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Identity crisis for Europe’s LCCs

The Southwest LCC model, as it was adopted in Europe, changed to suit the different operating environment, in particular the high density and concentration of population within the continent and the slow introduction of deregulation. In the early days Ryanair found a niche in generating and stimulating demand from UK regional cities to Ireland; attacking the pent-up VFR demand from the Irish diaspora in England. easyJet, in contrast, initiated domestic UK routes in direct competition with the incumbents, BA and British Midland; and then turned to leisure routes, diverting demand from traditional charter carriers.

Both were able to create a developmental leap forward in the early 2000s negotiating very advantageous deals with the main manufacturers following the equipment order slump after September 2001 – deals possibly never to be repeated. In the process of this growth they both concentrated on the KISS principle; but more importantly, wedded to the idea of pure point-to-point services and operating purely intra-European services, they were able to take advantage – thanks to the slow process of deregulation - of their legacy competitors' inability (or desire) to operate network services from bases outside their home countries. As a result, both have been able to build a series of bases in the main countries of western Europe and pan-European air transport brands, now accounting for some 20% of total intra-European capacity.

There are differences: Ryanair has tended to concentrate on secondary and tertiary airports that can provide the 25 minute turnaround essential to the schedules and special deals on landing fees, relatively low frequency but high number of destinations served from each base; easyJet has tended to be willing to operate at more primary airports – accepting a higher operational cost in the anticipation of higher achievable yields - while operating relatively higher frequencies on individual routes to attract business traffic. As part of the process of chasing ever lower costs the two have been instrumental in “unbundling” the product helping to change consumer expectations and behaviour – even to the point of creating their own self-service hub networks.

Other entrants have followed with variants on the basic principle. Norwegian was able to take advantage of the vacuum provided by the SAS acquisition of Braathens to establish itself as a serious contender against a very high cost competitor in a niche regional market. Vueling started off trying to create a Catalan low-cost contender, and has ended up, after a massive fares war in the Spanish market, merging with Iberia's affiliate Clickair. Flybe re-created itself as a low fares airline on secondary and tertiary city pairs, operating what otherwise would be termed regional flights on relatively low density aircraft. Air Berlin, originally came to the stockmarket in 2006 heralded as the third largest LCC in Europe – although to give them their due, with a substantial level of charter business, they stated that they ran a “hybrid” business model. With the acquisitions of dba, LTU, Balair, Niki and TuiFly, Air Berlin has established itself as Germany's second largest carrier. Wizz is focusing on central and eastern European services to secondary airport destinations in western Europe – having finally seen off SkyEurope's attempt to do the same.

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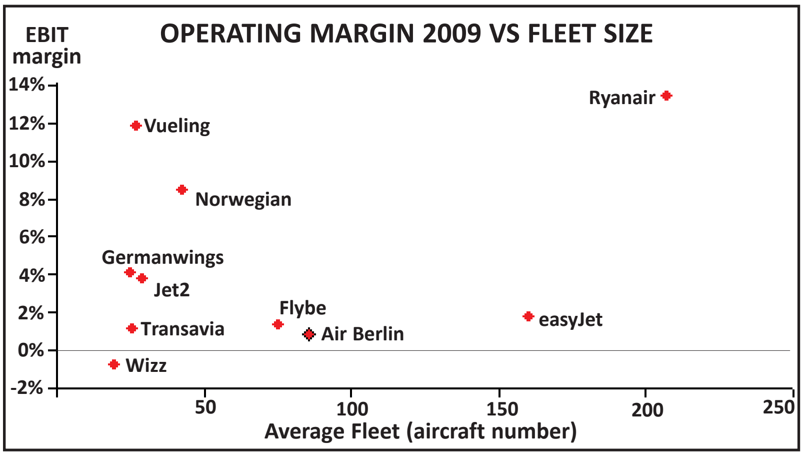
Each tries to offer a variety of the LCC model – some operate allocated seating (and charge for extra leg room); some such as Vueling, Norwegian and Air Berlin actively promote transfer routings; some even have FFPs – Norwegian through its own bank to get past the ban on the use of miles on domestic flights; Air Berlin in its pursuit of the corporate business customer has its Top Bonus program; and even easyJet has a possible precursor of a frequent flier club in its annual easyJet Plus card.



Few business models stay static forever. Ryanair has signalled an intention to slow its growth plans dramatically once the last of its current aircraft orders enters the fleet in 2012 (see *Aviation Strategy*, October 2010). The company has stated that while it will continue its basic opportunistic view of airport destinations, there are more offers coming its way to attract it to more major airports – emphasised by its new operations in Barcelona El Prat – and the management has suggested they would consider moves into any but the top three network hubs. This will no doubt have a knock-on effect on the rest of the industry.

At the same time, easyJet, whose recent financial performance has been well below that of smaller LCCs (see chart, above), is reassessing its direction. With a full change of personnel at board level (unlike Ryanair, easyJet's top management has rotated several times over the years, with little left of the "orange culture" introduced by Stelios Haji-Iannou and Ray Webster), the new CEO, Carolyn McCall, is expected to announce the result of the company's strategy review in late November. It was intriguing to note a recent online customer survey on their website asking such questions as whether they should offer allocated seating or even fly to and from Heathrow (assuming they could get slots of course). easyJet has tended to show in its route development a preference to reduce capacity on routes where it is in direct head-to-head competition with Ryanair. With the possibility of pressure from Ryanair providing more competition at primary airports, easyJet may need to consider moving even more to mainstream airport destinations – and so a move into Heathrow (it is already a major player at Paris CDG, Milan Malpensa and Geneva) may not be such a silly idea. Such a move may even raise the question of whether a potential link between them and incumbent BA (or the new IAG holding company) to provide BA's short-haul feed could be feasible or sensible.

Air Berlin also is moving even further away from the KISS principle of the Southwest model. It of course has built its own complexity – with intra-European hubs in Palma, Berlin Tegel and the congested Düsseldorf; in-flight service; FFP. It signed up with the oneworld alliance earlier this year – giving that global alliance its first real access within Germany. It will start code-sharing with AA this winter, and is set to start code shares with BA, Iberia, and Finnair from the summer of 2011 on all points east, west and south. It will now be able to join in with the alliance's FFPs and should gain some benefit for its long-haul, ex-LTU operations from the American sales exposure. It has even been invited by BA to move London operations to Gatwick from Stansted in order to improve European feed for BA's long-haul (admittedly leisure oriented) flights – although it is unlikely to be included within the immunised transatlantic joint venture between AA, IB and BA.

Meanwhile, the latest news from Norwegian is its plans to take two 787s on lease from ILFC in 2012 to pursue its future long-haul operations – the longest sector route in its network at present is the route from Oslo to Dubai, which at 5,100km may just be classified as long-haul (seven-hour flight on a 737!). This may be the next logical step for LCCs with existing effective short-haul hubs to develop access long-haul markets (see *Aviation Strategy* May 2010).

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The US Big Three: ROIC goals for Delta, American and United

With record third-quarter profits under their belt, and with prospects for continued recovery looking promising, will the three largest US carriers focus on international growth and alliance building in 2011? Or will they, at long last, make achieving margin and ROIC goals a priority?

Like many of their counterparts in other world regions, US airlines enjoyed a spectacular revenue-led recovery in the quarter ended September 30. The 11 largest passenger airlines (excluding regional operators) achieved an unprecedented 11.2% combined operating margin and a 7.6% net margin before special items (see table, page 4).

On the topic of what will happen next – assuming that the recovery will continue in 2011, which looks likely - there were two discussion threads of note in the airlines' third-quarter earnings conference calls.

First of all, there is concern in the financial community that the remarkable capacity discipline of the past few years will not be sustained. At least Southwest and American are returning to modest 4-5% ASM growth in 2011. Both United and American are looking to enter the Los Angeles-Shanghai market, hinting of a return to market share battles.

But commentary from the airline executives also indicated that the carriers are taking financial targets and shareholder returns more seriously. Perhaps it is only natural since, for the first time ever, sustained profitability and margin and ROIC goals seem within reach for many US airlines (other than just Southwest).

Could it really be that after a decade of restructuring, many Chapter 11 visits, an intensive new consolidation phase, better pricing models, smarter managements, etc., things have really changed permanently? Could US airlines soon start generating the kinds of returns other industries do? Or are they likely to fall back into the traps of the past?

Executives such as US Airways' CEO Doug Parker believe that, this time around, things really are different. In his 3Q comments, Parker also noted the unique current situation that the airlines have been producing record results when other industries are struggling.

One of the problems is that the three largest US legacies are currently in very different situations, each with different priorities. Delta, having successfully integrated Northwest and achieved stellar results, is ready to deleverage and think of shareholders. But American, which has been left out of the merger process and now suddenly has unique alliance opportunities, is feeling the pressure to grow and expand its global footprint. And the new United, having just closed a merger, faces the tough challenge of integrating two airlines. How is all of this likely to play out in terms of capacity growth and industry health in 2011?

Delta: a picture of restraint

Delta may have lost its ranking as the world's largest airline, but the Atlanta-based carrier has plenty to be happy about: being at last able to show concrete benefits from the 2008 acquisition of Northwest and returning to strong profitability. Delta led the legacy pack with a 13.5% operating margin in the third quarter and is on track to achieve its first profitable December quarter since 2000. It is making progress towards its goal of "consistent profitability with 10-12% annual operating margins".

Delta outperformed its peers in terms of unit revenue growth in the third quarter. Its total PRASM surged by 16%, driven by a higher corporate revenue and international mix. In particular, Delta benefited from its high Asia exposure (which came with Northwest); its Pacific PRASM rose by 45%, aided by the appreciation of the Yen. Overall corporate revenue was up by 35%.

US AIRLINES' THIRD QUARTER 2010 FINANCIAL RESULTS

	3Q10 Operating revenue $ (m)	% change vs 3Q09	3Q10 Operating result $ (m)	Operating margin %	3Q10 Ex-item Net result $ (m)	Ex-item Net margin %
Delta	8,950	18.0	1,209	13.5	929	10.4
AMR Corp.	5,842	14.0	342	5.9	143	2.4
UAL Corp.	5,394	21.7	598	11.1	473	7.2
Continental	3,953	19.2	454	11.5	367	9.3
Southwest	3,192	19.7	388	12.1	195	6.1
US Airways Group	3,179	16.9	312	9.8	243	7.6
Alaska Air Group	1,068	10.3	226	21.2	118	11.1
JetBlue	1,030	20.5	140	13.6	59	5.7
AirTran	668	11.8	57	8.5	18	2.7
Hawaiian	352	15.2	39	11.2	20	5.7
Allegiant	164	22.9	20	11.9	13	8.1
Total	**33,792**	**17.8**	**3,785**	**11.2**	**2,578**	**7.6**

Source: *Individual airlines*

At the same time, Delta's unit costs continue to be among the lowest in the legacy sector. The airline has managed to keep its non-fuel costs flat in the past three years, while bringing employee pay up to industry standards, and despite a 5% overall reduction in capacity.

The third quarter results reflected significant benefits from the merger, because Delta has only been able to free-flow aircraft since May – a key component of both the revenue and cost synergies. Delta claims to have clocked up $1.4bn in accumulated synergies so far and expects to reach the full run-rate of $2bn by the end of 2011.

So Delta is under no pressure to flex its muscle or respond to United/Continental. Quite the opposite: the Atlanta-based carrier is a picture of restraint. It is sticking to what are probably the most conservative spending and balance sheet management policies among the US legacy carriers, despite having a relatively old fleet and a much smaller orderbook than its peers.

Deleveraging is one of the top priorities. Delta announced late last year that it planned to use virtually all of the $6-7bn free cash flow projected for the 2010-2012 period to pay down debt. In the third quarter it paid down $750m of debt and is on target to reduce net debt by more than $2bn in 2010. The three-year plan aims to reduce lease-adjusted net debt from $17bn to $10bn or less by the end of 2012.

Commenting on the strategy in the 3Q earnings call, Delta executives argued that "this step and similar steps are the most accretive things we can do for our shareholders". They noted that airlines trade at a discount to the S&P500 Index and that "in order to get to parity, we need to de-risk the business".

Delta is focused on building a "sustainable industry model" and has an ROIC goal of 8-10%. The executives noted: "We owe it to our shareholders to get to that return on capital goal." That means being "very judicious about how we use our capital" and being firmly committed to capacity discipline. "We'll further streamline our fleet in 2011 and utilise aircraft more effectively. Capital-intensive capacity growth is not in our plans."

Delta expects its ASMs to increase by 1-3% in 2011, following 1% growth this year, thus keeping capacity growth "within GDP rates". Only international markets are likely to see growth. First, there will new daily services to Tokyo-Haneda from Detroit and Los Angeles, starting in February; Delta was fortunate to secure half of the total daily slots available to US carriers at Haneda next year. Second, Delta is seeking to serve Heathrow from Boston and Miami from March – slots that BA/American are required to divest at Heathrow. Third, Delta is looking to boost operations to Africa, where it has a stronger presence other US airlines.

Delta has made much headway recently in streamlining the unwieldy combined fleet, which at one point totalled 1,400 aircraft. In the third quarter it managed to reduce its owned fleet by 180 units – mostly regional aircraft but also including 25 DC9s – to 821 aircraft at the end of September. Some 128 regional aircraft were disposed of through the sale of two regional subsidiaries inherited from Northwest (Mesaba and Compass), though those aircraft merely changed ownership and remain in Delta Connection. Some of the RJ flying has been replaced by MD-80s. That Delta has been able to get rid of large numbers of aircraft while still growing ASMs by 1% this year speaks volumes of the network synergies offered by the merger; it has been possible to significantly boost aircraft utilisation through tighter scheduling.

Delta is looking to shed another 20-30 aircraft in 2011 – more 50-seat RJs, DC9s and some Saabs. It has decided to shrink its only remaining regional subsidiary, Comair, by more than half in the next two years.

Significantly, Delta has finally reached a deal with Boeing to reaffirm Northwest's order for 18 787s. The aircraft, which were originally scheduled to arrive between 2008 and 2010, will now be delivered in 2020-2022. Another important investment will be a $1.2bn project to enhance and expand Delta's New York JFK facilities.

On the alliance front, Delta is benefiting enormously from its immunised transatlantic JV with Air France/KLM/Alitalia, which has become more deeply integrated this year. But the fate of its relationship with V Australia and Virgin Blue is uncertain because the US DOT recently turned down their application for ATI (on grounds that the carriers could not demonstrate sufficient public benefits).

But otherwise the future thrust of Delta's alliance-building will be to develop SkyTeam around the world, particularly in Asia, where Vietnam Airlines is the latest addition and China Eastern and China Airlines are due to join in 2011. Recent months have also seen progress in Latin America: Aerolineas Argentinas has just begun the process of joining SkyTeam as the second Latin member (after Aeromexico).

Mexico has posed both challenges and opportunities for global alliances (and particularly US carriers) this year because of Mexicana's demise and because of the FAA's decision to downgrade Mexico to category 2 under the IASA safety assessment programme at the end of July. The downgrade, while only temporary, means that Mexican airlines cannot currently launch new service to the US or use their aircraft for codeshares with US carriers. It appears that Delta is benefiting: it is picking up traffic that would have flown on the Mexican carriers.

Delta's executives made the point that the global alliances, particularly when immunised, "de-risk the hiccups", which have also included recent strikes at Air France. In "metal neutral" alliances, where the airlines are agnostic as to whose metal customer flies, the partners are able to work closely together to make sure that the unaffected airline can temporarily switch to larger aircraft and pick up the traffic for the alliance. In such situations the alliance "acts as an insurance policy", to prevent traffic ending up at competing alliances.

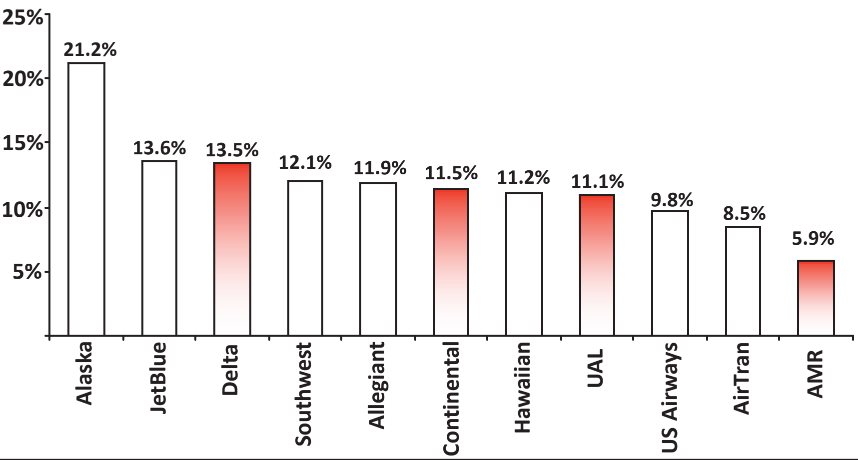
American: under pressure to grow

In contrast to Delta's situation, American is making an all-out effort to strengthen its network, be it via organic growth or alliances. There are several reasons why the company's focus has changed after it was the staunchest proponent of capacity discipline for many years. First, AMR trails in the profit margin league; it was the worst-performing US carrier in the third quarter. Second, competitor mergers have knocked AMR from the largest US airline to number three. Third, AMR has lost market share in key international business markets such as the transatlantic because of its inability (until very recently) to obtain antitrust immunity (ATI) for its alliance with BA. Fourth, all of a sudden there are now alliance-building opportunities.

The growth/network focus will not help AMR close the profit gap in the short term, but AMR feels that it has a lot of catching up to do on the network front. The company's executives recently described the strategy as "building the strongest network in the most important markets across the globe for the long term".

AMR's third-quarter results did show substantial improvement: operating and ex-item net profits of $342m and $143m, respectively, up from losses of $194m and $265m a year earlier. But the 5.9% operating margin was the lowest in the industry,

US AIRLINES' THIRD-QUARTER 2010 OPERATING MARGINS



and the margin gap has only worsened. AMR underperformed its peers on PRASM (up by only 10.7%) is expected to post losses for the current quarter and for 2010.

There are many reasons why AMR is underperforming its peers. It has higher labour and pension expenses – a consequence of having avoided bankruptcy. On the revenue side, it has been handicapped by its lack of alliance ATI. It is likely to have lost business traffic market share to Delta. This year American's entity mix has also been unfavourable: lack of exposure to Asia, which has seen the sharpest recovery, and a significant presence in Latin America/Caribbean, which weathered the recession relatively well in 2009 and is therefore now seeing more modest recovery.

American's new network initiatives focus on four areas. First, American, BA and Iberia are now going full-steam ahead with the implementation of their immunised transatlantic joint business, which they formally kicked off on October 1. The airlines have announced four new routes from April 2011: JFK-Budapest and Chicago-Helsinki by American, Heathrow-San Diego by BA and Madrid-LA by Iberia. American will boost frequencies on JFK-Barcelona and Miami-Madrid routes. The airlines have coordinated their schedules, started codesharing on numerous additional routes and improved and better aligned their FFPs.

The venture's biggest competitive strength will be in the JFK-Heathrow market, where BA and American currently offer 11 daily flights. Those flights will be more evenly spaced throughout the day and in the evening the airlines will offer a shuttle-type service with flights every half hour.

The airlines are contractually prohibited from releasing financial details, but it is known that revenues from the JV, which is initially a $7-8bn business, will be shared based on the capacity that each airline offers. This is intended to remove any incentive to channel passengers to a particular airline. But profitability levels are likely to differ since the airlines have different cost levels.

American's second major new network initiative is the planned JV with JAL on US-Japan routes, which received all the necessary regulatory clearances in October and is likely to be launched in early 2011. It is expected to essentially replicate the transatlantic JV. It represents a significant growth opportunity for American in the long term as the Pacific region currently accounts for only around 4% of its system capacity. Separately, early next year American will launch flights from JFK to Haneda, where it will be able to connect to JAL's strong domestic operations from that airport.

Third, American has announced plans to boost its strategic position in Los Angeles with new services and alliance-building next spring. This is the next step in the carrier's so-called "cornerstone strategy", which focuses service in five key markets: New York, Chicago, Dallas, Miami and Los Angeles. American will be launching LA-Shanghai flights in April, adding nine new domestic markets and expanding codesharing with Alaska Airlines (to Mexico). Including also Iberia's Madrid-LA flights, oneworld will then offer 18 daily international departures from LA.

The fourth component of American's network-strengthening effort is forging numerous "bilateral partnerships" with smaller carriers. Recent additions include three major LCCs in the Americas: GOL, JetBlue and WestJet. Of course, American continues to launch codeshares with new and prospective oneworld entrants; the latest such relationship is with Air Berlin.

Mexicana's demise has been a major setback for American and oneworld.

American anticipates over $500m in annual revenue benefits and cost savings from the two JVs and the cornerstone initiatives. A large portion of the benefits are expected to be realised in 2011, with the full value to be achieved by the end of 2012.

The most controversial aspect of American's plans is that they will mean consolidated ASMs growing by 4% in 2011, or by 1% domestically and 8% internationally. This may not sound unreasonable by global carrier standards, but it would be the highest rate among the US legacies. Analysts are unhappy about it because they fear that it risks a supply response from competitors and a return to market share battles. JPMorgan analysts said on October 20 that they were "discouraged by the first legacy example of ASM growth in excess of our 2.5% real GDP forecast". BofA Merrill Lynch suggested that "AMR feels compelled to expand in its core markets to defend its premium share of corporate contracts".

But everyone understands the logic of AMR's moves. In addition to the Shanghai, Haneda and new European flights, American will be adding services to Brazil and Mexico (the latter to backfill some of Mexicana's capacity). Part of the 4% ASM increase is accounted for by the full impact of the Chicago-Beijing service that was introduced this year after a one-year delay. American executives made the point that "all of these services make sense in terms of our network strategy and alliance partnerships". Furthermore, American says that its longer-term strategy is to grow the network "consistent with GDP growth in the regions of the world that we operate".

The company continues to take a "measured" approach to capital spending. Total capex will decline from this year's $2.1bn to $900m in 2011, as 737-800 deliveries are reduced from 45 in 2010 to 15 in 2011. AMR also continues to pay off debt; it remains extremely highly leveraged but has a healthy cash position and many assets that could potentially be monetised, including regional carrier American Eagle.

Financially, the trends are in the right direction. American's labour cost disadvantage is expected to diminish in the coming years as its competitors negotiate new labour contracts. Analysts expect AMR to start improving its relative unit revenues and reducing the operating margin gap in 2011.

The new United: integration challenges

Much of the effort of the management of United Continental Holdings (UAL), the entity created when United and Continental closed their merger on October 1, will obviously focus on tackling the numerous merger integration challenges in the next couple of years. However, it was still reassuring to hear from CEO Jeff Smisek at the 3Q earnings call that the new United will remain committed to capacity discipline. Total capacity at the combined company is currently slated to grow by just 1-2% in 2011.

Both United and Continental reported strong third-quarter results: operating margins of 11.1% and 11.5% and ex-item net margins of 7.25 and 9.3%, respectively. Combined operating cash flow was $750m. The executives said that the company is well positioned on the path to sustained profitability, but they disappointed analysts by not providing any specific financial targets.

The combine's unit revenue results were among the best in the industry. Interestingly, however, while United benefited enormously from its strong Asian presence ("China continues to be on fire", the executives exclaimed), Continental outperformed it in every other region and surpassed it as the unit revenue leader (its mainline PRASM surged by 20.8%, compared to United's 18.9% increase). Continental has a large Mexican presence and benefited from Mexicana's demise. On the revenue front, the future is obviously very bright, because the formidable combined network should attract many new corporate contracts.

When the merger closed, the two immediately introduced reciprocal FFP and preferred seating benefits. They have begun optimising the network and schedules, to offer customers more travel options. To start with, inter-hub schedules are being optimised to improve time of day coverage. Travellers will begin to see a more unified product in the spring of 2011, as key customer service and marketing activities are integrated. UAL currently expects to obtain a single operating certificate by the end of 2011, well ahead of the original schedule.

Optimising the fleet will obviously take time. At the end of September, the combined fleet in service totalled 708 mainline aircraft, plus 547 regional aircraft flown under capacity purchase agreements. UAL executives noted in the 3Q call that each airline brought much value to the merger in terms of fleets, that the combined orderbook is "very good" and that there is also much flexibility. Continental has 25 787s on order for delivery from 2H2011, while United has 25 A350s on order.

UAL expects to deliver $1-1.2bn of annual net synergies from the merger by 2013 and is focused on harvesting 25% of those benefits next year. One-time costs are estimated at $1.2bn, to be largely incurred over the next 12 months.

The fact that United and Continental have worked together over the past two years as alliance and JV partners bodes well for a successful integration. However, labour integration is often a contentious and lengthy process. CEO Smisek has set a goal of obtaining all of the joint collective bargaining agreements by the time a single operating certificate is secured. This seems ambitious, though at least the airlines have reached a "transition and process agreement" with both pilot groups.

The combine had an unprecedented $9.1bn in unrestricted cash, or 27.6% of trailing 12-month revenues, at the end of September. Carrying such an amount of excess cash gives UAL flexibility as it integrates and manages its debt maturities.

Since UAL has not yet sorted out its fleet plan for 2011 or even decided on aircraft interior configurations (whether to operate two classes or, like Continental, three classes), the 2011 capacity guidance is likely to be revised. So far, the airlines have announced new domestic expansion from their hub cities and four new routes to Mexico. Long-haul plans include United entering the Los Angeles-Shanghai market in 2011 (for a confrontation with American) and Continental launching Newark-Cairo flights in May 2011 (subject to government approvals).

On the alliance front, Continental has been busy developing cooperation with its Star partners around the world since joining that alliance a year ago. It is apparently already connecting more than twice as many passengers with Star partners at international gateways than it did with its former SkyTeam partners.

While United and Continental have implemented many aspects of their transatlantic JV with Lufthansa and Air Canada, the revenue share structure is only going in place in the current quarter (retroactive to January 1, 2010). Because of this delay, and because United and Continental have had strong transatlantic results this year, they are currently in the odd temporary situation of having a $100m liability for revenue sharing payments to their JV partners.

Last month the new United entered into an MoU with Air Canada to establish a revenue-sharing JV for trans-border flights, which is expected to come into effect in early 2011 (the airlines already have ATI). Also early next year, the combine will start implementing its planned immunised alliance and JV with ANA on US-Japan routes.

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THY: Europe's largest full-service airline by 2020?

THY Turkish Airlines ignored what it called the "year of crisis" in 2009 and expanded furiously, reflecting the dynamism of the Turkish economy (the China of Europe, as it has been dubbed with 6.6% GDP growth this year). Already the fourth largest AEA airline in Europe in terms of passengers carried, THY aims to increase capacity by around 15-20% each year in order to double passengers carried by 2015 and then become larger than Lufthansa by 2020. Is this a realistic target for Turkey's flag carrier?

THY's turnaround started back in 2002 after the state began to sell a 50.9% stake, abolished a tax on flights and encouraged the aviation sector in general to modernise itself. Since then the aviation industry has transformed itself in Turkey - a country with a population of 73 million - with domestic passenger numbers rising from under 10 million in 2002 to more than 41 million in 2009. This has mirrored a turnaround in the Turkish economy, which has seen gross national income per capita triple between 2002 and 2009, a rate of growth not seen anywhere else in Europe.

Against this background Temel Kotil, who joined THY in 2003 and became CEO in April 2005, put together a new strategy for the airline dependent on developing Istanbul airport into a hub for European passengers going on to destinations both eastwards in Asia and southwards. Essentially THY is aiming to take advantage of Istanbul's geographical position in the middle of what it calls the "Europe-Asia corridor" - Turkey is a three-hour flight from 50 different countries. This puts THY and Istanbul in competition with Dubai and other Middle Eastern hubs, using narrowbody against widebody aircraft – higher seat costs but also probably higher unit revenues.

THY's transfer passengers have almost quadrupled (to 4.5 million) in the last four years, but the airline believes there is still plenty of room for further improvement, and aims to increase transfer passengers from the current one-third of international passengers carried to more than 50% in the medium-term.

Altogether, Istanbul-based THY has seen its passenger traffic grow at a CAGR of more than 14% since 2002, and it currently operates to 166 destinations (127 international and 39 domestic). It confidently expects to overtake British Airways and become the third largest full-service European airline in terms of passengers carried by the end of 2010.

THY's stated ambition is to overtake the number one full-service airline (Lufthansa) in the next 10 years, which certainly means further aggressive expansion both in terms of destinations and fleet, even though the airline has only just completed an extensive fleet overhaul that has seen the average age fall to 6.5 years as of June 2010, with the oldest models now being A310 freighters (with an average age of 22 years), the 737-400s (18.4 years) and the A340s (13.7 years).

The mainline fleet currently stands at 126 (see table, below) but the group fleet (which includes Anadolu Jet) will rise from 148 at present to 184 in 2011, 205 in 2012 and 217 in 2003, in pursuit of increasing passengers carried from the 25.1 million carried last year to 56 million in 2015.

THY MAINLINE FLEET

	Fleet	Orders	Options
A310	4		
A319	4	6	10
A320	25		
A321	21	14	
A330	10	11	
A340	9		
737-400	2		
737-700	4		
737-800	42	10	15
737-900ER		10	
777-300ER	5	11	
Total	**126**	**62**	**25**

That's an aggressive schedule, but the aircraft are lined up, with no fewer than 62 on firm order. On short-haul, in January this year THY ordered six A319s and 14 A321s for delivery in 2011-12, as well as obtaining options for 10 unspecified A320-family aircraft, for 2013 delivery. The 20 firm orders will largely replace leased aircraft, but will also have the added advantage that they will have the same seat configuration – whereas the current leased A320s and 737s have a mix of configurations. Earlier this year THY also ordered 10 737-800s and 10 737-900ERs, to be delivered over 2011-14.

Long-haul focus

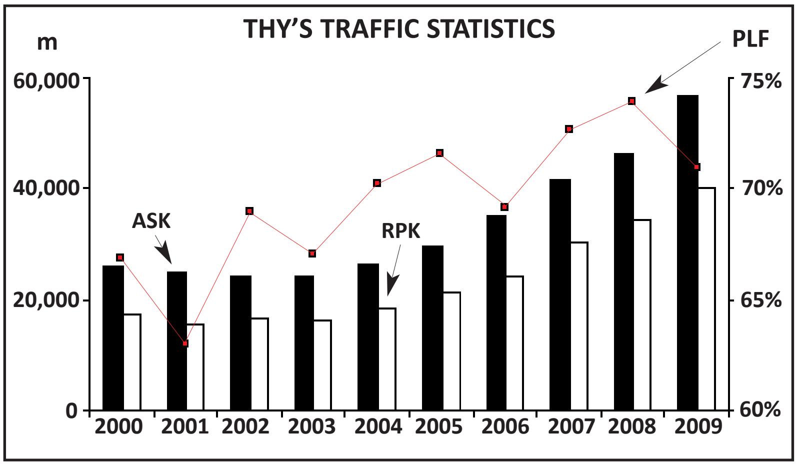
THY has doubled its long-haul capacity over the last two years but 22 further aircraft are coming, and the first of 12 777-300ERs on order arrived in October this year. The aircraft were ordered in 2009 and ideally THY needed them last summer in order to launch new routes to the US, but this wasn't possible. THY currently serves New York JFK, Chicago O'Hare and Toronto in North America, and increasing that network is seen as a priority. Plans to launch a non-stop service to Los Angeles in March 2010 had to be postponed until December and then March 2011 due to the inability to secure new 777s from Boeing, but from March the LA route will operate four times a week.

However, prior to the LA launch, a route to Washington Dulles commenced earlier this month, again non-stop from Istanbul using new 777s. This service goes on to Atlanta, which initially appears brave (or strange!) as this is the main hub for Delta Air Lines of the SkyTeam alliance. But the only non-stop competition THY faces on its routes to North America is from/to New York - from Delta, and THY is aggressively counter-attacking Delta in the expectation that Delta's passengers will prefer to fly direct to Istanbul rather than connect via New York. THY also began codesharing with US Airways in September, complementing its existing codeshare with United; THY has been a member of the Star alliance since 2008, but does not have antitrust immunity.

THY has been leasing four 777s from India's Jet Airways, but they are being returned as the new aircraft arrive. The new 777s are arriving at the rate of one a month and being introduced on the new routes to the US as well on services to Tokyo, Hong Kong and New York, on which THY is also introducing a premium economy class called "Comfort Class" onto its 777s.

In October THY received the first of 10 A330-300s on order, with four due to be delivered by the end of the year and the rest through 2011. They are being used to increase frequencies on existing routes to Asia as well as on new routes, which will include Ho Chi Minh City in Vietnam and Dhaka in Bangladesh, the former of which will start in December this year, from Istanbul via Bangkok. Routes to Guangzhou and Manila are also being launched.

THY also has outstanding orders for an A330-200 and an A330-200 freighter. Cargo accounts for around 8% of THY's revenue, and as well as freight capacity in passenger aircraft the airline has four A310-300 freighters that operate between 22 destinations. THY's cargo business will also be boosted by the arrival of the 777s, whose increased belly cargo capacity has helped THY's cargo revenue rise by 62% in the first half of 2010 compared with the same period in 2009. A further boost will come from two new A330-200Fs, the first of which has just been delivered to THY as a "test aircraft" (the model only became certified by Airbus in April this year). The other aircraft will be delivered in late 2011 and they will be used on cargo routes to



Asia/Pacific, most specifically China.

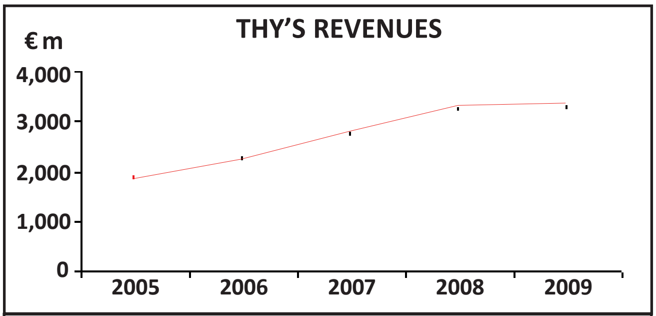
But the 777 and A330 aircraft may not be sufficient for these and other new long-haul destinations, so THY will also order very large capacity aircraft, with talks ongoing with Boeing and Airbus about the 747-8 and A380, aiming at a year-end decision. THY had been expected to order five or six aircraft, but the order may be as large as ten aircraft, and for delivery by 2013-14, given the spare production slots made available by cancellations from other airlines. THY is also expected to make an order for either A350s or 787s in the not-so-distant future, and the airline hints that as many as 20 may be needed.

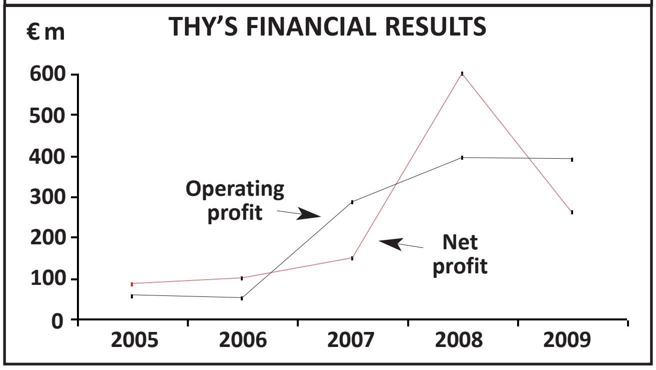
Even without these potential new aircraft types the long-haul fleet will almost double once the 777 and A330s are delivered by the end of 2011, and a clear focus for THY going forward is increasing long-haul traffic. The number of international passengers carried by THY surpassed domestic passengers in 2008, and in 2009 the airline carried 11.7m domestically and 13.4m internationally. Converted into revenue however, the disparity between domestic and international is much larger; in 2009 THY earned €636m revenue from domestic passengers and €2.3bn from international passengers.

In the first half of 2010 THY had a 60% share of the international market to-from Turkey (with foreign airlines taking 31% and other Turkish carriers 9%), while in the domestic market it had a 64% share.

Those figures exclude Antalya-based SunExpress, a charter airline set up in 1989 as a 50:50 joint venture with Lufthansa. It specialises in flights between Turkey and Germany and operates a fleet of 27, comprising 24 737s and three 757s, although the 757s are being returned to lessors through the rest of the year. SunExpress employs 1,400 and made a €51m net loss in the first half of 2010 on revenue of €185m.

THY also owns Anadolu Jet, which was launched two years ago as THY's LCC. Based at Ankara Esenborga airport, Anadolu Jet operates 22 A320s and 737s to more than 40 destinations, most of which are domestic. However, from this August Anadolu Jet





began operating all THY's flights from the second airport in Istanbul, called - Sabiha Gokcen - both domestic and internationally (including London Stansted, Amsterdam, Copenhagen and Moscow Sheremetyevo). THY had previously operated routes out of Sabiha with its own aircraft, but states that it is switching to Anadolu Jet operations as passengers would "have the chance of flying with much more economic prices".

THY also states that part of its competitive advantage is that it has lower (mainstream) costs than virtually all other full service airlines in Europe, so that, as Kotil explains it, THY can offer a "five-star services but at cheaper rates compared to low-cost Western or five-star Eastern competitors". Unit costs have been coming down steadily over the last few years, although 2008 was a blip due to fuel price increases, and CASK was also under pressure in the first half of 2010, again due to fuel costs, when it rose to 5.9 Euro Cents per ASK even despite the results of a major "Fuel Saving Programme" that was launched in April 2008.

How long THY can keep costs down as it keeps expanding will be a critical test for the airline. A potential strike was averted narrowly in May this year before management settled a dispute with union Hava-Is, after which a new collective agreement was signed that will cover the period up to May 2012. Greater cost pressure may come from finding pilots to operate the expanding fleet. There are apparently no unemployed pilots in Turkey, and the usual outlet of retiring military pilots is no longer sufficient to keep up with THY's demand for hires. Rising numbers of foreign pilots are having to be hired, although their salaries are higher than those paid to Turkish pilots.

Altogether THY had 15,934 employees as at June 2010, but although the workforce has risen, productivity as measured by passengers per employee has increased from 1,271 in 2005 to 1,644 in 2009. Fleet utilisation has also been increasing steadily too, thanks to more sophisticated scheduling and "a better fleet composition".

As shown in the graphs (see page 15), THY has seen steady growth in revenue and operating profits over the last few years, although net profit did dip in 2009 as even THY couldn't avoid the global recession. Nevertheless, its 2009 net margin of 7.9% is better than almost all its major full-service rivals, as with the odd exception (such as to London) THY managed to retain its fare structure over the last 18 months (rather than slashing prices, as rivals did), since its load factor held up well.

In the first-half of 2009 THY reported a 28% rise in revenue to €1.9bn, although operating profit fell by a third, to €55m, thanks to rising fuel expenditure (with fuel costs up 74% year-on-year). The Icelandic volcano crisis also cost THY an estimated €6.5m. But net profits for the six month period totalled €138m, up substantially on the €48m net profit it made in the first-half of 2009.

Passengers carried rose 19.3% to 13.4 million in the January-June 2010 period, with RPKs rising by 26.8%, significantly ahead of a 19.9% increase in capacity, resulting in load factor leaping 4.1 percentage points to 72.1%. For the full year THY is looking to carry more than 31 million passengers.

Financially, THY is fairly strong. As at June 30th this year its long-term debt stood at €1.5bn, a figure that has remained stable for the last couple of years, while at the same date THY had €328m of cash and cash equivalents.

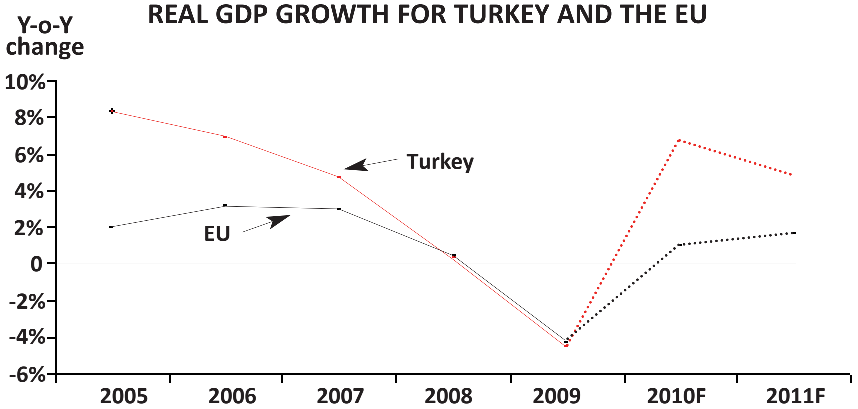
Time to acquire?

Overall, given its finances and its operational performance Kotil says the airline "is in heaven", and the airline is looking very closely at "three or four investment opportunities" in Europe, with an acquisition expected to be announced by the end of the year or early in 2011.

In July THY said it wanted to buy LOT Polish Airlines, although the deal was being held up by the restructuring of Poland's flag carrier. LOT is 68% owned by the Polish government and could offer THY a Warsaw hub, and THY's focus definitely appears to be to the north, with Kotil saying that "there is space for consolidation in eastern Europe, and we do not want to miss this opportunity".

In December 2008 THY agreed a deal to buy 49% of B&H Airlines, the flag carrier of Bosnia-Herzegovina based at Sarajevo airport. B&H operates four aircraft and had revenue of just €5m in the first-half of 2010. That deal has led to speculation that THY may invest in Serbia's flag carrier, Jat Airways, particularly after the Turkish prime minister visited Serbia over the summer and said that the two airlines needed to have a "close relationship" and that "a THY-Jat merger is the right decision". The Serbian government is actively searching for a strategic partner for Jat and will imminently start a second privati-

REAL GDP GROWTH FOR TURKEY AND THE EU



Source: *Eurostat, excluding Turkey forecast (E.I.U.)*

sation process for the airline.

Another airline that THY has been linked with in terms of an investment is Croatian Airlines, which is currently 95% owned by the Croatian state, while Russia may also be on THY's acquisition radar. THY currently operates to ten destinations in Russia and carried 600,000 passengers to/from the country last year, and in October this year Anadolu Jet started an Ankara-Moscow route. It has been reported that THY is interested in a strategic partnership with Aeroflot, although THY denied reports in the Turkish press of a joint start-up using a fleet of Sukhoi Superjet 100s.

THY is also being associated with a potential new airline in Iran, although more likely is a commercial agreement between THY and IranAir to include cross-selling and codesharing. More definite still is a potential aircraft component manufacturing venture by THY in collaboration with Turkish Aerospace Industries.

Of course it will not all be quite so "heavenly" for THY for ever. Sustained growth will inevitably increase cost pressure, although naturally management says it constantly endeavours to keep costs low (which may indicate a greater role for Anadolu Jet in the future). At some point THY may also encounter the "LCC problem" of finding enough profitable new routes to put its new capacity onto, although management says that as well as new routes it also aims to increase frequency on most of its existing network, given the high load factors that many routes are encountering.

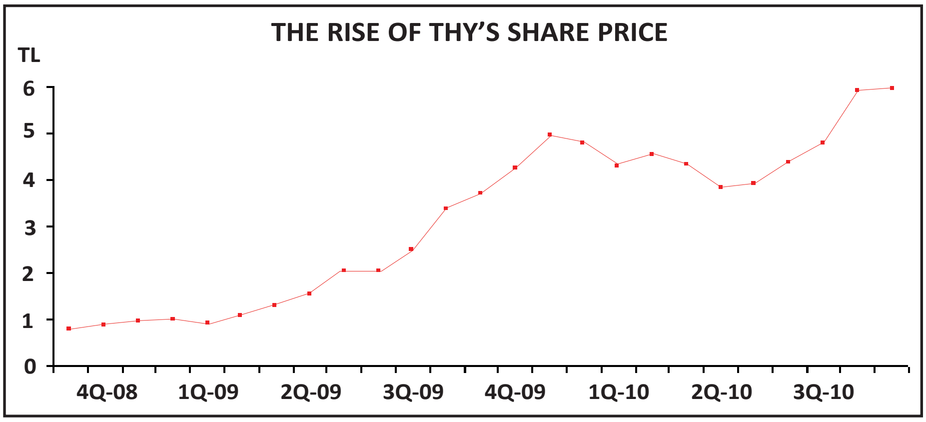
And THY's recent financial results have been magnified by the weak Turkish Lira, which boosts THY foreign currency revenue and reduces its costs. But this can't last forever, and indeed the Lira has been strengthening this year.

Also, THY will have to respond to expansion by rival airlines. The main threat may come from Pegasus Airlines, which was launched in 1990 by Aer Lingus and local Turkish partners but was bought by ESAS Holding in 2005 (which also owns a 16.5% stake in Air Berlin). The Istanbul-based airline operates both domestically and internationally to leisure and city destinations across Europe (including the UK, Germany, Russia and Greece), as well as to Iran. It has a fleet of 27 737s and has outstanding orders for another 26 737s, and began a partnership with Air Berlin in 2009 that will pose a threat to THY's routes, which currently cover nine destinations in Germany.

In relative terms those challenges are containable, particularly when THY still has the backing of the Turkish government, which retains 49.1% after the series of public offerings. That support shouldn't be underestimated, from the state's drive to sign bilaterals to the easing of visa restrictions with other countries to the ambition of joining the European Union (although that faces severe political impediments, from the influence of the military in Turkey to the occupation of northern Cyprus).

Crucially, the Turkish government is also planning a third airport at Istanbul, which would be able to handle around 60 million passengers a year. That capacity is needed urgently as the main airport, Ataturk, will run out of spare capacity in the next three or four years. A formal decision by the government on the third airport is expected by the end of 2010, and a positive decision will greatly aid THY in its longer-term plan to increase transit passengers as a proportion of international passengers carried up to two-thirds.

The general optimism about THY is being reflected in its share price, which has surged from under TL1 two years ago to around TL6 at present (see graph, above).



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Jet values and lease rates

The following tables reflect the current values (not "fair market") and lease rates for narrowbody and widebody jets. Figures are provided by The Aircraft Value Analysis Company (contact details opposite) are are not based exclusively on recent market transactions but more reflect AVAC's opinion of the worth of the aircraft. These figures are not solely based on market averages. In assessing current values, AVAC bases its calculations on many factors such as number of type in service, number on order and backlog, projected life span, build standard, specification etc. Lease rates are calculated independently of values and are all market based.

NARROWBODY VALUES (US$m)

	NEW	5 years old	10 years old	20 years old
A318	26.1	17.5		
A319 (IGW)		25.5	19.4	
A320-200 (IGW)		31.0	23.7	9.1
A321-200 (LGW)		34.4	25.4	

	NEW	5 years old	10 years old	20 years old
717-200		9.9	7.4	
737-300 (LGW A)				3.6
737-400 (LGW A)				3.7
737-500 (LGW A)				2.7
737-600 (LGW)		17.6	11.5	
737-700 (LGW)		25.7	19.9	
737-800 (LGW)		33.2	25.2	
737-900		25.2	18.4	
757-200 (RB 211)			15.4	9.2
757-200ER (PW)			15.2	9.1
757-300 (LGW)			17.5	
MD-82				1.5
MD-83				1.9
MD-87				1.4
MD-88				2.0

WIDEBODY VALUES (US$m)

	NEW	5 years old	10 years old	20 years old
A300B4-600				4.0
A300B4-600R				7.9
A310-300 (IGW)				5.4
A330-200			51.8	
A330-300 (IGW)			41.6	
A340-300 (LGW)			35.1	
A340-300			39.1	
A340-300ER			42.0	
A340-500 (IGW)		67.3		
A340-600 IGW)		67.8		
A380-800	197.1			

	NEW	5 years old	10 years old	20 years old
747-400 (PW)			43.7	18.6
767-200 (CF6)				3.7
767-300 (CF6)			16.9	8.2
767-300ER (LGW)			26.7	13.6
777-200 (PW)			37.4	
777-200ER	108.0	85.6	63.2	
777-300		72.7	50.7	
787-8	103.2			
MD-11P				14.5

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

NARROWBODY LEASE RATES (US$000s per month)

	NEW	5 years old	10 years old	20 years old
A318	242	175		
A319 (IGW)		251	204	
A320-200 (IGW)		287	246	135
A321-200 (LGW)		311	254	

	NEW	5 years old	10 years old	20 years old
717-200		137	110	
737-300 (LGW A)				79
737-400 (LGW A)				70
737-500 (LGW A)				59
737-600 (LGW)		148	113	
737-700 (LGW)		256	208	
737-800 (LGW)		301	256	
737-900		213	169	
757-200 (RB 211)			164	139
757-200ER (PW)			167	141
757-300 (LGW)			178	
MD-82				57
MD-83				58
MD-87				46
MD-88				68

WIDEBODY LEASE RATES (US$000s per month)

	NEW	5 years old	10 years old	20 years old
A300B4-600				119
A300B4-600R				115
A310-300 (IGW)				119
A330-200			547	
A330-300 (IGW)			459	
A340-300 (LGW)			449	
A340-300			474	
A340-300ER			499	
A340-500 (IGW)		741		
A340-600 IGW)		705		
A380-800	1,670			

	NEW	5 years old	10 years old	20 years old
747-400 (PW)			441	281
767-200 (CF6)				97
767-300 (CF6)			172	125
767-300ER (LGW)			325	245
777-200 (PW)			387	
777-200ER	914	774	643	
777-300		719	570	
787-8	862			
MD-11P				199

Source: *AVAC*
Note: As assessed at end-October 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.
Air France/ KLM Group	Oct-Dec 08	7,880	8,136	-256	-666	-3.2%	-8.5%	64,457	51,255	79.5%	17,934	106,773
YE 31/03	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
	Jul-Sep 09	8,015	8,082	-67	-210	-0.8%	-2.6%	66,862	56,141	84.0%	19,668	105,444
	Oct-Dec 09	7,679	8,041	-362	-436	-4.7%	-5.7%	61,407	49,220	80.2%	17,264	105,925
	Year 2009/10	**29,096**	**31,357**	**-2,261**	**-2,162**	**-7.8%**	**-7.4%**	**251,012**	**202,453**	**80.7%**	**71,394**	**104,721**
	Apr-Jun 10	7,301	7,469	-168	939	-2.3%	12.9%	60,345	49,283	81.7%	17,623	102,918
British Airways	Jul-Sep 08	4,725	4,524	201	-134	4.3%	-2.8%	38,911	29,480	75.8%	8,831	42,330
YE 31/03	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	
	Jul-Sep 09	3,479	3,507	-28	-167	-0.8%	-4.8%	37,767	31,552	83.5%	9,297	38,704
	Oct-Dec 09	3,328	3,287	41	-60	1.2%	-1.8%	34,248	26,667	77.9%	7,502	
	Year 2009/10	**12,761**	**13,130**	**-369**	**-678**	**-2.9%**	**-5.3%**	**141,178**	**110,851**	**78.5%**	**31,825**	**37,595**
	Apr-Jun 10	3,092	3,207	-115	-195	-3.7%	-6.3%	32,496	24,192	74.4%	7,013	
Iberia	**Year 2008**	**8,019**	**8,135**	**-116**	**47**	**-1.4%**	**0.6%**	**66,098**	**52,885**	**80.0%**		**21,578**
YE 31/12	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
	Jul-Sep 09	1,667	1,744	-77	-23	-4.6%	-1.4%	16,275	13,369	82.1%		21,113
	Oct-Dec 09	1,589	1,784	-195	-134	-12.3%	-8.5%	14,846	11,759	79.2%		20,096
	Year 2009	**6,149**	**6,796**	**-647**	**-381**	**-10.5%**	**-6.2%**	**62,158**	**49,612**	**79.8%**		**20,671**
	Jan-Mar 10	1,453	1,552	-98	-72	-6.8%	-5.0%	14,360	11,605	80.8%		19,643
	Apr-Jun 10	1,502	1,498	27	40	1.8%	2.6%	15,324	12,648	82.5%		20,045
	Jul-Sep 10	1,730	1,637	93	95	5.4%	5.5%	16,834	14,404	85.6%		20,668
Lufthansa	Jul-Sep 08	9,835	9,542	293	230	3.0%	2.3%	52,487	42,437	80.9%	18,913	109,401
YE 31/12	Oct-Dec 08	8,237	7,715	522	-5	6.3%	-0.1%	47,075	36,632	77.8%	17,150	108,711
	Year 2008	**36,551**	**34,625**	**1,926**	**812**	**5.3%**	**2.2%**	**195,431**	**154,155**	**78.9%**	**70,543**	**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
	Jul-Sep 09	8,484	8,061	423	272	5.0%	3.2%	56,756	46,780	82.4%	22,164	118,945
	Oct-Dec 09	9,041	9,090	-49	-109	-0.5%	-1.2%	55,395	43,110	77.8%	21,204	117,521
	Year 2009	**31,077**	**30,699**	**378**	**-139**	**1.2%**	**-0.4%**	**206,269**	**160,647**	**77.9%**	**76,543**	**112,320**
	Jan-Mar 10	7,978	8,435	-457	-413	-5.7%	-5.2%	52,292	39,181	74.9%	19,031	117,732
	Apr-Jun 10	8,763	8,560	203	248	2.3%	2.8%	57,565	45,788	79.5%	22,713	116,844
	Jul-Sep 10	9,764	8,754	1,010	810	10.3%	8.3%	63,883	53,355	83.5%	26,089	116,838
SAS	Jul-Sep 08	2,114	2,085	30	-316	1.4%	-14.9%	10,984	8,180	74.5%	7,325	24,298
YE 31/12	Oct-Dec 08	1,652	1,689	-36	-359	-2.2%	-21.7%	9,750	6,559	67.3%	6,612	23,082
	Year 2008	**8,120**	**8,277**	**-107**	**-977**	**-1.3%**	**-12.0%**	**41,993**	**29,916**	**71.2%**	**29,000**	**24,635**
	Jan-Mar 09	1,352	1,469	-118	-90	-8.7%	-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
	Jul-Sep 09	1,522	1,486	36	21	2.3%	1.4%	8,958	6,868	76.7%	6,245	17,825
	Oct-Dec 09	1,474	1,676	-202	-186	-13.7%	-12.6%	8,160	5,764	70.6%	6,055	16,510
	Year 2009	**5,914**	**6,320**	**-406**	**-388**	**-6.9%**	**-6.6%**	**35,571**	**25,228**	**70.9%**	**24,898**	**18,786**
	Jan-Mar 10	1,322	1,428	-106	-99	-8.0%	-7.5%	7,951	5,471	68.8%	5,735	15,835
	Apr-Jun 10	1,321	1,367	-46	-66	-3.5%	-5.0%	8,769	6,612	75.4%	6,282	15,709
Ryanair	Apr-Jun 08	1,215	1,202	13	-141	1.0%	-11.6%			81.0%	14,953	
YE 31/03	Jul-Sep 08	1,555	1,250	305	280	19.6%	18.0%			88.0%	16,675	
	Oct-Dec 08	798	942	-144	-157	-18.0%	-19.7%			71.3%	14,029	6,298
	Jan-Mar 09	623	592	31	-223	5.0%	-35.8%			74.6%	12,902	
	Year 2008/09	**4,191**	**3,986**	**205**	**-241**	**4.9%**	**-5.7%**			**81.0%**	**58,559**	
	Apr-Jun 09	1,055	844	211	168	20.0%	15.9%			83.0%	16,600	
	Jul-Sep 09	1,418	992	426	358	30.0%	25.2%			88.0%	19,800	
	Oct-Dec 09	904	902	2	-16	0.2%	-1.8%			82.0%	16,021	
	Year 2009/10	**4,244**	**3,656**	**568**	**431**	**13.5%**	**10.2%**			**82.0%**	**66,500**	
	Apr-Jun 10	1,145	992	152	120	13.3%	10.5%			83.0%	18,000	7,828
	Jul-Sep 10	1,658	1,150	508	426	30.7%	25.7%			85.0%	22,000	8,100
easyJet	**Year 2006/07**	**3,679**	**3,069**	**610**	**311**	**16.6%**	**8.5%**	**43,501**	**36,976**	**83.7%**	**37,200**	**5,674**
YE 30/09	Oct 07-Mar 08	1,795	1,772	22	-87	1.2%	-4.8%	23,442	19,300	82.3%	18,900	
	Apr-Sep 08	2,867	2,710	157	251	5.5%	8.7%	32,245	28,390	88.0%	24,800	
	Year 2007/08	**4,662**	**4,483**	**180**	**164**	**3.9%**	**3.5%**	**55,687**	**47,690**	**85.6%**	**43,700**	**6,107**
	Oct 08-Mar 09	1,557	1,731	-174	-130	-11.2%	-8.3%	24,754	21,017	84.9%	19,400	
	Apr-Sep 09	2,607	2,063	280	251	10.7%	9.6%	33,411	29,549	88.4%	25,800	
	Year 2008/09	**4,138**	**3,789**	**93**	**110**	**2.3%**	**2.7%**	**58,165**	**50,566**	**86.9%**	**45,200**	
	Oct 09-Mar10	1,871	1,995	-106	-94	-5.6%	-5.0	27,077	23,633	87.3%	21,500	

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation.

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Alaska	Jan-Mar 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
	Jul-Sep 09	967	807	160	88	16.5%	9.1%	9,812	8,079	82.3%	4,240	9,002
	Oct-Dec 09	846	793	53	24	6.3%	2.8%	9,133	7,322	80.2%	3,765	8,701
	Year 2009	**3,399**	**3,132**	**267**	**122**	**7.9%**	**3.6%**	**37,246**	**29,550**	**79.3%**	**15,561**	**8,915**
	Jan-Mar 10	830	804	26	5	3.1%	0.6%	8,917	7,197	80.7%	3,641	8,537
	Apr-Jun 10	976	866	110	59	11.3%	6.0%	9,836	8,162	83.0%	4,170	8,621
American	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
	Jul-Sep 09	5,126	5,320	-194	-359	-3.8%	-7.0%	62,026	52,064	83.9%	22,403	78,700
	Oct-Dec 09	5,063	5,453	-390	-344	-7.7%	-6.8%	59,356	48,131	81.1%	20,893	78,000
	Year 2009	**19,917**	**20,921**	**-1,004**	**-1,468**	**-5.0%**	**-7.4%**	**244,250**	**197,007**	**80.7%**	**85,719**	**78,900**
	Jan-Mar 10	5,068	5,366	-298	-505	-5.9%	-10.0%	59,296	46,187	77.9%	20,168	77,800
	Apr-Jun 10	5,674	5478	196	-11	3.5%	-0.2%	61,788	51,821	83.9%	22,166	78,300
	Jul-Sep 10	5,842	5,500	342	143	5.9%	2.4%	64,277	53,985	84.0%	22,468	78,600
Continental	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
	Jul-Sep 09	3,317	3,256	61	-18	1.8%	-0.5%	46,562	39,616	85.1%	16,795	41,000
	Oct-Dec 09	3,182	3,181	1	85	0.0%	2.7%	42,308	34,700	82.0%	15,258	41,000
	Year 2009	**12,586**	**12,732**	**-146**	**-282**	**-1.2%**	**-2.2%**	**176,305**	**143,447**	**81.4%**	**62,809**	**41,000**
	Jan-Mar 10	3,169	3,220	-51	-146	-1.6%	-4.6%	42,350	33,665	79.5%	14,535	39,365
	Apr-Jun 10	3,708	3,380	328	233	8.8%	6.3%	39,893	33,910	85.0%	16,300	38,800
Delta	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
	Jul-Sep 09	7,574	7,370	204	-161	2.7%	-2.1%	100,115	85,904	85.8%	43,742	81,740
	Oct-Dec 09	6,805	6,851	-46	-25	-0.7%	-0.4%	85,814	70,099	81.7%	37,947	81,106
	Year 2009	**28,063**	**28,387**	**-324**	**-1,237**	**-1.2%**	**-4.4%**	**370,672**	**304,066**	**82.0%**	**161,049**	**81,106**
	Jan-Mar 10	6,848	6,780	68	-256	1.0%	-3.7%	85,777	68,181	79.5%	36,553	81,096
	Apr-Jun 10	8,168	7,316	852	467	10.4%	5.7%	94,463	80,294	85.0%	42,207	81,916
	Jul-Sep 10	8,950	7,947	1,003	363	11.2%	4.1%	102,445	87,644	85.6%	44,165	79,005
Southwest	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
	Jul-Sep 09	2,666	2,644	22	-16	0.8%	-0.6%	39,864	31,714	79.6%	26,396	34,806
	Oct-Dec 09	2,712	2,545	167	116	6.2%	4.3%	37,828	29,249	77.3%	25,386	34,726
	Year 2009	**10,350**	**10,088**	**262**	**99**	**2.5%**	**1.0%**	**157,714**	**119,823**	**76.0%**	**101,338**	**34,726**
	Jan-Mar 10	2,630	2,576	54	11	2.1%	0.4%	36,401	27,618	75.9%	23,694	34,637
	Apr-Jun 10	3,168	2,805	363	112	11.5%	3.5%	40,992	32,517	79.3%	22,883	34,636
	Jul-Sep 10	3,192	2,837	355	205	11.1%	6.4%	41,130	33,269	80.9%	22,879	34,836
United	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
	Jul-Sep 09	4,433	4,345	88	-57	2.0%	-1.3%	59,599	50,572	84.9%	22,076	43,600
	Oct-Dec 09	4,193	4,267	-74	-240	-1.8%	-5.7%	54,121	44,273	81.8%	19,618	42,700
	Year 2009	**16,335**	**16,496**	**-161**	**-651**	**-1.0%**	**-4.0%**	**226,454**	**183,854**	**81.2%**	**81,246**	**43,600**
	Jan-Mar 10	4,241	4,172	69	-82	1.6%	-1.9%	53,023	42,614	80.4%	18,818	42,800
	Apr-Jun 10	5,161	4,727	434	273	8.4%	5.3%	58,522	49,319	84.3%	21,234	42,600
	Jul-Sep 10	5,394	4,859	535	387	9.9%	7.2%	61,134	52,534	85.9%	22,253	42,700
US Airways Group	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
	Jul-Sep 09	2,719	2,713	6	-80	0.2%	-2.9%	36,214	29,920	82.6%	20,284	31,592
	Oct-Dec 09	2,626	2,612	14	-79	0.5%	-3.0%	32,456	25,509	78.6%	18,801	31,333
	Year 2009	**10,458**	**10.340**	**118**	**-205**	**1.1%**	**-2.0%**	**136,939**	**110,171**	**80.5%**	**77,965**	**31,333**
	Jan-Mar 10	2,651	2,661	-10	-45	-0.4%	-1.7%	31,957	24,659	77.2%	17,931	30,439
	Apr-Jun 10	3,171	2,800	371	279	11.7%	8.7%	35,517	29,461	82.9%	20,642	30,860
	Jul-Sep 10	3,179	2,864	315	240	9.9%	7.5%	36,808	30.604	83.1%	20,868	30,445
JetBlue	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
	Jul-Sep 09	854	788	66	15	7.7%	1.8%	13,504	11,309	83.7%	6,011	10,246
	Oct-Dec 09	832	768	64	11	7.7%	1.3%	12,855	10,208	79.4%	5,457	10,704
	Year 2009	**3,286**	**3,007**	**279**	**58**	**8.5%**	**1.8%**	**52,396**	**41,769**	**79.7%**	**22,450**	**10,704**
	Jan-Mar 10	870	828	42	-1	4.8%	-0.1%	13,557	10,412	76.8%	5,528	11,084
	Apr-Jun 10	939	845	94	30	10.0%	3.2%	13,981	11,468	82.0%	6,114	10,906
	Jul-Sep 10	1,039	890	140	59	13.5%	5.7%	14,648	12,390	84.6%	6,573	10,669

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

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
ANA	Year 2005/06	12,040	11,259	781	235	6.5%	2.0%	86,933	58,949	67.8%	49,920	30,322
YE 31/03	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	
	Year 2009/10	13,238	13,831	-582	-614	-4.4%	-4.6%	83,827	55,617	66.3%	44,560	
Cathay Pacific	Jan-Jun 07	4,440	4,031	409	341	9.2%	7.7%	49,836	38,938	79.6%	8,474	19,207
YE 31/12	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
	Jan-Jun 10	5,320	4,681	917	892	17.2%	16.8%	55,681	46,784	84.0%	12,954	
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	Year 2006/07	11,975	11,106	869	568	7.3%	4.7%	122,119	97,622	79.9%	36,450	34,267
YE 30/6	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
	Year 2009/10	12,150	11,926	223	102	1.8%	0.8%	124,717	100,727	80.8%	41,428	32,490
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	7,523	6,718	805	710	10.7%	9.4%	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	Jan-Mar 09	198	84	114	56	57.6%	28.4%	5,207	3,487	67.0%	3,147	
YE 31/12	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	
	Jan-Mar 10	260	159	89	66	34.2%	25.4%	5,929	4,090	68.9%	3,700	7,500

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
August 10	31.2	23.8	76.3	22.2	19.6	88.2	15.9	13.8	86.7	55.8	48.3	86.5	85.9	71.5	83.2
Ann. change	3.6%	4.6%	0.7	-0.7%	-1.5%	-0.8	-0.3%	1.4%	1.5	0.6%	1.4%	0.7	1.4%	2.1%	0.6
Jan-Aug 10	221.5	154.4	69.7	148.8	125.2	84.2	117.8	98.2	83.4	398.1	330.6	83.1	610.1	480.2	78.7
Ann. change	-1.7%	0.8%	1.8	-4.5%	-0.9%	3.0	-3.8%	1.4%	4.3	-2.4%	1.3%	3.1	-2.1%	1.4%	2.7

Source: AEA.

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	08 Nov	Saudi Arabian A/L	12 x 777-300ER	plus 10 options
	08 Nov	Midwest Airlines	1 x 737-800	
	08 Nov	SpiceJet	30 x 737-800	
	02 Nov	BOC Aviation	8 x 777-300ER	
Airbus	04 Nov	China Aviation Supplies Hldg.	50 x A320 family, 6 x A330, 10 x A350XWB	
	03 Nov	BOC Aviation	30 x A320 family	
	13 Oct	Hong Kong A/L	10 x A330-200, 15 x A350XWB	

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