep capacity in check. They are more interested in margins than market share these days.

Having contracted by over 5% last year, Southwest is keeping its ASMs "roughly flat" in 2010, though there will be growth in the second-half following capacity declines in the early part of the year. The intention is to continue the same philosophy in 2011. CEO Gary Kelly noted recently that the company has not met its return on capital targets in a decade and is therefore going to "err on the side of caution". "Until we are comfortable that we are getting our profit targets, it makes no sense to grow the fleet."

However, Southwest will still be adding new destinations; it will simply cull or reduce service in less effective markets to keep overall capacity flat – a strategy that really helped revenue generation last year.

JetBlue has been criticised by some analysts for accelerating its ASM growth to 6-8% this year. But it will be opportunistic expansion in two targeted areas: Boston and the Caribbean; the rest of the network will still be flat.

AirTran has indicated that as long as macroeconomic conditions remain uncertain, its growth plans remain "conservative". In the first half of the year, ASMs were up by around 5%. There will be no aircraft deliveries until March 2011, and with only seven scheduled for 2011, next year's ASM growth could be only 3-4%.

Bolstering global presence

US carriers' international activities in 2010 have two broad themes: opportunistic expansion and, increasingly, preparing for or taking advantage of alliance relationships.

First, there are the special new high-growth markets such as China. After many delays, American finally launched a Chicago-Beijing service in late May, to complement its Shanghai flights that began in 2006 and to bolster Chicago's role as the airline's main gateway to Asia.

Delta, in turn, began Seattle-Beijing operations in early June, as part of its efforts to strengthen Seattle as its main West Coast gateway to Asia (with the help of codeshare partner Alaska). Delta's other new Asia service launches this summer have included Seattle-

Osaka, Detroit-Seoul and Detroit-Hong Kong.

Then there are the special opportunities such as the opening of Tokyo's Haneda Airport to more international flights when a fourth runway opens there in October 2010. In May the DOT tentatively awarded the four daily slot pairs that will be available to US airlines at Haneda this year, subject to the signing of the US-Japan open skies treaty. Delta was selected to serve Haneda from Detroit and Los Angeles, American from JFK and Hawaiian from Honolulu.

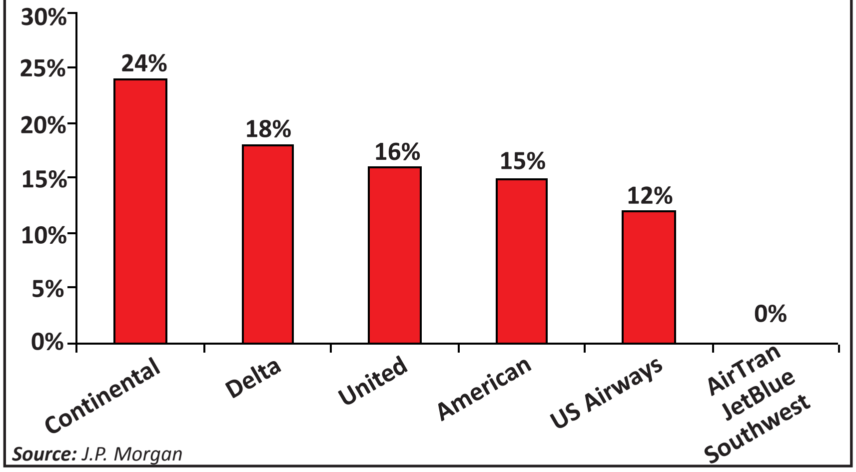
This was an important gain for Delta after it failed to win JAL as a partner earlier this year. But it also boosts Delta's already strong position as the largest US carrier to Asia. The DOT apparently especially liked its plans to fly 747s, which offer more seats and hence competition than the 777s and 767s proposed by the other airlines. United and Continental got left out, meaning that they will not be able to link to their partner ANA's extensive services at Haneda in the near term, but there will be more Haneda opportunities in future years.

The robust Latin America markets continue to be a major focus for US carriers. American began a New York-San Jose (Costa Rica) service in April. Delta plans Detroit-Sao Paulo flights from October and is looking to implement codesharing with Gol. Much of US Airways' international growth this year is due to a 20% increase in Latin American flying - mainly restoration of Mexico service and new service to Brazil. After launching Charlotte-Rio in December, US Airways hopes to gain access to Sao Paulo through a slot swap with Delta and plans to begin codesharing with the newest Star partner TAM.

The underserved but promising African markets have caught the attention of at least two US legacies. Delta, which has served Africa since late 2006, has just launched Atlanta-Accra flights and hopes to extend that service Monrovia in September. United has introduced Washington-Accra flights this month.

The North Atlantic market, which was hit hard in 2009, is also seeing some new US carrier activity this year. United added Chicago-Rome flights in May, after launching a rather creative Dulles-Madrid service with partner Aer Lingus in the first quarter (taking advantage of the EU-US open skies treaty). US Airways began Charlotte-Rome flights in May with A330-300s. After joining Star late last year, Continental has been busy building connectivity with its new alliance partners, among other things, by launching Newark-Munich flights and boosting Newark-Heathrow frequencies. Delta has announced plans to add flights between New York and the key European business markets from September.

US AIRLINES EXPOSURE TO EUROPE: TRANSATLANTIC REVENUES AS % OF SYSTEM REVENUE (2009)



Source: *J.P. Morgan*

Looking further ahead, Continental recently became the first airline in the world to specify a route to be operated by the 787: Houston-Auckland from November 2011 (subject to government approvals).

In addition, there has been much strategic positioning at home aimed at bolstering key hubs and international gateways. Examples include American's "cornerpost" strategy and new interline/ticketing partnership with JetBlue in New York and Boston (see April issue of *Aviation Strategy*), United's efforts to strengthen service at its Chicago and Los Angeles hubs, Delta's New York revamp/strengthening and new codeshare deal with WestJet, and the proposed Delta/US Airways slot/route rights swap.

In the coming months, some of the US legacies hope to be able to get busy implementing planned international JVs. American and BA are expecting final approvals from the DOT and EU on their planned transatlantic ATI and JV in mid-summer, while decisions on the American/JAL and United/Continental/ANA deals on the Pacific are expected in late 2010.

By Heini Nuutinen
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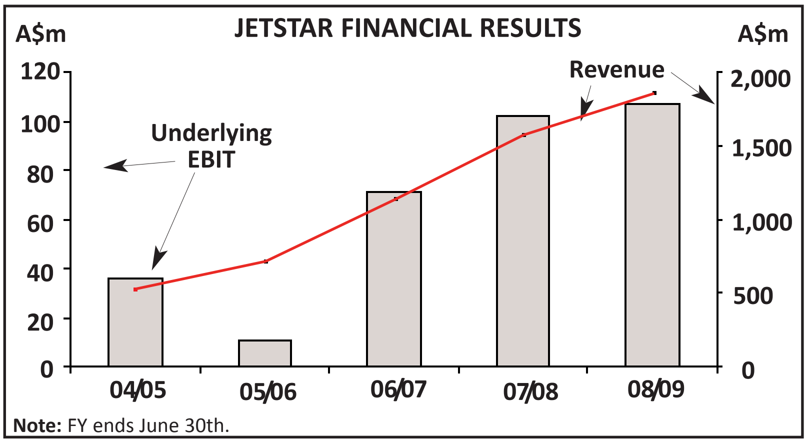
Jetstar: the growth part of Qantas' two-brand strategy

In the second part of a series on Asian LCCs, *Aviation Strategy* takes a look at Jetstar and Tiger Airways, both of which have ambitious expansion plans for the Asia/Pacific market.

In November 2003 Qantas bought domestic carrier Impulse Airlines and relaunched it in 2004 as a low cost, low fare subsidiary under the name Jetstar. International services started later that year and today the Melbourne-based Jetstar group has three separate airlines that operate 62 aircraft to approximately 30 destinations domestically in Australia and New Zealand, and internationally to 14 Asian destinations.

Jetstar (plus the Valuair airline/brand) is now controlled by a holding company called Newstar Investment, which is owned 49% by Qantas and 51% by Westbrook Investments, which is controlled by Singaporean businessman Choo Teck Wong.

In the first half of the 2009/10 financial year (the six month period to December 31st 2009), the Jetstar group (including the main Australian operation, a Singapore-based airline and a minority stake in a Vietnamese Jetstar) recorded revenue of A$1,131m (US$958m) - 18.1% up on H1 2008/09 - and "underlying EBIT" of A$121m (US$102.5m), compared with A$43m in July-December 2008.



Note: FY ends June 30th.

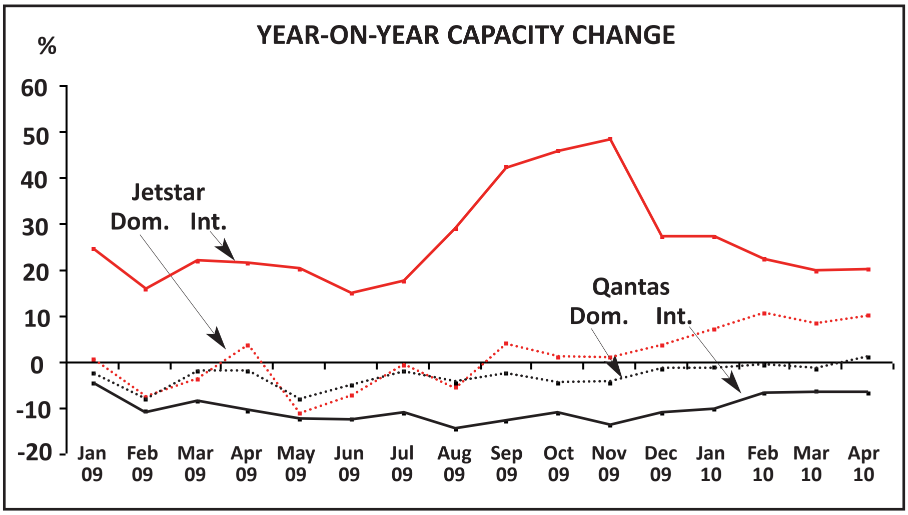
In the second half of 2009 Jetstar flew 4.3m passengers domestically in Australia, 2.7% up year-on-year, with a 3.3% rise in RPKs despite a 0.1% fall in ASKs leading to a 3.3 percentage point increase in load factor, to 83.6%. The main Jetstar operation carried 2m passengers internationally, up 107% year-on-year, with capacity up 34.9%, RPKs up 40.2% and load factor 2.9 points higher at 77.6%. The Singaporean business carried 1m passengers in the half year, at a load factor of 79.6%.

LCC with frills

Although it is an LCC, with passengers having to pay for extra leg room, in-flight entertainment, meals etc, it does offer substantial frills, such as the ability to earn points in Qantas's FFP and a premium/business service called StarClass on international routes using A330s, which includes leather seats, meals and in-flight entertainment. Jetstar also interlines with a number of airlines, including Qantas, Japan Airlines, Etihad, Qatar, Royal Jordanian and, since April, with Air Canada.

Jetstar is a key part of the Qantas group's "two brand" strategy, with the mainline Qantas being the premium brand and Jetstar being the "low fare" carrier; on average Jetstar's fares are around 35%-40% lower than Qantas's.

Indeed the Qantas group has been switching capacity aggressively from Qantas to Jetstar on primarily leisure routes, allowing the group to make a profit (or reduce losses) on routes that were underperforming when operated by mainline Qantas. As can be seen in the chart (see right), domestic Qantas capacity has been cut since the start of 2009, while domestic Jetstar capacity has been growing since September 2009. The trend is even more pronounced on international routes to/from Australia, where double-digit percentage decreases at Qantas have been mirrored by even larger increases in Jetstar capacity. In the summer of 2009 Jetstar became the second-largest airline serving Australia internationally, while it is now also the third biggest airline in the Australian domestic market, having increased its share of the domestic market to approximately a quarter by outpacing the underlying growth in the market.



Jetstar's Australian network is designed to funnel leisure traffic into Jetstar international gateways at Perth, Darwin, Cairns and the Gold Coast. Two routes were launched in the second-half of 2009 (Sydney-Perth and Sydney-Melbourne) and with the introduction of four more A320s to its existing fleet of 42 A320 family aircraft Jetstar is increasing frequency on 11 domestic Australian routes through this year, largely out of Melbourne and Sydney.

Domestically Jetstar is becoming as aggressive as Ryanair in reducing costs. It has already moved services from Brisbane International to the Gold Coast airport because of fee increases at the former, and in May the airline closed its daily Brisbane-Rockhampton service after failing to agree a reduction in fees at Rockhampton airport (where Jetstar competed against Virgin Blue and Sunstate Airlines, a regional carrier owned by Qantas). Jetstar is also threatening to reduce flights at Hobart and Darwin over actual or proposed fee increases there; at the former Jetstar claims the airport has increased fees by 50%, while at Darwin (where it has three aircraft and wants to increase its fleet to seven by 2012) Jetstar is apparently looking at building its own terminal if charges do not come down.

The constant pressure on costs is apparent through the 16.5% fall in costs per ASK at Jetstar in the July-December 2009 period year-on-year – but that was needed as "greater competition in south east Asia and New Zealand" led to a 10.9% drop in yield over the same period.

In the summer of 2009 Jetstar took over domestic New Zealand routes (between Auckland, Christchurch, Queenstown and Wellington) previously operated by Qantas. However, on the lucrative trans-Tasman market, Jetstar (and Qantas) is facing increased competition now that Air New Zealand and Virgin Blue/Pacific Blue have just announced they will co-ordinate their Australia-New Zealand network, which will include extra frequencies and better connectivity (although this is subject to approval by the relevant regulators). There is also speculation that Tiger Airways and even AirAsia X would like to enter the trans-Tasman market.

Out of Australia Jetstar currently serves 11 international destinations in Japan, Thailand, Hawaii, Bali, and - from March - Fiji. These are operated with seven A330s loaned from Qantas; 15 787s are on order, but until they arrive international growth will depend on getting extra A330s from Jetstar's parent.

Jetstar Asia

Some A330s from Qantas will also go to Jetstar's Singaporean operation, called Jetstar Asia Airways. The airline is based at Singapore's Changi airport and was launched in 2004 to operate intra-Asian routes, which are currently offered to Cambodia, Hong Kong, India, Indonesia, Macau, Myanmar, the Philippines, Taiwan and Thailand. Jetstar Asia currently has seven A320s, with two more due to arrive before the end of the summer.

The Jetstar group has been "aligning" its Australia and Singaporean operations recently, which is leading to S$20m (US$14.4m) in synergy benefits a year. Capacity out of Singapore has increased by 50% in the last 12 months, and will grow by close to 50% again this year.

Jetstar says it will launch long-haul services out of Changi to Australia, northern Asian and potentially even southern European destinations by the end of 2010, using extra A330s from Qantas, the first of which is due to arrive in November. The aircraft will have a 303-seat capacity in two classes, including StarClass, although the group has not yet announced whether Jetstar Asia or the Australian Jetstar will operate the long-haul routes. In Europe Rome, Athens and a southern France destination are believed to be under consideration, while Beijing is among the leading contenders in north Asia, with an announcement of the first long-haul destination expected soon (very likely to be in Asia, with the first European route more likely to start towards the end of 2011).

In April Jetstar Asia also won rights to operate between Singapore and Tokyo Narita, although the airline originally wanted to operate to Tokyo Haneda, but was denied this after the Singaporean regulator gave the rights to SIA instead. Services to Narita have yet to be announced, but they will use A330s (although a daily Singapore-Osaka service, operating via Taipei, will start in July using A320s).

Interestingly, Jetstar has already taken over from Qantas on some Australia-Japan routes (which means that it now provides 50% of capacity between Australia and Japan), which Qantas says "overturns conventional wisdom that the structure of the Japanese travel market is not conducive to an international low fares carrier with a predominantly online booking model". This may be a hint as to Jetstar's desire to launch services in the domestic Japanese market, as it believes that the unreformed domestic market would welcome competition from a LCC.

Jetstar Pacific

Jetstar's Vietnamese operation dates back to 1991, when it was launched as Pacific Airlines by Vietnam Airlines and the State Capital Investment Corporation (SCIC). After Temasek Holdings (the Singaporean state investment company) took a 30% stake in 2006 the airline was relaunched as a LCC in February 2007, and then once Qantas took an 18% stake in June 2007 the airline was rebranded as Jetstar Pacific in May 2008. Today the Qantas group has a 27% stake in the airline (just under the 30% maximum allowed for a foreign investor, to which it is committed to raising its stake) while SCIC has 69.9%, with the rest owned by the Saigon Tourist company and former CEO Luong Hoai Nam.

Jetstar Pacific is based in Ho Chi Minh City and has 1,000 employees. It operates to five domestic destinations (having abandoned plans to launch international routes) and is adding a sixth, Nha Trang, from June, which it will serve from Hanoi. It operates five 737-400s and an A320, with the 737s scheduled to be replaced by A320s.

Although it carried 1.9m passengers in 2009, Jetstar Pacific could be seen as the weak link in the Jetstar group, with the airline losing more than US$30m due to fuel hedging in 2008 and 2009. The hedging losses have resulted in an investigation by Vietnamese authorities, and Jetstar Pacific's CFO (Tristan Freeman) and COO (Daniela Marsilli) were prevented from leaving the country at the end of 2009, leading to their resignations in January (although it is believed they are still being paid salaries by Jetstar).

Since the start of the year Qantas/Jetstar has had to parachute in at least a half dozen key executives into its troubled Vietnamese offshoot, including Jason Cameron – who was previously head of Jetstar's New Zealand business – as the new COO. Alan Joyce, CEO of Qantas, says the departing executives were carrying out normal fuel hedging practices and were not part of any criminal activity, but the Vietnamese authorities also placed Luong Hoai Nam, the former CEO of Jetstar Pacific (he resigned in November 2009,) under house arrest. He was replaced by Le Song Lai, the chairman of the airline, as interim CEO; Lai is an executive at Vietnam's SCIC.

In another blow, in May the Civil Aviation Administration of Vietnam (CAAV) ordered Jetstar Pacific to stop using the logo and branding of Jetstar Airways in its marketing, in order to help the Vietnamese market understand the "differences" between the two airlines. If it doesn't comply then CAAV may not renew Jetstar Pacific's operating licence, which is due to expire later this year.

Jetstar points out that cross-border use of a brand is standard international practice, but apparently VietJet AirAsia (see *Aviation Strategy*, May 2010) will also be refused permission to operate if it relies on the AirAsia brand to build its business in the country.

SCIC has also been trying to reduce its stake in the airline by finding new investors, but it may be difficult to find a replacement given the carrier's current troubles.

Fleet growth

Altogether the Jetstar group has 54 A320s on order, and in the 2010/11 financial year (ending June 30th) the Australian and Singaporean airlines will receive eight A320s and two A330s (the latter from Qantas). As part of their new alliance (covered in the May issue of *Aviation Strategy*), Jetstar and AirAsia are looking at launching a leasing company to market their older A320s as they are replaced by new models.

Jetstar's A330 fleet will rise to 12 before the first 787 arrives in 2013. The 787s will also allow Jetstar to operate more point-to-point services, rather than having to connect via hubs, which the Qantas group says "is a key advantage of 'end-of-line' carriers".

JETSTAR GROUP FLEETS

	Fleet	Orders	Options
Jetstar Asia Airways			
A320	7		
Jetstar Pacific			
A320	1		
737-400	5		
Total	**6**		
Jetstar Airways			
A320	36	54	40
A321	6		
A330	7		
787-9		15	50
Total	**49**	**69**	**90**

According to Qantas, Jetstar is managed and operated independently of its parent. However, unions at Qantas have become concerned at alleged "secret transfers" of assets from Qantas to Jetstar, which they say makes the LCC more profitable than it really is and helps Qantas's management make the case that the mainline Qantas needs to reduce pay and conditions for its staff. Barry Jackson, president of the Australian and International Pilots Association, says: "It is time for management to explain why - if it's so successful - Jetstar needs to be propped up by Qantas paying for its gates at major airports here and abroad, paying for significant training costs and paying for its participation in an expensive spare parts pooling arrangement with other A330 operators."

Unconfirmed reports from Australia also claim that the transfer of four A330s from Qantas to Jetstar to allow it to commence long-haul routes has given the airline A$440m (US$372.7m) worth of fleet for free, and that Jetstar's fuel hedging costs were being paid from sources reported in Qantas's account, thereby improving the relative performance of Jetstar.

Tiger Airways: Expansion post-IPO

Tiger Airways launched in 2004 as an LCC by Singapore Airlines and a number of investment companies, and carried out an IPO in January this year, raising S$247.7m (US$178.2m) through selling shares worth just over 30% of the expanded share base. The shares were sold at S$1.50 each, giving it a market capital on listing of S$781.3m (US$562.1m), with 92% of shares going to institutional investors and the rest to the Singaporean public. Unsurprisingly they were heavily oversubscribed - at the institutional tranche by 4.5 times the shares on offer, and by 21 times for the public shares - and since then the shares have risen to above S$1.70 (see chart, page 20). Following the IPO the largest shareholders are now SIA Group, 34.4%; RyanAsia (owned by the Ryan family), 11.2%; Indigo Partners, 15%; and Dahlia Investments (which is owned by Temasek Holdings), 7.7%.

The Tiger group currently operates to 11 countries in Asia out of Singapore Changi, Melbourne Tullamarine and Adelaide, and this is split into two operations – the main Tiger Airways, based in Singapore, and an Australian subsidiary, Tiger Airways Australia, which was set up in 2007.

The main airline operates to 17 destinations in Singapore, the Philippines, Indonesia, China, Australia, Thailand and Vietnam and is aiming to expand routes out of Singapore substantially over the next three years, with its current fleet of 10 rising to 12 by March 2011.

In the 2009/10 financial year (ending March 31st) the Tiger Airways group recorded revenue of S$486.2m (US$349.8m) - 28.6% up on 2008/09 - based on a 53.8% rise in passengers carried, to 4.9m. RPKs rose by 29% in the 12 month period, ahead of a 21.5% increase in capacity and leading to a 5.7 percentage point rise in load factor, to 85.1%. But while ancillary revenue per passenger rose from S$15.9 in 2008/09 to S$19.3 (US$13.9) in 2009/10 (see chart, right), the average fare per passenger fell sharply, from S$103.5 in 2008/09 to $80.5 (US$57.9) in 2009/10 – although that's partly due to a steep fall in average sector length, from 1,614km to 1,371km over the two financial years. Revenue per ASK rose from S$ Cents 5.85 in 2008/09 to S$ Cents 6.20 (US$ Cents 4.46) in 2009/10, with costs per ASK falling from S$ Cents 6.59 to 5.84 over the same period.

In 2009/10 the Tiger group made an operating profit of S$28m (US$20.1m), compared with a S$47.5m operating loss in 20008/09, and a S$28.2m net profit (compared with a S$50.8m net loss in 2008/09).

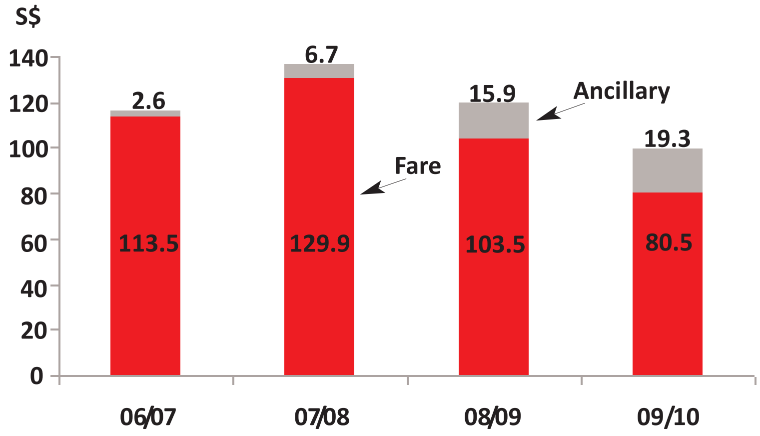
As at March 31st 2010 the group had long-term debt of S$132m (US$95m), compared with S$30.3m a year earlier, although thanks to the IPO its cash stood at S$206.7m (US$148.7m), compared with just S$13.2m as at March 31st 2009.

Australia close to break-even

Within that group result, the Singaporean operation earned a S$25m (US$18m) operating profit on revenue of S$277.9m (US$200m), while Tiger Airways Australia made an operating loss of S$0.6m (US$0.4m) on revenue of S$208m (US$150m). So while the Singaporean operation made a third straight year of operating profit, the Australian business has still to break even, although the 2009/10 result was much improved on the previous financial year (see chart, right) and if it follows the progressive pattern of the Singapore business, then it looks well placed to break into the black in 2010/11.

Tiger Airways Australia operates domestically to 12 destinations with a fleet of nine A320s and is based at Tullamarine, the main airport in Melbourne. It also has a base at Adelaide (it based a third aircraft there recently) and will open a third base, at Melbourne's Avalon airport, later this year. Two aircraft will be stationed at Avalon, increasing to 11 the number of aircraft at the subsidiary. Tiger says that Avalon has "Australia's lowest cost airport infrastructure" and will give the airline a significant advantage. Services advertised on Tiger's website for November bookings, but awaiting regulatory approval, include Adelaide, Sydney, Alice Springs, Perth, Rockhampton, Gold Coast and Mackay. The Sydney route out of Avalon will compete directly against Jetstar, which operates services to Sydney and also Brisbane out of the airport.

TIGER AIRWAYS' REVENUE PER PASSENGER



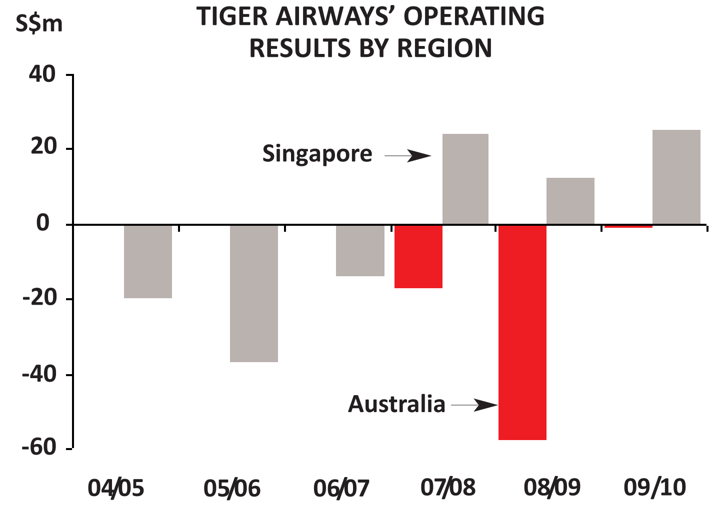
Note: FY ends March 31st.

International ambitions curbed for now

In March Crawford Rix, previously managing director at bmibaby, took over as managing director of Tiger Airways Australia, succeeding Shelley Roberts, who has headed up the Australian operation since its launch. Tiger wants to launch international services to/from Australia but until now this has been prohibited, so the airline will have to concentrate on adding frequencies domestically through 2010. In June, Tiger Airways Australia is resuming its Melbourne-Darwin route, which it suspended back in October 2008 after complaining about the high cost of operating from Darwin airport, and is launching a Melbourne-Cairns service from September, where it will compete against Qantas, Jetstar and Virgin Blue, its fierce competitors in the domestic market.

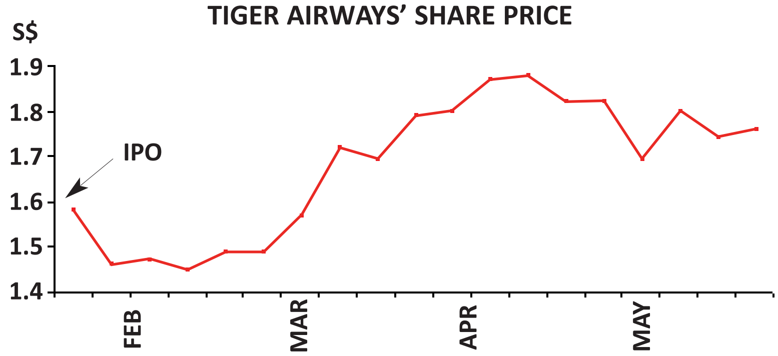
Incidentally the reaction of Tony Davis, CEO and president of Tiger Airways, to the AirAsia-Jetstar alliance (see *Aviation Strategy*, May 2010) was telling, and while he was undoubtedly annoyed by the timing of the announcement (coming as the Tiger IPO was occurring) Davis's harsh words also revealed deep concern about the impact the allied rivals could have on Tiger.

TIGER AIRWAYS' OPERATING RESULTS BY REGION



Note: FY ends March 31st.

TIGER AIRWAYS' SHARE PRICE



Most of the cash raised in the IPO is going to fund fleet expansion. Currently Tiger Airways (including its Australian subsidiary) has a fleet of 19 A320 family aircraft, and it wants to increase that to 33 by March 2012 and 68 by the end of 2015, with 52 A320s on firm order.

Until recently Tiger had leased all its aircraft, but its new policy is to own its fleet, and in January it received its first two owned aircraft, which were financed through the Standard Chartered Bank. These were used for a Singapore-Hong Kong service that started in February, while in March extra frequencies were added to routes from Brisbane to Adelaide and Melbourne.

These two aircraft were originally due to be delivered to Tiger in 2016, but were brought forward in order to provide much needed capacity for the airline. Three other aircraft scheduled for 2016 delivery have been brought forward, for delivery in 2011, and again they are being financed with help from Standard Chartered, while in the 2010/11 financial year a total of seven A320s will be delivered, although two aircraft will leave the fleet when their operating leases expire in early 2011.

TIGER'S FLEETS

	Fleet	Orders	Options
Tiger Airways Australia			
A320	9		
Tiger Airways			
A319	2		
A320	8	52	
Total	**10**	**52**	**0**

By Nick Moreno
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A "cub" airline

Part of the IPO proceeds will also be used to "establish potential new airlines and/or operating bases". Tiger believes that the LCC model has lots of potential for growth in the Asian region and wants to launch what it describes as a new "cub" airline in Asia, and is in negotiations with a number of potential joint venture partners across the region.

Tiger previously tried – and failed – to launch airlines in the Philippines and South Korea, and instead has seen main LCC rival AirAsia forge ahead outside its home country of Malaysia into Thailand, Indonesia and now Vietnam. While Tiger claims it's not playing "catch-up" with its rival, in effect this is precisely what it is doing, and no doubt Tiger is looking again at both the Philippines and Korean markets.

The Indian sub-continent is also a key target for Tiger Airways. It already operates to Chennai and Bangalore, and routes between Singapore and Trichy in the south of India and Trivandrum (the capital of Kerala state, on the west coast of India) will start in November. Interestingly the latter will compete against service from SilkAir, the subsidiary of SIA. Other destinations are also under consideration but again Tiger is playing catch-up with rival AirAsia, which has already announced a major expansion of routes into India.

The other key target country is China. Tiger currently operates to Haikou, Guangzhou, Hong Kong, Macau and Shenzhen, but would like to add other destinations, such as Hangzhou, Shantou, Xiamen and even Taipei in Taiwan.

Earlier this year Tiger also started a cargo trial on routes from Singapore to Bangkok, Jakarta, Kuala Lumpur, Kuching and Penang, as part of a push to increase ancillary revenue. If successful, the trial will be extended to other routes and then potentially to a full roll-out across the airline, with cargo space being sold on all aircraft.

Freighter values and lease rates

The following tables reflect the current values (not "fair market") and lease rates for freighters. Figures are provided by The Aircraft Value Analysis Company.

FREIGHTER VALUES (US$m)

	New	5 years old	10 years old	20 years old
A300-F4-600R		42.9	32.6	
A330-200F	98.6			
737-300QC			11.0	7.0
747-400M			50.1	25.9
747-400F (CF6)	104.1	89.9	72.0	
747-400ERF	107.8	94.4		
757-200PF			23.3	14.3
767-300F	60.8	50.2	39.7	
777-200LRF	151.1			
MD-11C			27.4	
MD-11F			36.4	

FREIGHTER LEASE RATES (US$000s per month)

	New	5 years old	10 years old	20 years old
A300-F4-600R		353	303	
A330-200F	816			
737-300QC			151	117
747-400M			483	373
747-400F (CF6)	1,002	896	750	
747-400ERF	1,042	948		
757-200PF			188	180
767-300F	430	403	366	
777-200LRF	1,259			
MD-11C			310	
MD-11F			420	

Source: *AVAC*
Note: As assessed at end-April 2010; mid-range values for all types.

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
ANA	**Year 2004/05**	**12,024**	**11,301**	**723**	**251**	**6.0%**	**2.1%**	**85,838**	**55,807**	**65.0%**	**48,860**	**29,098**
YE 31/03	**Year 2005/06**	**12,040**	**11,259**	**781**	**235**	**6.5%**	**2.0%**	**86,933**	**58,949**	**67.8%**	**49,920**	**30,322**
	Year 2006/07	**12,763**	**11,973**	**790**	**280**	**6.2%**	**2.2%**	**85,728**	**58,456**	**68.2%**	**49,500**	**32,460**
	Year 2007/08	**13,063**	**12,322**	**740**	**563**	**5.7%**	**4.3%**	**90,936**	**61,219**	**67.3%**	**50,384**	
	Year 2008/09	**13,925**	**13,849**	**75**	**-42**	**0.5%**	**-0.3%**	**87,127**	**56,957**	**65.4%**	**47,185**	
Cathay Pacific	**Year 2006**	**7,824**	**7,274**	**550**	**526**	**7.0%**	**6.7%**	**89,117**	**71,171**	**79.9%**	**16,730**	**18,992**
YE 31/12	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
	Year 2009	**8,640**	**7,901**	**740**	**627**	**8.6%**	**7.3%**	**111,167**	**96,382**	**86.7%**	**24,558**	**18,511**
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 2005**	**7,439**	**7,016**	**423**	**198**	**5.7%**	**2.7%**	**66,658**	**49,046**	**73.6%**	**21,710**	**17,573**
YE 31/12	**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**	**-1,806**	**-1.0%**	**-19.0%**	**77,139**	**55,054**	**71.4%**	**21,960**	**18,600**
	Year 2009	**7,421**	**7,316**	**105**	**-49**	**1.4%**	**-0.7%**	**80,139**	**55,138**	**68.8%**	**20,750**	
Malaysian	**Year 2004/05**	**3,141**	**3,555**	**-414**	**-421**	**-13.2%**	**-13.4%**	**64,115**	**44,226**	**69.0%**		**22,513**
YE 31/03	Apr-Dec 05	2,428	2,760	-332	-331	-13.7%	-13.6%	49,786	35,597	71.5%		22,835
YE 31/12	**Year2006**	**3,696**	**3,751**	**-55**	**-37**	**-1.5%**	**-1.0%**	**58,924**	**41,129**	**69.8%**	**15,466**	**19,596**
	Year 2007	**4,464**	**4,208**	**256**	**248**	**5.7%**	**5.6%**	**56,104**	**40,096**	**71.5%**	**13,962**	**19,423**
	Year2008	**4,671**	**4,579**	**92**	**74**	**2.0%**	**1.6%**	**52,868**	**35,868**	**67.8%**	**12,630**	**19,094**
	Year 2009	**3,296**	**3,475**	**-179**	**140**	**-5.4%**	**4.3%**				**12,000**	
Qantas	Jul-Dec 06	6,099	5,588	511	283	8.4%	4.6%	61,272	49,160	80.2%	18,538	33,725
YE 30/6	**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**
	Jul-Dec 09	6,014	5,889	124	52	2.1%	0.9%	62,476	51,494	82.4%	21,038	32,386
Singapore	**Year 2005/06**	**6,201**	**5,809**	**392**	**449**	**6.3%**	**7.2%**	**109,484**	**82,742**	**75.6%**	**17,000**	**13,729**
YE 31/03	**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**
	Year 2009/10	**8,908**	**8,864**	**44**	**196**	**0.5%**	**2.2%**	**105,674**	**82,882**	**78.4%**	**16,480**	
Air China	**Year 2005**	**4,681**	**4,232**	**449**	**294**	**9.6%**	**6.3%**	**70,670**	**52,453**	**74.2%**	**27,690**	**18,447**
YE 31/12	**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%**	**88,078**	**66,013**	**74.9%**	**34,250**	**19,972**
	Year 2009							**95,489**	**73,374**	**76.8%**	**39,840**	
China Southern	**Year 2005**	**4,682**	**4,842**	**-160**	**-226**	**-3.4%**	**-4.8%**	**88,361**	**61,923**	**70.1%**	**44,120**	**34,417**
YE 31/12	**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**	**45,474**
	Year 2008	**7,970**	**8,912**	**-942**	**-690**	**-11.8%**	**-8.7%**	**112,767**	**83,184**	**73.8%**	**58,240**	**46,209**
	Year 2009	**8,022**	**7,811**	**211**	**48**	**2.6%**	**0.6%**	**123,440**	**93,000**	**75.3%**	**66,280**	
China Eastern	**Year 2005**	**3,356**	**3,372**	**-16**	**-57**	**-0.5%**	**-1.7%**	**52,428**	**36,381**	**69.4%**	**24,290**	**29,301**
YE 31/12	**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%**	**37,220**	**44,153**
	Year 2009	**5,896**	**5,629**	**267**	**25**	**4.5%**	**0.4%**	**84,422**	**60,918**	**72.2%**	**44,030**	
Air Asia	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	
	Jul-Sep 09	211	145	66	37	31.1%	17.6%	5,449	3,769	69.2%	3,591	
	Oct-Dec 09	263	169	95	23	35.9%	8.6%	5,863	4,410	75.2%	3,995	
	Year 2009	**905**	**539**	**366**	**156**	**40.4%**	**17.3%**	**21,977**	**15,432**	**70.2%**	**14,253**	

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 %
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	72.0
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
2009	322.1	219.3	68.1	227.8	187.7	82.4	181.2	145.8	80.5	603.8	488.7	80.9	912.7	701.1	76.8
Mar 10	27.8	18.2	66.8	16.9	14.0	82.4	14.8	12.6	85.1	48.7	40.2	82.4	74.6	57.8	77.5
Ann. change	-1.6%	5.1%	4.2	-5.1%	4.4%	7.5	-5.2%	3.9%	7.5	-3.5%	4.3%	6.2	-2.4%	5.2%	5.6
Jan-Mar 10	75.5	47.6	63.0	47.5	37.0	82.4	42.9	35.8	83.0	140.3	113.5	80.9	212.5	159.8	75.2
Ann. change	-1.9%	3.3%	5.4	-5.5%	1.2%	7.1	-5.4%	1.1%	6.9	-3.8%	1.9%	5.9	-2.6%	2.8%	5.6

Source: AEA.

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	02 June	Luxair	1 x 737-800	
	06 May	RwandAir	2 x 737-800	
	29 Apr	Angola Airlines	2 x 777-300ER	plus 2 purchase rights
Airbus	08 June	Emirates Airline	32 x A380	
	27 May	South African A/W	5 x A320	2013 onwards / IAE V2500

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