Aviation Strategy

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easyJet: A tale of two strategies

Once again easyJet appears to be running into a conflict with founder and major shareholder Sir Stelios Haji-Ioannou. This month the chairman of easyGroup published an open letter to the board of easyJet questioning the legality and requesting further clarification of the company's announcement in January this year – when it stated that it had converted 15 existing A320 options to firm orders, 20 existing A319 contracted deliveries to A320 deliveries and had secured options on a further 33 A320s.

In particular he seems to be demanding that the shareholders should be given a chance of reflecting on a new Class 1 Circular detailing the order (a document to shareholders required under stock market regulations in particular circumstances that could have material impact on a company's financial position), given that its size will impact the company's valuation – these aircraft represent capex of $5.75bn at list prices against easyJet's market capitalisation of $3.2bn at the time of the announcement. He also required that the confidential discounts to list price be disclosed (that *really* would please Airbus). Whatever might be said about the personalities involved, there is a fundamental difference of opinion: the pursuit of market share and growth or the generation of profits and dividends.

As Ryanair with Boeing, easyJet created a substantial advantage for itself by signing a long-term deal with Airbus in 2002 (expanded in 2006) for up to 120 A319s (and a further 120 purchase rights) at a time when both the major aircraft manufacturers were desperate for orders of any kind. At the time the A319 had a "list price" of around $50m but (although the negotiated price is highly confidential) we would estimate that the company achieved a discount to list of well over 50%, giving an in-price in the low $20m range - and that this superior discount has had a lasting positive impact on the company's cost base: indeed it is possible to calculate that the sum of these superior discounts of those aircraft delivered could equate to some 80% of the company's total balance sheet equity. In the announcement in January the company said that the new aircraft order (and the conversions) were all related to the original deal, the A320s must be coming into the fleet well below current "fair values". This should still give easyJet a continuing ownership cost competitive advantage.

At the time of the original order it appeared that the 156 seat A319 offered superior operating economics for easyJet's then route profile; it is only in recent years as the network has been maturing and (perhaps more particularly) fuel prices have risen that the higher capacity 180 seat A320 has appeared more attractive, since when easyJet has been gradually increasing the sub-fleet. Stelios may have a point in his letter that the board should have considered discussions with Boeing perhaps

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for the 737-800 as an alternative. But the board probably did; and it would have been intriguing to know whether they could have bettered the advantageous Airbus contract considering that order books are now so full.

The company's growth since that aircraft order in the early 2000s has been substantial – from 26 aircraft at the end of 2001 to 196 by the end of 2010. The number of passengers booked has increased by a compound annual average 24% from 7m in 2001 to 48m in the year ended September 2010. According to IATA in 2010 it was the world's third largest carrier by numbers of international passengers carried and the 14th largest by total numbers of passengers. The operation currently has 19 bases in the UK, France, Germany, Italy and Spain (with the twentieth, in Lisbon, due to open in winter 2011).

easyJet can claim to be one of only two carriers with a truly pan-European brand; and by 2010 has built a share of intra-European traffic of over 8% (albeit two-thirds the size of Ryanair). It is the largest intra-European carrier by number of departing seats in the UK, and second largest behind the incumbent flag carrier groups in the Netherlands, Switzerland, Portugal, France, Greece (assuming the effective non-competition pact between Olympic and Aegean), Gibraltar and Slovenia. The UK is still its largest area of operation accounting for 35% of departing seats in 2010, while Italy, France and Spain each accounted for a further 13%.

Over the same period revenues have grown by a compound annual average 26% to £2.9bn from £356m and profits went from £40m in 2001 to a peak of £202m in 2007 – dipping thereafter but at least have recovered to £154m in the year to end September 2010 despite an estimated £57m impact of the eruption of Eyjafjallajøkull.

However, whereas fuel accounted for a mere 15% of easyJet's operating costs in fiscal 2001, in the last financial year it accounted for nearly 30% (and without hedging gains could have accounted for nearly 40%) of costs. With energy costs likely to remain high, with the introduction of ETS on top of other passenger taxes, and the sluggish recovery in European economies the effect on demand must be depressing – and this certainly raises questions about the advisability of pursuing growth per se. Another changed factor is that Europe's largest airline, Ryanair, has seemingly announced plans to halt growth and switch to generating cash and dividends to shareholders.

Still, the fleet order in January was probably necessary – and heralded at the announcement of the annual results in November 2010 when the management pointed out that firm orders from Airbus would finish in 2012 – as some of the earlier A319s are eight years old. As the plan stands the company suggests that its fleet will grow from 196 at the end of September 2010 by an average net eight units a year to end September 2013 with a fleet of 220 aircraft (all Airbus A320 family). The company maintains a significant level of flexibility with 74 of the current fleet on operating lease and 111 owned – and has a target of maintaining 30% of the fleet leased.

In its response to Stelios the board mentioned that it would be ensuring a winter fleet capacity of 204 aircraft for the next two years (emphasised in its recent interim management statement) – suggesting perhaps that as with Ryanair it is looking at increased seasonality of business and the sense of parking aircraft in the winter (see *Aviation Strategy*, June 2011),

At the time of the annual results last November, easyJet revealed elements of its strategic review. Under the grand vision of "turning Europe orange", it highlighted its intention to build towards a 10% share of intra-European traffic with annual increases in capacity for the next couple of years of around 7-8%; while emphasising that its fleet flexibility allowed it a longer term range of 4-8% growth thereafter. Seemingly bowing to the pressure from Stelios, it announced the intention to declare a modest dividend for the year ended September 2011 (and payable in 2012) along with targets of achieving profits of £5 per passenger (against an underlying profit per pax in 2010 of £3.36) and returns on capital employed of 12% through the cycle.

At the same time the company stated its intention to pursue more business-orientated markets and traffic – though its own figures indicate that it only has a 4% share of intra-European business passengers. easyJet has a preference for mainstream primary and secondary airports, and increasingly operates business-friendly schedules (three daily rotations being the prerequisite). It had already been promoting through the GDSs and noted that on such ticket sales it achieves a 20-30% uplift in yield.

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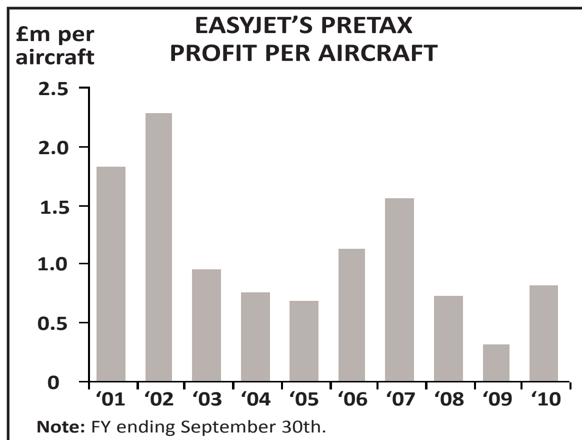


Note: FY ending September 30th.

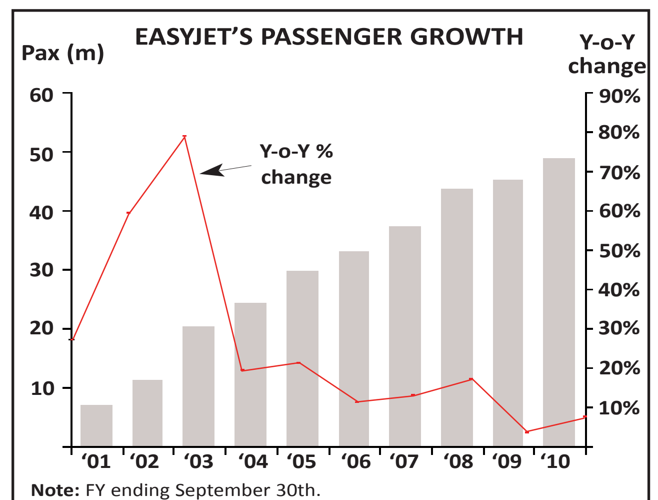
easyJet is recruiting a corporate sales team, has already introduced an online flexible fare and has been increasing frequencies and improving time of day departures on key weekday business routes further to increase attractiveness for business day- and short-trips. In addition some of the usual "perks" of intra-European business travel can be bought on the website – including priority boarding and business lounge access. It has yet to go as far as introducing seat assignment or a frequent flyer plan; but these will come in time.

In the Q3 interim management statement (for the period up to June) the management emphasised progress in this strategy. Passenger and seat numbers were up by 17% year on year in the quarter (9% excluding the closure of European airspace last year) and total revenue per passenger climbed by 5%, including a strong 17% increase in ancillary revenues per passenger – due in part to the improvements in "quality" of the network structure, and particularly on capacity based in France, Switzerland, Spain and Italy, and higher yield routes out of London.

At the same time it stated that it expected to be able to announce a pre-tax profit for the full year to September of between £200m and £230m (giving a return on capital of between 10% and 12% and bringing it back to reporting profits of over £1m per aircraft). However, it has reined in its plans for 2012. The company now expects to keep capacity flat in the winter – with a maximum of 204 aircraft in the fleet for the next two winter seasons – and expects capacity for the full year to September 2012 to rise by 3-4% (implying an 8% increase in peak season seats); and by implication capacity growth in FY 2013 looks set to be similar. As with Ryanair, if it sticks to its plans to have 220 aircraft in the fleet by end 2013, it will be grounding increasing numbers of aircraft in the off-season.

easyJet has tended to differentiate itself from Ryanair and now is trying to move even more "up market" by chasing the higher yielding business passenger. This, by its nature could lead to increasing operations at congested primary airports and perhaps a deterioration of its ability to maintain the high utilisation and quick turnaround times essential to keep costs to a minimum, while it certainly adds to the complexity of operation and may blur the LCC KISS principle and make it increasingly look like a "normal" airline.

There is still a wide gap between easyJet's costs and those of its legacy carrier competitors, which may mean that this will not necessarily act as a constraint on growth potential (and there may of course be the possibility of linking with one of the legacy carriers to provide feed, as Air Berlin has done by joining oneworld). easyJet could achieve its stated aim of a 10% share of intra-European traffic within five or six years with an annual 8% growth but with the next two years' capacity possibly running at half this level that target may be extended to the end of the decade. If on the other hand easyJet were to abandon this stated aim and not take on new aircraft beyond 2012, growth would be muted and it could perhaps concentrate on the more profitable elements of the route network to achieve that £5/pax target quicker, and some £400m a year capital expenditure would be avoided to flow straight through to increasing cash balances (and paying dividends) – although storing up pressures on direct operating costs as the fleet ages.



Note: FY ending September 30th.

AMR: Time to stem the losses

The $40bn of orders that American announced in July for 460 Airbus and Boeing narrowbody aircraft, aimed at "turbo-charging" fleet renewal and "positioning the company for long-term success", have not been well received in the investment community. Many analysts have questioned how the airline can justify such spending while failing to earn returns on its existing capital base.

JP Morgan analysts were quite scathing in their criticism in a July 20 research note: "When enterprises lose money by such a wide margin relative to peers, one would normally expect a material cost-reduction program and/or aggressive top-line strategy in response. We see neither in the case of AMR."

And UBS analysts were just as blunt: "This announcement represents a ton of new capital being put into a failing business model. We hope management is able to reassure the Street that profits are imminent to support this level of expenditure."

AMR has had only two profitable years in the last decade (2006 and 2007). It incurred net losses totalling $12.2bn in 2001-2010 and is expected to lose more than $1bn in the next two years (according to Thomson/First Call consensus estimates).

AMR reported a disastrous $286m net loss for the quarter ended June 30, compared to a year-earlier loss of $11m, when all the other US major carriers remained profitable, albeit at reduced levels because of the sharply higher fuel prices. AMR also had an operating loss (1.3% of revenues) in what is typically one of the industry's strongest quarters.

Analysts are particularly unhappy because American's relative margin performance worsened in the second quarter – a reversal of a previous convergence trend. Bank of America Merrill Lynch estimated that AMR's operating margin was seven points below the industry average margin.

AMR's management have long been fond of making the point (in quarterly calls and presentations) that airlines must plan for the long term even while managing through near-term challenges. The problem is that AMR seems to have focused exclusively on planning for the long term.

All of the management's proposed remedies to the lagging financial performance bear fruit only in the distant future. The $500m in annual revenue benefits anticipated from the transatlantic and transpacific joint ventures and the "cornerstone" initiatives will not be realised until the end of 2012. The expected convergence of AMR's and its competitors' labour costs will take years. And now the fleet modernisation – a five-year process. Not surprising analysts could not muster enthusiasm for the orders.

So what is needed now is for the management to start managing for the near-term, with the aim of stemming the losses. That was basically the message many analysts were trying to convey to the management in AMR's second-quarter call.

Another problem that American has had in recent times is that it does not want to cut capacity. It has been demoted from the largest US airline to number three as a result of the Delta-Northwest and United-Continental mergers. It is likely to have lost corporate market share as a result of the increased scale and strength of the merged entities. It is behind competitors in global alliance building efforts. And, because it cut capacity more aggressively than competitors a few years ago, American has been using that as the justification for needing to cut less now.

But the world does not work like that. It does not matter what happened in the past; if American is posting losses when other airlines are profitable, it probably should cut more deeply than other airlines.

Prompted by the second-quarter losses and growing concerns about the global economy and potentially weakening air travel demand in the autumn, like its peers, American has announced new cost and capacity cuts. It is adjusting its autumn schedule, eliminating routes such as San Francisco-Honolulu and Los Angeles-San Salvador, temporarily suspending New York-Tokyo Haneda (through mid-2012) and closing its reserva-

tions office in Dublin. Together with its JV partners, it is in the process of evaluating the transatlantic winter schedule. These measures mean that mainline capacity will now increase by 1.9% in 2011, consisting of 5% international growth and flat domestic capacity.

In conjunction with the aircraft orders, AMR also announced its intent to move forward with the divestiture of AMR Eagle, which it first talked about a couple of years ago. More detail will be disclosed in August. The current thinking is that the regional unit will be spun off to AMR shareholders.

AMR is the only one of the large network carriers that has kept most of its regional flying in-house. This has inevitably meant higher costs, so Eagle's divestiture should lead to American securing more competitive rates and services for its regional feed.

The Airbus and Boeing orders

The deals announced on July 20 included firm orders for 460 aircraft, with deliveries beginning in 2013, and options and purchase rights for 465 additional aircraft through 2025. American has said that it considers them as two separate orders, rather than as an order split between the manufacturers.

As part of the Boeing deal, American will take 100 of the current 737NG family (starting in 2013), plus 100 of the future 737NG that will be powered by CFM International's LEAP-X engines (which Boeing is expected to formally launch this autumn). As part of the Airbus deal, American will take 130 of current-generation A320 family (also starting in 2013), plus 130 A320neos from 2017.

So American will be the first US network carrier to receive the A320neo and the first airline to commit to Boeing's expected new 737 family offering.

These orders will enable American to rapidly renew its narrowbody fleet, to achieve the "youngest, most fuel-efficient fleet among US industry peers in about five years". American operates some of the oldest aircraft in US fleets; its 224 MD-80s average 20+ years of age. The airline is looking to reduce its fleet age from 14.8 years at the end of 2010 (similar to Delta's) to 9.5 years by the end of 2017.

Some commentators have argued that it did not make sense to order both 737s and A320s. But American will still be able to simplify its fleet. It will transition from four fleet types (MD-80, 737-800, 757 and 767-200) to two (the 737 and A320 families).

Significantly, American will benefit from around $13bn of committed financing provided by Airbus and Boeing through lease transactions. This covers the first 230 deliveries. In other words, half of the aircraft will be taken on operating leases.

The details and terms of the financing are obviously strictly confidential, but the speculation is that this was simply too good a deal to miss. AMR CEO Gerard Arpey described it as "an incredible opportunity for our company that presented itself from two great manufacturers". Given the unique circumstances – Airbus' strong desire to win American back, Boeing's horror at potentially losing the exclusive relationship, etc – American was able to play the manufacturers off against each other like no other airline has before. It would have been a fool not to grab this opportunity. American estimates that the transaction will create $1.5bn of net present value.

Of the US network carriers, American probably deserved this type of opportunity the most, because it has never been in Chapter 11 bankruptcy. When announcing the orders, Arpey reminded everyone that "we have a long track record of meeting our obligations to all of our stakeholders, including strategic partners, lenders, suppliers and investors".

These orders will significantly increase American's lease-adjusted debt burden in the future. AMR is already highly leveraged, with total lease-adjusted debt of $17.1bn at the end of June, and has significant debt repayments scheduled over the next few years.

However, AMR is not currently considered a Chapter 11 risk. Even JP Morgan analysts played down that possibility: "We simply don't view an AMR Chapter 11 filing as likely or even close to likely given current industry dynamics."

The deals give American the ability to acquire up to 925 aircraft over 12 years. With the long-term fleet plans in place, perhaps more management time will focus on sorting out the tough labour issues.

By Heini Nuutinen
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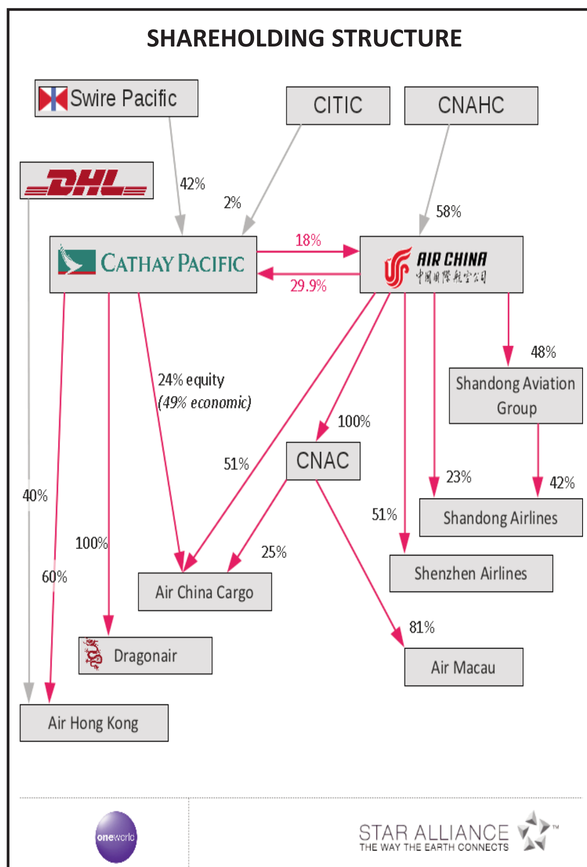
Cathay Pacific: Western approach to the East

As the hub carrier in Hong Kong, Cathay Pacific provides one of the major international gateways into China – the world's economic powerhouse – which in the medium term is likely to provide the highest rate of air traffic growth of any region in the world. Cathay should be able to benefit strongly from this growth, assuming it can exploit its strategic link with Air China.

Hong Kong itself as a major financial and manufacturing centre provides a solid level of point to point demand, and the economy is again growing strongly: after a 2% contraction in 2009 the GDP grew by 7% in 2010 and recent IMF forecasts suggest annual GDP growth of 4-5% a year for the next few years. China, however, saw GDP grow by 10% in 2010 (and it was hardly affected by the global slowdown) and the economy is forecast to increase at a similar rate of between 9% and 10% in the medium term.



Statistics from CAAC show that Chinese airlines' total air traffic growth in RPKs has averaged 15% a year in the past decade – with an average annual compound growth of 16% on domestic routes and 12% on international routes. Included within domestic routes those to Hong Kong and Macau (which exclude Cathay's and Dragonair's figures) have seen annual average growth of only 7%. However in 2010, total domestic traffic grew by 16%, Hong Kong and Macau traffic by 29% and international traffic increased by 33%. With its large population, increasing urbanisation and strong growth in per capita incomes the Chinese originating market is growing fast. It overtook Japan as the largest originating tourist market in 2003 and is expected to provide some 65m people travelling overseas in 2011. By 2020 the WTO estimates that this will grow to 100m people a year.

Cathay has one of the major gateways into China – but is seeing increasing competition from the developments of Air China at Beijing, China Eastern at Shanghai and China Southern in neighbouring Guangzhou. Also, the number of international gateways away from the major three mainland hubs is likely to grow as China increasingly opens; and as the PRC progressively permits cross-Straits flights to Taiwan there is a possibility of increased erosion of transfer demand between Hong Kong and the island. Even so, the Hong Kong-Taipei route is still the busiest international route in the world with nearly 6m passengers in 2010 (and Cathay operates 108 flights a week to Taipei and 28 a week to Kaohsiung). (Meanwhile, of note, the route between Hong Kong and Shanghai is the world's sixth densest route with over 3m passengers a year and five of the top ten international routes in Asia involve Hong Kong).

Relationships in China notoriously take time to develop. Cathay Pacific, its immediate parent Swire Pacific and ultimate parent John Swire & Sons have a distinct advantage in their commitment to the region over the past 160 years; and a strong positive benefit from being one of the British hongs not to have left Hong Kong on the handover to the PRC in 1997. Cathay has been

positioning itself with the Chinese aviation operators for the past 20 years. In the early 1990s the group accepted an investment from mainland government fund CITIC and CNAC in return for relinquishing control of Dragonair which had achieved significant access to mainland Chinese routes. In 2004 on the IPO of the new Beijing-based Air China, Cathay acquired an initial 10% stake. Two years later and nearly ten years after the handover, in 2006, Cathay and Air China created a mutual strategic partnership in which among other things Cathay took back full control of Dragonair (at last providing the opportunity to develop a true network transfer operation at HKIA) increased its shareholding in Air China from 10% to 17.3% while Air China acquired a 17.5% stake in Cathay. In 2009 this was extended by a further realignment of shareholdings: Air China increased its stake to 29.9% and Swire Pacific its interest in Cathay back above 40%.

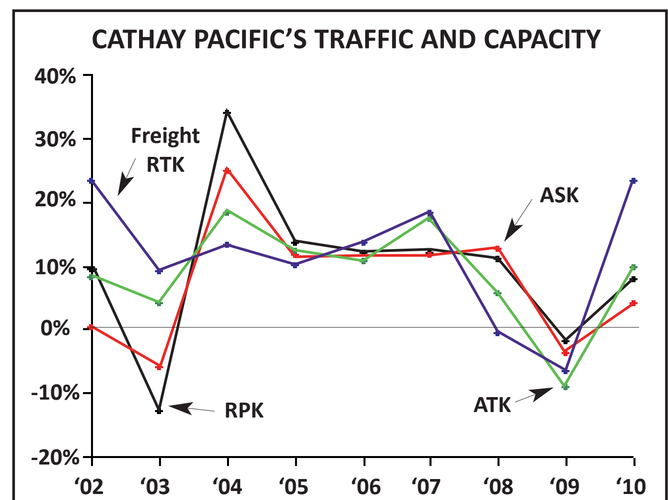
The fact that the two carriers are in different global branded alliances – Cathay a founding member of oneworld and Air China in Star – may be irrelevant given the growth potential in their local markets.

Last year the two carriers also received regulatory approval for a cargo joint venture which has been put into effect this year: based in Shanghai and using Air China's existing cargo subsidiary Cathay will be selling a handful of 747-400BCFs and providing management expertise. Cathay has a 24% equity interest (funded by the sale of the freighters) and an additional 25% economic interest in the JV.

Cathay's current strategy is stated as:

- to develop HKG as one of the world's leading aviation hubs
- fully support the development of a third runway at HKIA
- no compromise in quality and brand, strong service proposition to the customer
- develop benefits from the strategic relationship with Air China
- prudent financial approach

It recognises that its cost base remains relatively high in comparison with near neighbour competitors and that its competitive advantage is in the quality of operation and service. It is concentrating increasingly on developing frequencies of lower capacity aircraft on long haul routes to maximise the premium potential and minimise the requirement to fill the back-of-the-



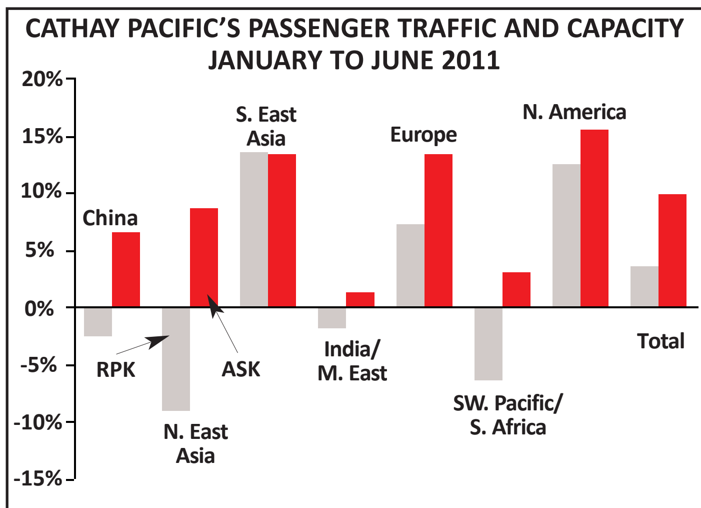
bus on ultra low fares; while recognising that the most valuable transfer traffic is the premium transfer traffic and that to build and maintain an efficient transfer hub at Hong Kong high value transfer traffic is required. The recent order for A350s (see below) is in part to provide a replacement for the ageing and operationally expensive 747s and A340s. Were the third runway at Hong Kong not to gain approval, perhaps this fleet strategy must needs change; and in time the group would reconsider the A380 or 747-8 for high density routes.

Recent performance

Cathay has benefited strongly from the region's growth in the last ten years. Since 2001 total passenger traffic in RPK has grown by a compound annual average 9% - despite the gyrations of the impact of SARS in 2003 and the post-Lehman downturn in 2009. Freight traffic has grown faster with a compound annual growth of 11%; while total capacity in ATK has increased at an average 8% a year.

It has increased its route network substantially with 146 destinations served in 2010 up from 56 in 2001; and in doing so it has managed to improve staff efficiency (in terms of ATK per employee) by an average 4.5% a year. Between 2000 and 2007 it remained consistently profitable, averaging a 9.2% operating margin and 7.5% net margin.

In 2008 with the turn of the cycle, the group turned in its first major loss of over HKD8bn (US$1bn) – but almost all was due to the need to mark hedging contracts to markets (along with a provision for its share of similar losses at



Air China). Despite the weak operating environment in 2009, the company still managed to return a profit – of HKD4.6bn – and this time saw a HK$2bn recognition of mark-to-market profits on fuel hedge contracts. The balance sheet had been badly impacted by the 2008 losses – with net debt to equity rising from 30% to 69% and the group decided to sell nearly half of its 27% holding in HAECO to parent company Swire Pacific.

In 2010 the group benefited strongly as passenger demand – both premium and economy - as well as freight demand bounced back from the recession. Total passenger capacity increased by a modest 4% as the group gradually restored services halted in the previous year – particularly from June onwards. Passenger demand grew at twice this rate and the total numbers of passengers increased to a record for the company of 26.8m up by 9%. The recovery in premium demand from the lows of 2009 along with reasonably strong economy demand led to a 20% bounce back in yields – almost back to the level of 2008 – and total passenger revenues jumped by nearly 30%. The recovery in the freight business was more dramatic with an 18% growth in freight traffic while capacity increased by 15% as the group progressively dusted off the sand from the freighters it had parked in the previous year. Freight yields recovered by 25% and total freight revenues increased by over 50%.

Total group revenues were up by a third on the prior year levels. Fuel prices however rose by 28% during the year and total fuel costs excluding hedging increased by 40% year on year: total fuel expenditure accounted for 36% of total costs. Further to improve the balance sheet the group sold its remaining 15% in HAECO and its shareholding in Hactl to parent company Swire Pacific, helping to generate exceptional gains of HK$2bn. In addition, the group recognised a gain of nearly HKD0.9bn on the deemed disposal of shares in Air China (as it did not participate in a rights issue) and nearly HK$2.5bn from the share of the results of Air China itself. Total operating profits reached HK$11bn and net profits an extraordinary HK$14bn or 15% of revenues. Even excluding the asset sale gains the net profit however would still have represented an exceptional 12% margin. As a result of all these effects the group restored its balance sheet to its more normal conservative 28% net debt to equity – and restored year-end cash balances to HK$24bn from HK$17bn at the end of 2009.

2011 first half trading

The restoration of capacity growth in the latter half of 2010 has continued into the current year with an increase in RPKs of 9% in the first six months. The company states that premium demand has remained consistently strong and that it is registering continued yield improvements in both premium and economy cabins. However there appears to have been a weakness in demand in economy class, and total passenger demand in the first six months has only increased by 3.6% giving a five point decline in load factors to 79%.

Demand by region also appears mixed. Unsurprisingly traffic to and from Japan has been hit by the aftermath of the earthquake and tsunami, and demand on North East Asian routes is down by some 9% cumulatively year on year; traffic on routes to SW Pacific and South Africa are also down by 6%. Disturbingly, traffic on Chinese mainland routes is also down by 2.5% year on year against a 7% increase in capacity – in contrast to figures from the mainland carriers suggesting growth. On the other hand traffic on routes within South East Asia is up by 14%, to North America up by over 12% and to Europe by 7%.

The concern may be that the persistently high oil price (and the necessary fuel surcharges) are having dampening effect on tourist demand. Freight traffic however does seem to be showing significant softness with monthly year on year

declines since April and a total growth for the six months of only 0.5%. The company states that this weakness has been most pertinent in its main markets out of Hong Kong and mainland China giving concern for coincident economic activity in the region – although it is the weak season of the year. However, there has apparently been an interesting improvement in inbound demand, particularly for high value imports into China which is starting to produce a better traffic flow balance (always the headache of full freight cargo airlines). Meanwhile the Air China Cargo joint venture finally got under way in March and is showing modest performance with load factors around 60%.

Fleet and capex

Cathay has managed its fleet conservatively and consistently but is currently entering a period of fleet renewal. The fleet has an average age of 14 years – but the oldest of the passenger 747s are 22 years old, while the earliest 777s, A330s and A340s were built in the early 90s. It appears that the company will be replacing its fuel expensive four engine aircraft with twin engine equipment. Towards the end of 2010 the company announced its largest ever aircraft order for 30 A350XWB (+10 options) for delivery between 2016 and 2019 and six additional 777-300ERs, supplemented by an order for another two A350s in December.

Earlier this year it announced an order for 15 new A330s and 10 777-300ERs. In addition it has orders for 10 747-8Fs and an additional 14 options. Originally slated for delivery in 2009 the first new generation 747 freighter is now expected in the second half of this year – and considering the fuel costs of the classic long range version no doubt eagerly awaited. The current order book stands with 86 aircraft due for delivery in the next eight years and additional options for 24 aircraft. In the 2010 annual report the company also suggested that it was in negotiation for another order for a further 14 aircraft. Meanwhile it still has one A330 and three A340s in storage – the latter likely to be returned to lessor.

CATHAY PACIFIC'S FLEET

	In service	Orders	Options	LOI	Storage	Total
747-400	21					**21**
747-400F	21					**21**
747-800F		10	14			**24**
777-200	5					**5**
777-300	34	24		4		**62**
A320	11					**11**
A321	6					**6**
A330-300	46	20			1	**67**
A340-300	11				3	**14**
A350-900		32	10			**42**
Total	**155**	**86**	**24**	**4**	**9**	**273**

***Source**: Ascend*

The group is expected to use these orders in part for replacement and part for growth; but in doing so it aims to reduce the average size of aircraft in order to concentrate on premium traffic potential rather than physical seat capacity. This acquisition plan is likely to lead to a gross capital expenditure requirement of some HK$45bn over the next three years.

Also, the company is in the process of building a state-of-the-art cargo terminal at HKG. Put on hold in the depths of the financial crisis, originally designed to open this year, the group restarted the project in 2010 and now expects to be able to open it in 2013 presenting "an unwavering commitment to Hong Kong as an international air cargo hub". This will be a common facility terminal managed by an arms-length subsidiary of Cathay and run on a 20 franchise form the airport authority, designed to cope with 2.6m tonnes of cargo annually: the total cost of construction is estimated at HK$5bn.

HKIA has recently published proposals for the development of the airport in Hong Kong over the next twenty years. It appears likely that HKG will run out of capacity by 2020 on current growth rates, while the airport authority argues that the current plans for airports in the Pearl River Delta will also not be able to cope with anticipated demand. It has put forward alternative base proposals for consultation by September this year: maintain the two runway system and develop the existing terminal structure; or build a third runway and associated passenger and apron facilities.

Cathay has put its weight behind the proposal for a third runway. This will involve a significant further amount of land reclamation, but, without a third runway Cathay would have to revisit its fleet plan towards the end of this decade and, despite earlier indications to the contrary, might even consider the need to look to acquire some A380s to accommodate growth on congested routes.

By James Halstead
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Emirates: Relentless expansion, political defensiveness

After unveiling its twenty-third consecutive year of profit, Emirates is mounting a fierce counter-attack to charges that it benefits from substantial direct and indirect help from the Dubai state. The airline appears to have identified a protectionist backlash from Western network carriers as the main threat to its apparently relentless expansion.

For an airline founded only in the 1980s, the rise and rise of Emirates is staggering. In the 2010/11 financial year (ending March 31st) the Emirates Group shrugged off rising fuel prices and last year's volcanic ash disruption to record its twenty-third consecutive year of profit (having made a loss in just one year since launching), with revenues rising 26.4% year-on-year to US$15.6bn and operating profit up 44.1% to $1.6bn.

The Emirates Group includes Dnata, the largest airport service company in the Middle East with contracts at 75 airports around the world, and more than 50 other business units, but the vast majority of group revenue and profit comes from the airline operation, which saw a 25.2% rise in revenue to $14.8bn in 2010/11 and operating profit up 52.6% compared with 2009/10, to $1.5bn. Emirates SkyCargo, which operates eight freighter aircraft and the space on passenger aircraft, saw revenue rise 27.6% in 2010/11 to $2.4bn. But profit at the mainline would have been $272m higher if it had not been for a 41% increase in fuel prices to $4.6bn in 2010/11, which now accounts for 34% of the airline's total operating costs.

Emirates is also having to cope with the effect of the so-called "Arab Spring" (which directly forced rival Gulf Air to cut 200 jobs). Emirates says that this has impacted on traffic in the region, although it reacted swiftly to pull out of Libya and reduce capacity in Egypt and Tunisia as soon as unrest hit those countries. It's interesting to note that while the UAE is very stable compared to the rest of the Middle East but political freedom is restricted, and there always must be a degree of concern, however small, about the tensions caused by the extent of conspicuous consumption in the region.

Importantly for Emirates, premium traffic recovered well in 2010/11, and overall passenger yield rose 8.5% in the last financial year when Emirates carried 31.4m passengers in total, a 14.5% increase on the year before. While capacity rose by 13% in the year, traffic rose faster - at 15.7% - and so load factor rose 1.9 percentage points to exactly 80%.

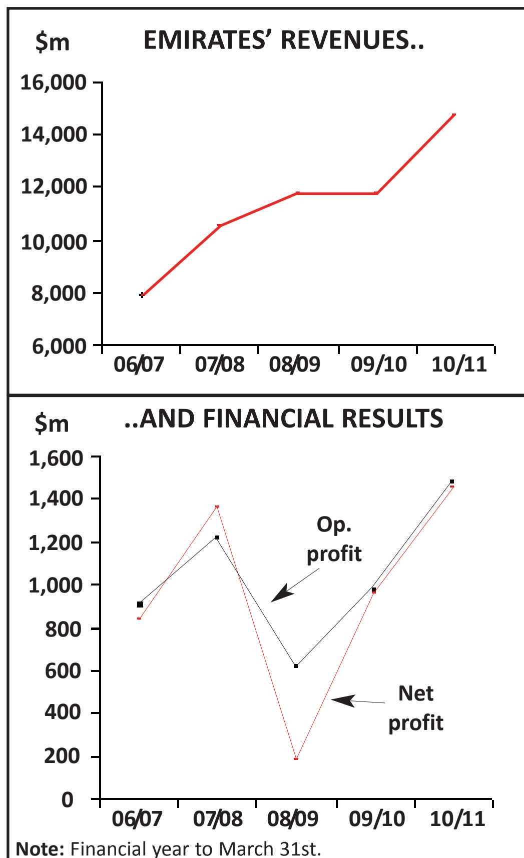
Massive orders

Emirates currently operates to more than 110 destinations in almost 70 countries but the long-term aim is to operate to "several hundred destinations", according to chairman and chief executive Sheikh Ahmed bin Saeed al Maktoum, adding that "I'm sure this will make a lot of people unhappy but the market is there to grow. Airlines in Europe don't want to see us there because we are giving them competition."

The fleet has 153 aircraft (see table, page 10), of which 93 are Boeing models and 60 Airbus, but what makes Emirates unique is that has a huge order book totalling some 213 aircraft, with another 117 aircraft on option. On its own, Emirates accounts for more than 3% of the firm order book at Airbus and Boeing combined.

Those firm orders include 15 747-8Fs, six 777-200Fs, 47 777-300ERs (orders for 30 of which were placed last year) and 70 A350s, of which 50 are -900 models and 20 are -1000 variants. The A350s were ordered back in 2007 but today the airline says that it now doesn't really need aircraft with less than 300 seats, and so the 290-seat -900s may change to larger capacity -1000s, which will have at least 320 seats.

However, a complicating factor is that



Note: Financial year to March 31st.

while the -900s would be delivered from 2015 onwards, the stretched -1000s do not yet have a delivery date to Emirates as their design has still not been finalised, with various airlines around the world lobbying Boeing for different features to be included in the -1000 variant. If Emirates does decide to switch to the -1000 model it would then use the 30 extra 777-300ERs ordered last year to fill in capacity while it waits for the-1000s.

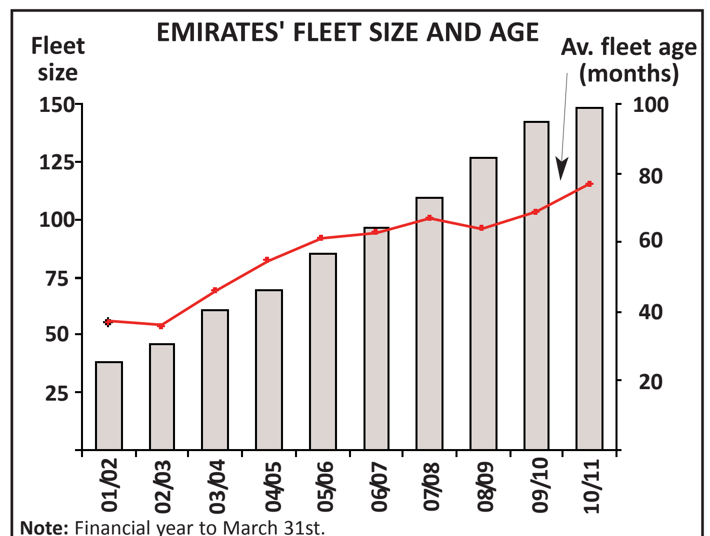
On top of all those are orders for 75 A380s, making Emirates the largest single customer for the model. 32 of these orders were placed in 2010 and the Dubai-based carrier wants a total fleet of around 120 A380s, a statistic that some analysts and not a few rival aviation executives find difficult to rationalise in terms of finding enough routes where they could be utilised profitably.

Eight aircraft were delivered to Emirates in the 2010/11 financial year ending March 31st (including seven A380s), and this year six A380s and 13 777s are being delivered, but from 2012 Emirates will receive new aircraft at the rate of two per month for at least the following six years.

However, earlier this year Andrew Lobbenberg, equity analyst at the Royal Bank of Scotland (RBS) calculated that Emirates will easily be able to find enough routes for the A380s it has on order, and not only that but that the airline is likely to place a substantial amount of new orders in the latter part of this decade and the next as it continues its global expansion. Already there are signals coming from Emirates that it may announce major new aircraft orders at the Dubai air show this November.

The RBS analyst report commented that in the period to 2015 the A380s will spread throughout Emirates' routes to Europe, North America, Australian, China and Japan, and that in the last part of the decade the emphasis in new A380 capacity will turn to North America and southern Asian destinations.

RBS also forecasts that the Emirates fleet will reach 250 by the end of the decade, which it points out is substantially smaller than the Lufthansa group, for example. Indeed some of the aircraft on order will replace almost 70 older widebodies (A330-200s, A340-300/500s and 777s) that Emirates began to phase out from February this year. As can be seen in the chart, below, as the fleet has grown through the last decade the average age has crept up and is more than six years, although this will drop as new aircraft are delivered and older widebodies are disposed of.



Note: Financial year to March 31st.

EMIRATES' FLEET

Type	In Service	On Order	Options
A330-200	27		3
A340-300	8		
A340-500	10		10
A350-1000		20	
A350-900		50	50
A380-800	15	75	10
747-400ERF	3		
747-400F	3		
747-8F		15	
777-200	3		
777-200ER	6		5
777-200F	2	6	
777-200LR	10		
777-300	12		
777-300ER	54	47	39
Total	**153**	**213**	**117**

Still, the pace of route expansion will need to rise substantially; just six new destinations were added in the last financial year, to Amsterdam, Prague, Al Medinah al Munawarah, Madrid, Dakar and Basra – although capacity was added to many existing routes, with A380s introduced on services to Manchester, Beijing and Hong Kong, as well as being re-introduced onto the New York route.

In April Shanghai became the thirteenth Emirates destination to be served by the A380, joining the other Chinese routes of Beijing and Hong Kong, but the likely deployment of the model over the next decade is pretty clear from the current expansion priorities for the carrier, which are Asia and the Americas.

As can been seen in the table, right, the most important market for Emirates in terms of revenue is what it terms "East Asia and Australasia", and although the Americas is currently the smallest market for the airline it is also the fasting growing region, with revenue up 31% in the last financial year. One of Emirates' strengths is that its revenue base is geographically diverse, with no one region accounting for more than 30% of revenue, and the airline is keen to increase the revenue contribution from the Americas as it seeks to diversify its revenue base.

Emirates currently operates to four US destinations (New York, Houston, Los Angeles and San Francisco), with another point due to be announced soon. Capacity is increasing to most of these – A380s have returned to the Dubai-Newark route and are likely to be added to the San Francisco service as well at some point. Emirates also operates a Dubai-Toronto route with A380s but further expansion into Canada is restricted by the current bilateral, in which UAE airlines are allowed only seven flights a week between the countries. Currently Emirates and Etihad have three flights each, but both have been lobbying hard to increase this, quoting the very high load factors on the routes.

On the other side Air Canada has been pressurising the Canadian authorities to resist a change in the bilateral, claiming there is not enough traffic between the two countries. At one point the row between the two countries became so heated that the UAE refused to renew the lease on a Canadian military base in Dubai, though the argument seems to have calmed down, and Emirates is hopeful a liberal bilateral will be signed at some point in the not-too-distant future.

In South America, Emirates only serves Sao Paulo, although a daily non-stop Dubai-Rio de Janeiro route, going on to Buenos Aires, will start in January 2012 and routes to Santiago and Lima are the next on the list of target destinations. Emirates also wants to increase weekly flights to Australia from the current 70 services, although the current bilateral restricts the airline to a maximum of 85 flights.

Europe will see the addition of a twenty-seventh destination in August with the

EMIRATES AIRLINE 2010/11 REVENUE BY REGION

	Revenue
Middle East	10.6%
Europe	27.2%
Americas	10.4%
E. Asia/Australasia	29.2%
W. Asia/Indian sub-continent	12.1%
Africa	10.5%
Total	**100%**

launch of daily non-stop flights between Dubai and Copenhagen (which will take total destinations in the Emirates' network to 112), but the airline has run into problems in Germany, where the existing bilateral restricts UAE airlines to four airports in the country, much to the frustration of Emirates, which already operates almost 50 flights a week between Dubai and Frankfurt, Munich, Düsseldorf and Hamburg, but which also wants to launch routes to Berlin and Stuttgart. Germany doesn't want to alter the existing bilateral, so all Emirates can do is add capacity to the four existing services (including using A380s on the route to Munich).

Emirates' relentless addition of capacity can be seen in the chart, below, although it is interesting to note that the rise in ASKs has been accompanied by an increase in load factor (other than in 2008/09). That certainly backs up Emirates' claims that the routes it serves are underserved and that there is plenty of scope to add capacity and routes into its network as the new aircraft come on stream.

In terms of codeshares, until now Emirates has linked with just a handful of airlines, although partnerships with JetBlue and Virgin America were signed late last year, and many more are likely to be signed over the next few years as new markets join the Emirates' network.

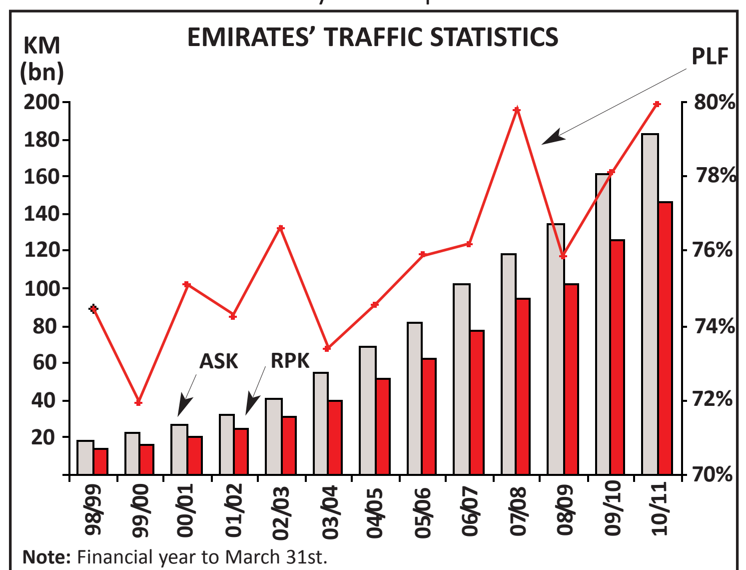
Infrastucture constraints

Future expansion, however, depends on overcoming infrastructure constraints, with Tim Clark, president of the Emirates airline, saying that "physical constraints are the single largest inhibitor to our growth, including which airports can take the A380 and how quickly the Dubai hub can be built to match our expansion. If it hadn't been for those inhibitors we would have placed much larger orders for expansion over the next 10 years".

Indeed Emirates' entire strategy is based on its geographical advantages, and specifically that two-thirds of the world's population is within an eight-hour flight of Dubai. The value of the Dubai hub to Emirates is immense, and no less than 60% of all Emirates' passengers transfer through the hub. Along with rivals such as Etihad Airways and Qatar Airways, it's not an exaggeration to say that Emirates has been at the forefront of a restructuring of global traffic flows; for example, traffic that previously operated between Europe and Africa now tends to go via the Gulf region, thanks to the large onwards networks operated out of Dubai and other local hubs.

Following the opening of Terminal 3 in 2008 (which is used exclusively by Emirates), Dubai airport can handle more than 60 million passengers a year, operating 24 hours a day (much to the envy of some European airports). However, in 2010 international passengers to/from Dubai airport totalled 47.2 million – almost double the figure carried in 2005, and there is limited apron capacity, with Emirates saying it would have had placed even more A380 orders if it wasn't for the fact that there is not enough space at Dubai airport to park them overnight. That problem will only go away once the airline transfers operations to Al Maktoum International airport, which will be open for passenger operations in 2012 and be fully operational by the end of the decade.

Incidentally, Emirates appears not to be affected by the rise of FlyDubai, the LCC launched in 2009 by Al Maktoum, the chairman of Emirates. FlyDubai operates out of



Note: Financial year to March 31st.

Dubai with a fleet of 17 737-800s to more than 30 regional destinations, has 38 737 aircraft on order, and recently announced it was recruiting another 600 pilots over the next five years.

Finance

Assuming that Emirates finds enough new routes and markets for the massive amount of new capacity being added over the next five years, the other question mark on Emirates' strategy is just how it's going to pay for all those aircraft, with fleet investment of $38bn needed in the period to 2017. In fact Emirates' financial position is strong; cash rose to $4.4bn at the end of March 2010, which Al Maktoum says "is a nice cushion to have" given the uncertainty on where fuel prices will go, and the airline has found little difficulty in raising debt as needed.

Currently only a handful of aircraft are owned outright; 70% of the fleet is under operating leases and almost all the rest are on finance leases, and this June Emirates financed the delivery of 10 new aircraft (five 777s and five A380s) being delivered over the next 12 months through three foreign entities - Doric Asset Finance of Germany, Natixis from France and San Francisco-based Jackson Square Aviation. The aircraft are worth $3bn at list prices, but of course Emirates has secured them at substantial discounts to those sticker prices.

To strengthen its balance sheet, this June the Emirates Group closed the issuance of $1bn worth of bonds, which were listed on the London stock exchange and which have a five-year term at a semi-annual coupon of 5.1%. Emirates had originally looked to raise $0.5bn but the strength of demand was such that the group decided to double the amount raised, which will be used for "general corporate financing purposes". Emirates repaid a seven-year $0.5bn bond that matured in March this year, and as at the end of March 2011 the airline had long-term debt of USS6.5bn, which was 21.2% up on a year earlier.

Nevertheless, the impending large rises in capacity will probably hit Emirates' profitability in the medium-term as the airline chases passengers in new markets, but while Emirates is likely to return to the bond market in the future, more cash is likely to be raised whenever Emirates carries out an IPO. The Group insists that an IPO is not on the cards either this year or in 2012, but it is likely that one is coming in order to secure a partial exit for the Dubai government. A quoted company would also make it easier for Emirates to carry out an acquisition or merger, but although Etihad and Virgin Atlantic have been rumoured to be of interest, Clark says that "getting sidetracked into a merger, acquisition or alliance would bring us to a complete stop as half the time our DNA does not jibe with other airlines."

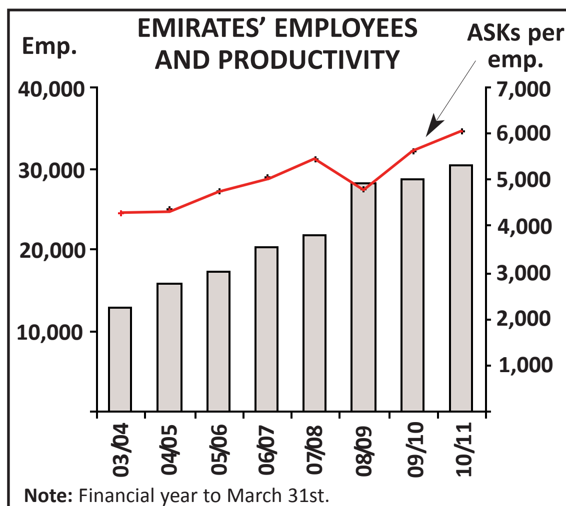
But there's another reason why an IPO may come sooner rather than later; an injection of new investors may ease some of the rising political pressure that Emirates Group is facing due to its closeness to the Dubai emirate.

Emirates and the state

Perhaps mindful of a future IPO, Emirates is at the forefront of the fight back against claims by European airlines that Gulf carriers have certain "unfair" advantages in the global aviation market. In January this year Ulrich Schulte-Strathaus, secretary general of the AEA, said that the expansion of the three main Gulf airlines made him "uneasy", and other airlines have weighed in with accusations that Emirates is effectively heavily subsidised by the Dubai emirate, whether in terms of export credits guarantees when buying new aircraft or the hefty support given to airport infrastructure.

Emirates appears to have taken a conscious decision that it can longer stand back as criticism grows, and earlier this year hit back with a claim that a "troubling trend is emerging", and that Western airlines were co-ordinating activity to deliberately limit the growth of Gulf airlines.

Specifically, Emirates insists it does not benefit from subsidised fuel costs, nor indeed from subsidies of any kind, and points out that the airline has paid a total of $1.6bn in dividends to its owner, the state-owned Investment Corporation of Dubai, since 2002.



Note: Financial year to March 31st.

The airline does use export credit-backed funding but it says that this is an acceptable practice worldwide, and that in the 14 year period ending in 2010, of the total $22bn raised to finance new aircraft "just" $5.2bn came from EU/US credit agencies. Emirates also says that it pays similar fuel rates as airlines pay elsewhere in the world, and that it does not get preferential treatment at Dubai airport.

Emirates does not pay any airport taxes at Dubai airport, which Emirates says is part of the "tax-free regime that prevails in the UAE and which existed before Emirates started flying in 1985". In fact, the non-tax regime affects all aspects of Emirates' cost structure – fuel, emissions, personal income, corporate profits, etc. – and this understandably infuriates Western network carriers which are over-burdened by taxes. But there is little that they can do about it, apart from reverting to protectionist measures, which eventually will rebound on them and their home economies. The playing field in aviation just isn't level.

In June a study released by UK consultancy Oxford Economics claimed that the Dubai aviation industry has not benefited from government support of any kind – although this report, called Explaining Dubai's Aviation Model, was directly commissioned by Emirates itself. Unfortunately, as a result, the report's unremittingly positive findings about Emirates, Dubai Airport, the local economy and global aviation read rather more like a propaganda exercise than an objective analysis.

Nevertheless, the report reveals some interesting facts – while the Emirates airline employs 30,000 people (see chart, left), the aviation sector directly supports 58,000 jobs in Dubai, rising to 125,000 if indirect jobs are included, contributing some $11.7bn a year to Dubai's economy.

But whatever reports Emirates commissions, the criticisms of the friendly regime that the airline operates in will not go away, and is only likely to increase as the fleet and network reach of Emirates keeps on expanding.

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Spirit Airlines: America's ULCC pioneer goes public

Late May saw a notable new addition to the publicly traded US airline ranks: Spirit Airlines, a Fort Lauderdale-based ultra-low cost carrier (ULCC), which completed a modest $190m IPO to pay down debt and fund growth. Famous for its Ryanair-style pricing and unbundling strategies, Spirit has developed a successful niche catering for leisure and VFR travellers to and from Florida, the Caribbean and Latin America. Just about to achieve "major carrier" status with $1bn-plus revenues in 2011, Spirit has been profitable for four years and has promising growth prospects. But, given possible labour and legislative challenges, are 20% annual ASM growth and strong profits sustainable?

The IPO was poorly timed. It was one of several offerings in the US in the last week of May that had to be downsized and priced below expected range due to insufficient investor interest. Both broader market volatility and company-specific factors were to blame. In Spirit's case, investors worried about the high fuel price environment and the possibility that airline ancillary revenues could fall prey to regulatory changes.

Spirit sold 15.6m shares at $12 each (plus 256,513 shares through a partial exercise of underwriters' overallotment option), compared to the original expectation of 20m shares at $14-16. The $190m in total proceeds raised was 37-45% less than what had been expected at the $15 mid-point price.

But the shortfall did not really matter. Spirit floated to the public only about 22% of its stock. Its two deep-pocketed and committed private-equity backers, Oaktree Capital Management and Indigo Partners, retained a controlling combined 71.5% stake by converting their preferred shares to common stock. Some of the proceeds were used to repay notes held by the private equity firms and to redeem stock held by another shareholder. While Oaktree collected $3m from the sale of the overallotment shares, Indigo received a $1.8m fee in connection with the termination of its "professional services agreement" with the carrier.

The proceeds boosted Spirit's unrestricted cash reserves from $62.6m to around $197m (pro-forma, as of March 31) – a very healthy 25% of last year's revenues. The recapitalisation eliminated all of the carrier's long-term debt ($281m) and increased its equity from negative $97m to positive $388m.

As one of the major benefits, the stock market listing (on Nasdaq) will enable Spirit to tap the US public capital markets (equity or debt) to fund its fleet expansion in the future.

After the disappointing public debut (which included the stock falling initially and then barely lifting above the $12 offer price level for six weeks), Spirit's shares took off in early July after five analysts initiated coverage of the company with "buy" or "strong buy" recommendations, and by mid-July the stock was trading at the $14 level. Although those five analysts were from financial institutions that were underwriters on the IPO, several other brokerages have also initiated coverage of Spirit with equally bullish reports.

Spirit's key strengths include its ultra-low cost structure and innovative revenue strategies, including a focus on ancillary revenues. These characteristics may give it an especially resilient business model and customer base, making it even more recession-resistant than mainstream US LCCs.

Spirit has also found a profitable growth niche – the stumbling block for many LCC-hopefuls in the past. It has developed a substantial network to the Caribbean and Latin America, to supplement its US domestic operations on high-volume routes and in profitable niche markets.

Fort Lauderdale-Hollywood Airport, where Spirit is the largest operator of international flights and where 59% of its daily flights depart or arrive, is the perfect home base for a Caribbean/Latin America-focused LCC. It has a great geographical location,

large catchment area population and significant demand for VFR travel from the large ethnic population. It also has relatively low costs and room for growth (it is in the process of being expanded).

A couple of analysts have suggested that, rather than being threatened by American's Miami hub, Spirit - given its operating efficiency and low fares - may in fact be pulling leisure market share from American and Miami.

Spirit is well-positioned for growth also because of its new Airbus fleet and solid orderbook, its substantial experience of international operations in the Caribbean since 2003, and its financial strength.

On the negative side, Spirit does not have the Southwest/WestJet/JetBlue-style good labour relations and corporate culture. In June 2010 its flight operations were shut down by a five-day pilot strike. Spirit now faces increasingly unhappy flight attendants, who have had an open contract for four years.

Spirit also faces a potential government crackdown on unbundling and non-ticket revenues, which account for 31% of its total revenues. Among the various threats, proposed legislation would impose federal taxes of up to 7.5% on charges for carry-on and checked baggage.

Spirit's background

Spirit has gone through an interesting metamorphosis in its 47-year history. Founded in 1964 as Clippert Trucking Company in Detroit, in 1983 the company transformed into a tour operator (Charter One) providing packages to entertainment destinations such as Atlantic City, Las Vegas and the Bahamas. In 1990 the company received an air carrier certificate and launched charter flights. Scheduled services followed in 1992, when the present name was adopted.

So Spirit is probably the only independent survivor from the early 1990s crop of LCC start-ups in the US (now that Frontier is in the Republic camp and AirTran has been acquired by Southwest).

In the 1990s Spirit operated typical LCC-style north-south low-fare services, utilising DC-9s and MD-80s (the last DC-9 left the fleet in 2003) and achieving high load factors. It had only two unprofitable quarters in that decade.

However, those were frustrating years as the legacy carriers fought tooth and nail to keep LCCs out of their hubs. Spirit never succeeded in acquiring or sub-leasing its own gates at Northwest's Detroit hub. It achieved fame in early 2000 by taking on Northwest in a lawsuit that accused the legacy of predatory pricing and of trying to prevent it from competing in Detroit.

In 1999 Spirit moved its headquarters from Detroit to Fort Lauderdale, where it had already built a substantial presence, and began calling itself "South Florida's hometown airline". The move also reflected interest in Latin America routes, though international operations did not begin until late 2003.

Spirit was hit hard by 9/11. It had to cut 40% of its schedule and lay off one third of its workers, and it took 18 months to return to the former flight and staffing levels. As further major setbacks, an equity deal that had been in the works (with Raymond James) fell through because of 9/11, and Spirit was also turned down by the government's loan guarantee programme.

Nevertheless, in the 1999-2003 period Spirit doubled its annual revenues and made significant investments in its systems, technology, product and brand. The investments included a new class of service, "Spirit Plus" business class, which featured leather seats and complimentary drinks and snacks and was sold at a $40-$100 mark-up. In other words, Spirit essentially transformed itself to a more up-market LCC – probably encouraged by JetBlue's huge immediate success in 2000.

As a major milestone, in February 2004 Spirit received a $125m equity investment from Los Angeles-based Oaktree Capital Management. The investment gave Oaktree a controlling 51% stake and reduced Spirit chairman/CEO Jacob Schorr's stake from reportedly 75% to 37%.(Schorr had originally invested $2.25m for a 21% stake when he joined the company as CIO in 1997, and within three years he had acquired a 51% stake

and taken over at the helm.)

Oaktree's investment facilitated a much-needed fleet renewal programme and a new growth phase for the airline. Spirit immediately placed orders for up to 95 A320-family aircraft (35 firm and 60 options, some from Airbus and some from lessors), to replace its 32 ageing MD-80s and provide for growth.

In July 2005 Spirit received another $100m in new funding from Oaktree and Goldman Sachs Credit Partners for the purpose of accelerating its fleet renewal. As a result, the transition to an all-Airbus fleet was completed in 2006, two years earlier than planned.

Having launched its first international route in December 2003 (to Cancun, Mexico), after the Oaktree investment Spirit formally positioned itself as an LCC with a special focus on the Caribbean and Latin America. It filed applications to serve some 10 countries in the region. As the Airbus deliveries began in November 2004, Spirit launched its second international route, to Santo Domingo in the Dominican Republic.

In 2004 Spirit also made many changes to its domestic network, terminating unprofitable routes and announcing expansion in major new markets. Significantly, it gained access to Washington National that year via a special granting of slots by the DoT.

With the change in ownership, Spirit also began to reconstitute its management team. In January 2005 Ben Baldanza was brought in from US Airways as president/COO, and in May 2006 he was named CEO, enabling Schorr to retire to chairman's position (he subsequently passed that role to Indigo's managing partner Bill Franke). Before his role as SVP marketing and planning at US Airways, Baldanza was Grupo Taca's managing director/COO.

In July 2006 Spirit was again recapitalised when Indigo Partners, a Phoenix-based private equity fund, acquired a majority stake and control from Oaktree, which also injected more funds and remained the second-largest investor. Indigo focuses mainly on investing in airlines and currently has stakes in five other LCCs or ULCCs – Singapore's Tiger Airways, Hungary's WizzAir, Mexico's Volaris, Russia's Avianova and Indonesia's Mandala Airlines.

The new investment was aimed at providing Spirit the resources to accelerate growth and "consolidate the company's position as the leading LCC to the Caribbean". Oaktree also wanted to bring in Indigo's significant airline expertise. Bill Franke was previously America West's chairman/CEO and, in addition to his LCC interests around the world, he manages a private equity fund focused on investments in Latin America.

Following Indigo's involvement, Spirit was "redefined" as a ULCC in 2006. It began a rapid transformation from a mainstream LCC to the ultra-low cost business model.

In September 2010 Spirit's shareholders agreed on a new recapitalisation plan that would take the airline public in 2011. Among other things, the plan stipulated that all debt will be repaid or redeemed and all preferred stock exchanged for common stock in the IPO.

Financial turnaround

The new fleet, the network realignment and the switch to the ULCC business model had an immediate dramatic impact on Spirit's financial performance. After three years of operating and net losses totalling $172m and $236m, respectively, the airline turned modestly profitable in 2007, despite a 46% surge in capacity.

2008 again saw modest profits, but in 2009 – when the rest of the industry suffered the worst effects of the recession – Spirit achieved record earnings: operating and net profits of $111.4m and $83.7m, respectively. The 15.9% operating margin was among the highest in the US airline industry.

The stellar 2009 results reflected success in reducing ex-fuel unit costs while maintaining relatively stable total unit revenues. Between 2006 and 2009, Spirit's ex-fuel CASM fell by a stunning 21%, from 6.89 to 5.45 cents, while RASM was unchanged (9.37 and 9.35 cents).

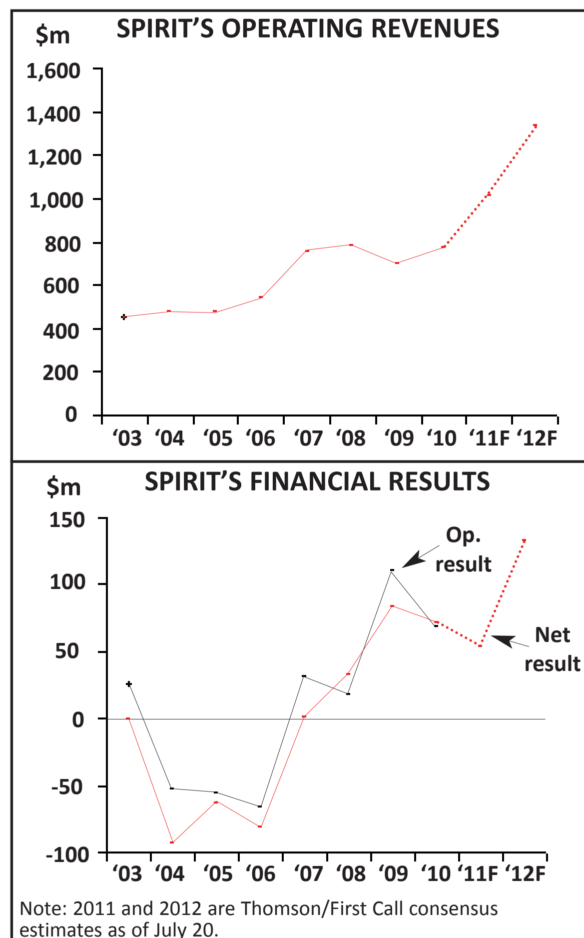
After the sharp growth spurt in 2007, Spirit responded to the fuel and economic challenges by trimming its capacity by 2.4% in 2008 and 9.4% in 2009. It terminated at least seven A319 leases. As a result, in the

2006-2009 period capacity was up by 29%, which was largely achieved through a stunning 43% increase in average daily aircraft utilisation from 9.1 to 13 hours.

Spirit's 2010 earnings (operating and net profits of $68.9m and $72.5m, about 9% of revenues) were adversely affected by higher fuel prices and the June pilot strike. But in this year's first quarter the airline was back at double-digit operating margins (11.5%), despite higher fuel prices and the acceleration of ASM growth to 20.9%.

Spirit's labour costs are among the lowest in the US industry. The airline is also fortunate in that the June 2010 pilot strike left no obvious lasting negative impact. The pilots ratified a new five-year agreement in August 2010, which is expected to increase pilot labour costs by around 11% in 2011, compared to the cost of the previous agreement. The airline believes that the deal will enable it to retain competitive pilot labour costs.

Spirit will need to pull the same trick with its two other unions. Its flight attendants' contract has been open since August 2007, and the dispatchers' contract becomes amendable in July 2012.



Note: 2011 and 2012 are Thomson/First Call consensus estimates as of July 20.

Unique niche and ULCC strategy

Spirit is probably the only example of a Ryanair-style operation in the Americas, where a more upmarket approach has become the norm among successful LCCs. The only airline that has a similar pricing and revenue strategy is Allegiant, but the Las Vegas-based carrier is truly a niche operator and has unusual features such as old MD-80s, low aircraft utilisation, etc. (see *Aviation Strategy* briefing, January/February 2007).

In the IPO prospectus Spirit argued that the diminished legacy-LCC cost differential in the US, which has resulted from the legacy restructurings, has provided an opportunity for the introduction of the ULCC business model "as a subset of the more mature group of low-cost carriers". Having studied the other ULCCs, particularly Ryanair, Spirit had concluded that "the ULCC model focused on routes from the US to the Caribbean and Latin America could be successfully deployed".

In other words, this is a niche strategy – albeit involving a very large and promising growth niche. The Caribbean/Latin American markets seem tailor-made for the ULCC model. VFR traffic, which Spirit specifically targets because it is an important contributor to non-ticket revenue production (higher baggage volumes, etc.), accounts for as much as 35% of Caribbean-originating travel to the US, while the large populations of Caribbean and Latin American descent in New York and South Florida – Spirit's traditional strongholds – generate much VFR travel. Many of the markets have historically been underserved by LCCs. Furthermore, South America, where air travel by the emerging middle classes is set to soar, is obviously a major future growth market for leisure/VFR travel to the US.

The ULCC business model is built on extremely low costs. There seems to be a

SPIRIT'S CHANGED REVENUE STRUCTURE

	2006	2010	Difference
Average ticket revenue per passenger flight segment	$104.56	$77.39	($27.17)
Average non-ticket revenue per passenger flight segment	$4.80	$35.00	$30.20
Total revenue per passenger flight segment	$109.36	$112.39	$3.03

consensus that Spirit has achieved one of the lowest cost structures among airlines in the Americas. According to Citigroup, its stage-length adjusted CASM is 24% below JetBlue's and 6% below Southwest's.

Like ULCCs typically, Spirit achieves its low cost structure through high aircraft utilisation, a single-type fleet, high-density seating, short turnaround times, high labour productivity, a low-cost base of operations, use of outsourced services and extensive use of low-cost distribution methods (web-based sales, direct-to-consumer marketing).

The low costs enable Spirit to offer very low base fares, which are combined with a range of optional services for additional fees. The low fares stimulate demand, and the resulting higher passenger volumes and load factors lead to increased sales of ancillary products and services. This, in turn, enables Spirit to "reduce the base fare even further, stimulating additional demand".

Since adopting the unbundling strategy in 2007, Spirit has lowered its base fares by up to 40%. Its average base fare was $77 in 2010 and $82 in first-quarter 2011, though it regularly offers promotional fares of $9 or less.

The key difference between Spirit's and other US airlines' unbundling strategies is that other airlines look at ancillary revenues as additional revenue streams, but Spirit wants them so that it can reduce fares. Spirit typically lowers its base fares whenever it adds a new fee. This has understandably caused some angst among analysts, but the strategy seems to be paying off.

The strategy certainly helped Spirit weather the recession (during which air fares faced downward pressure anyway). Between 2006 and 2010, Spirit's non-ticket revenues grew from $23.8m to $243.3m, to account for 31% of its total revenues. On a per-passenger-flight-segment basis, non-ticket revenues increased from $4.80 to $35, which more than offset the decline in average ticket revenue from $104.56 to $77.39 (see table, left).

Spirit stipulates that the base air fare should provide "everything necessary for a complete and safe flight". The airline has firmly ruled out some of the more extreme ideas floated by Ryanair CEO Michael O'Leary, such as charging for bathroom use.

US travellers have become used to paying fees in the past 2-3 years as most of the carriers have begun charging for checked baggage, food/drink, change, call-centre bookings and suchlike. But many people felt that Spirit crossed the line when it began charging for carry-on bags in August 2010. The move received much negative media and government attention, with one New York Senator even calling for legislation to define carry-on bags as a "reasonable necessity" for air travel. The brouhaha died down because no other airline was interested in introducing such fees. One year on, Spirit and its customers seem happy with the policy. Spirit reduced its fares by $40 (the amount of the bag charge if purchased at the airport). Its customers can avoid the fee if they pack so lightly that their bag fits under their seat. And the boarding and disembarking processes are now faster and less stressful.

As another first, Spirit recently began imposing a $5 fee for boarding passes printed by check-in agents. The airline passes through all distribution-related expenses. Its optional offerings include advance seat selection, "Jump the Line" priority boarding and upgrades to "Big Front Seat".

In addition, Spirit has developed non-flight related ancillary revenue streams, including a "$9 Fare Club" (an annual subscription service giving access to the lowest fares and discounted baggage fees), a "Free Spirit" affinity credit card programme, sale of online and onboard advertising, sale of hotel bookings, car rentals and airport parking through its website, and sale of vacation packages.

In its own words, Spirit has a "low-cost, viral marketing strategy incorporating provocative, edgy content". The Miami Herald recently aptly described it as having

"gained notoriety by poking fun at the indiscretions and criminal misdeeds of politicians, actors and sports figures".

However, it should be noted that the CEO has the opposite image. Baldanza gives the appearance of being a gentle and low-profile figure – also contrasting with the brash, controversial and publicity-seeking CEO of Ryanair.

Spirit faced some unique challenges when it began switching to the new business model after being a mainstream LCC. There was a surge in customer complaints lodged with the DOT, as the former customer base was not necessarily impressed by the higher seating density and the new fees. So Spirit has had to make special efforts to offer transparent pricing and communicate better with customers. Its website allows customers to see all available options and their prices prior to ticket purchase.

Much like Ryanair, Spirit now has a loyal customer base. Its customers know that they are being nickel-and-dimed, but they are used to it and like the low fares.

The biggest threat to this strategy is the potential government crackdown in the form of taxes on non-ticket revenues and restrictions on unbundling. Congress is investigating the industry practice of unbundling. Proposed legislation in the Senate, if enacted, would impose federal taxes of up to 7.5% on charges for carry-on and checked baggage. It seems certain that US airlines' ability to generate lucrative non-ticket revenues will be reduced. And Spirit, with its heavy reliance on non-ticket revenues, is likely to be among the worst-affected carriers.

Growth plans and prospects

Spirit's principal target growth markets are the Caribbean and Latin America, a region where it already serves an impressive 25 destinations. The airline is also looking to selectively expand in large US domestic markets that either feed traffic to and through the South Florida base or are underserved by LCCs and make it possible to develop a significant share of local traffic.

The current fleet plan is to grow from 35 aircraft (as of March 31) to 68 at the end of 2015. The 33 firm orders include 20 for A320s and 13 for A319s (which may be converted to A320s) – giving the carrier useful flexibility. Spirit is currently assessing its fleet needs in 2016 and beyond. All of the current fleet is leased, and at least the next seven A320 deliveries from Airbus will be taken through sale-leasebacks.

SPIRIT'S FLEET PLAN

	2010	2011	2012	2013	2014	2015
A319	26	26	26	26	29	39
A320	4	9	16	23	27	27
A321	2	2	2	2	2	2
Total	**32**	**37**	**44**	**51**	**58**	**68**

Note: Number of aircraft in service at year-end; Spirit has the option to convert the 13 A319 deliveries in 2014-2015 to A320s.
Source: *Spirit Airlines*

Analysts are generally very bullish on Spirit's earnings growth in the next couple of years. Avondale Partners (which was not an underwriter on the IPO) suggested in a mid-July report that the airline can deliver revenue and income growth above 20% for several years.

Spirit does not really have direct competition. Its fee and fare structure and lack of frequencies make it very clear that it caters for a different market and is not after business traffic. As the Avondale report observed, "traditional carriers may well view the Spirit customers as not worth pursuing".

Nevertheless, the likes of JetBlue and American may in the future challenge Spirit, especially when it becomes a major force in the Caribbean/Latin America. JetBlue also operates through Fort Lauderdale and has been growing rapidly in the Caribbean. American has just announced plans to grow its departures from Fort Lauderdale by 30% next winter, with new services to Los Angeles, Chicago and Dallas.

Many analysts have made the point that the most important thing that Spirit must do is hold down non-fuel costs – something that the additional A320s and continued ASM growth should help it accomplish.

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		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Air France/	**Year 2008/09**	**34,152**	**34,335**	**-184**	**-1,160**	**-0.5%**	**-3.4%**	**262,359**	**209,060**	**79.7%**	**73,844**	**106,933**
KLM Group	Apr-Jun 09	7,042	7,717	-676	-580	-9.6%	-8.2%	63,578	50,467	79.4%	18,703	106,800
YE 31/03	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
	Jul-Sep 10	8,579	7,835	743	374	8.7%	4.4%	66,558	56,457	84.8%	19,704	
	Oct-Dec 10	7,956	7,847	109	-62	1.4%	-0.8%	62,379	50,753	81.4%	17,551	101,946
	Year 2010/11	**31,219**	**19,236**	**1,171**	**810**	**3.8%**	**2.6%**	**250,836**	**204,737**	**81.6%**	**71,320**	**102,012**
British Airways	**Year 2008/09**	**15,481**	**15,860**	**-379**	**-616**	**-2.4%**	**-4.0%**	**148,504**	**114,346**	**77.0%**	**33,117**	**41,473**
YE 31/03	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	
	Jul-Sep 10	3,908	3,332	576	365	14.7%	9.3%	37,163	31,066	83.6%	9,339	
IAG Group	Oct-Dec 10	5,124	5,116	8	121	0.2%	2.4%	50,417	39,305	78.0%		56,243
	Jan-Mar 11	4,969	5,109	-139	45	-2.8%	0.9%	51,118	37,768	73.9%		56,159
Iberia	Jan-Mar 09	1,436	1,629	-193	-121	-13.4%	-8.4%	15,369	11,752	76.5%		20,715
YE 31/12	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	Jan-Mar 09	6,560	6,617	-58	-335	-0.9%	-5.1%	44,179	32,681	74.0%	15,033	106,840
YE 31/12	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
	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
	Year 2010	**36,057**	**34,420**	**1,636**	**1,492**	**4.5%**	**4.1%**	**235,837**	**187,700**	**79.3%**	**91,157**	**117,019**
	Jan-Mar 11	8,792	9,031	-239	-692	-2.7%	-7.9%	60,326	43,726	72.5%	22,078	117,000
SAS	Jan-Mar 09	1,352	1,469	-118	-90	-8.7%	-6.6%	8,870	5,541	62.5%	5,748	22,133
YE 31/12	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
	Jul-Sep 10	1,471	1,538	-67	-145	-4.6%	-9.8%	9,180	7,239	78.9%	6,655	15,570
	Oct-Dec 10	1,556	1,606	-51	7	-3.2%	0.4%	8,761	6,389	72.9%	6,557	15,123
	Year 2010	**5,660**	**5,930**	**-270**	**-308**	**-4.8%**	**-5.4%**	**34,660**	**25,711**	**74.2%**	**25,228**	**15,559**
	Jan-Mar 11	1,336	1,395	-59	-54	-4.4%	-4.0%	8,528	5,655	66.3%	6,093	14,972
Ryanair	**Year 2008/09**	**4,191**	**3,986**	**205**	**-241**	**4.9%**	**-5.7%**			**81.0%**	**58,559**	
YE 31/03	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
	Oct-Dec 10	1,015	1,016	-1	-14	-0.1%	-1.3%			85.0%	17,060	8,045
	Year 2010/11	**4,797**	**4,114**	**682**	**530**	**14.2%**	**11.0%**			**83.0%**	**72,100**	
easyJet	Apr-Sep 08	2,867	2,710	157	251	5.5%	8.7%	32,245	28,390	88.0%	24,800	
YE 30/09	**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	
	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	
	Year 2009/10	**4,635**	**4,364**	**271**	**240**	**5.9%**	**5.2%**	**62,945**	**56,128**	**87.0%**	**48,800**	
	Oct 10 - Mar 11	1,950	2,243	-229	-181	-11.7%	-9.3%	29,988	26,085	87.0%	23,900	

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

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Alaska	**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
	Jul - Sep 10	1,068	851	216	122	20.2%	11.4%	10,531	8,980	85.3%	4,562	8,737
	Oct - Dec 10	959	839	119	65	12.4%	6.8%	10,037	8,410	83.8%	4,141	8,711
	Year 2010	**3,832**	**3,361**	**472**	**251**	**12.3%**	**6.6%**	**39,322**	**32,749**	**83.3%**	**16,514**	**8,651**
	Jan - Mar 11	965	831	134	74	13.9%	7.7%	11,445	9,419	82.3%	5,752	11,884
	Apr - Jun 11	1,110	1,052	58	29	5.2%	2.6%	12,020	10,127	84.3%	6,246	11,907
American	**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 -J un 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
	Oct - Dec 10	5,586	5,518	68	-97	1.2%	-1.7%	61,219	49,927	81.6%	21,299	78,300
	Year 2010	**22,170**	**21,862**	**308**	**-471**	**1.4%**	**-2.1%**	**246,611**	**201,945**	**81.9%**	**86,130**	**78,250**
	Jan - Mar 11	5,533	5,765	-232	-436	-4.2%	-7.9%	60,912	46,935	77.1%	20,102	79,000
	Apr-Jun 11	6,114	6,192	-78	-286	-1.3%	-4.7%	63,130	52,766	83.6%	22,188	80,500
Continental	**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
	Jul - Sep 10	3,953	3,512	441	354	11.2%	9.0%	46,844	40,257	85.9%	16,587	38,900
Delta	**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
	Oct - Dec 10	7,789	7,495	294	19	3.8%	0.2%	91,774	74,403	81.1%	39,695	79,684
	Year 2010	**31,755**	**29,538**	**2,217**	**593**	**7.0%**	**1.9%**	**374,458**	**310,867**	**83.0%**	**162,620**	**79,684**
	Jan - Mar 11	7,747	7,839	-92	-318	-1.2%	-4.1%	90,473	69,086	76.4%	36,764	81,563
Southwest	**Year 2009**	**10,350**	**10,088**	**262**	**99**	**2.5%**	**1.0%**	**157,714**	**119,823**	**76.0%**	**86,310**	**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
	Oct - Dec 10	3,114	2,898	216	131	6.9%	4.2%	38,891	32,196	80.7%	22,452	34,901
	Year 2010	**12,104**	**11,116**	**988**	**459**	**8.2%**	**3.8%**	**158,415**	**125,601**	**79.3%**	**88,191**	**34,901**
	Jan - Mar 11	3,103	2,989	114	5	3.7%	0.2%	39,438	30,892	78.3%	25,599	35,452
United	**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
United/Continental	Oct-Dec 10	8,433	8,515	-82	-325	-1.0%	-3.9%	100,201	82,214	82.0%	35,733	80,800
Pro-forma FY 2010	**Year 2010**	**34,013**	**32,195**	**1,818**	**854**	**5.3%**	**2.5%**	**407,304**	**338,824**	**83.2%**	**145,550**	**81,500**
	Jan - Mar 11	8,202	8,168	34	-213	0.4%	-2.6%	96,835	75,579	78.0%	32,589	82,000
	Apr-Jun 11	9,809	9,001	808	538	8.2%	5.5%	104,614	87,296	83.4%	37,000	81,100
US Airways Group	**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
	Oct - Dec 10	2,907	2,802	105	28	3.6%	1.0%	33,823	27,271	80.6%	20,118	
	Year 2010	**11,908**	**11,127**	**781**	**502**	**6.6%**	**4.2%**	**138,107**	**111,996**	**81.1%**	**79,560**	
	Jan - Mar 11	2,961	3,000	-39	-114	-1.3%	-3.9%	33,034	25,762	78.0%	18,851	30,621
	Apr-Jun 11	3,503	3,326	177	92	5.1%	2.6%	36,698	30,754	83.8%	21,209	31,321
JetBlue	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
	Oct - Dec 10	940	883	57	9	6.1%	1.0%	13,727	11,239	81.9%	6,039	11,121
	Year 2010	**3,779**	**3,446**	**333**	**97**	**8.8%**	**2.6%**	**55,914**	**45,509**	**81.4%**	**24,254**	**11,121**
	Jan - Mar 11	1,012	967	45	3	4.4%	0.3%	13,696	11,143	81.4%	6,039	11,281

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 2006/07**	**12,763**	**11,973**	**790**	**280**	**6.2%**	**2.2%**	**85,728**	**58,456**	**68.2%**	**49,500**	**32,460**
YE 31/03	**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**	
	Year 2010/11	**15,889**	**15,093**	**796**	**269**	**5.0%**	**1.7%**	**85,562**	**59,458**	**69.5%**	**45,748**	**33,000**
Cathay Pacific	**Year 2007**	**9,661**	**8,670**	**991**	**900**	**10.3%**	**9.3%**	**102,462**	**81,101**	**79.8%**	**23,250**	**19,840**
YE 31/12	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	
	Year 2010	**11,522**	**10,099**	**1,813**	**1,790**	**15.7%**	**15.5%**	**115,748**	**96,548**	**84.0%**	**26,796**	**21,592**
JAL	**Year 2005/06**	**19,346**	**19,582**	**-236**	**-416**	**-1.2%**	**-2.2%**	**148,591**	**100,345**	**67.5%**	**58,040**	**53,010**
YE 31/03	**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 2006**	**8,498**	**7,975**	**523**	**363**	**6.2%**	**4.3%**	**71,895**	**52,178**	**72.6%**	**22,140**	**16,623**
YE 31/12	**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**	**19,178**
	Year 2010	**10,313**	**8,116**	**120**	**421**	**1.2%**	**4.1%**	**79,457**	**60,553**	**76.2%**	**22,930**	
Malaysian	**Year2006**	**3,696**	**3,751**	**-55**	**-37**	**-1.5%**	**-1.0%**	**58,924**	**41,129**	**69.8%**	**15,466**	**19,596**
YE 31/12	**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%**	**42,790**	**32,894**	**76.9%**	**11,950**	**19,147**
	Year 2010	**4,237**	**4,155**	**82**	**73**	**1.9%**	**1.7%**	**49,624**	**37,838**	**76.2%**	**13,110**	
Qantas	**Year 2007/08**	**14,515**	**13,283**	**1,232**	**869**	**8.5%**	**6.0%**	**127,019**	**102,466**	**80.7%**	**38,621**	**33,670**
YE 30/6	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**
	Jul - Dec 10	7,176	6,832	344	226	4.8%	3.1%	66,821	54,592	81.7%	22,948	32,369
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**	
	Year 2010/11	**10,911**	**9,956**	**955**	**863**	**8.8%**	**7.9%**	**108,060**	**81,801**	**75.7%**	**16,647**	
Air China	**Year 2006**	**5,647**	**5,331**	**316**	**338**	**5.6%**	**6.0%**	**79,383**	**60,276**	**75.9%**	**31,490**	**18,872**
YE 31/12	**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**	**23,506**
	Year 2010	**12,203**	**10,587**	**1,616**	**1,825**	**13.2%**	**15.0%**	**107,404**	**86,193**	**80.3%**	**46,420**	
China Southern	**Year 2006**	**5,808**	**5,769**	**39**	**26**	**0.7%**	**0.4%**	**97,044**	**69,575**	**71.7%**	**49,200**	**45,575**
YE 31/12	**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**	**50,412**
	Year 2010	**11,317**	**10,387**	**930**	**857**	**8.2%**	**7.6%**	**140,498**	**111,328**	**79.2%**	**76,460**	
China Eastern	**Year 2006**	**3,825**	**4,201**	**-376**	**-416**	**-9.8%**	**-10.9%**	**70,428**	**50,243**	**71.3%**	**35,020**	**38,392**
YE 31/12	**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**	**45,938**
	Year 2010	**11,089**	**10,248**	**841**	**734**	**7.6%**	**6.6%**	**119,451**	**93,153**	**78.0%**	**64,930**	
Air Asia (Malaysia)	**Year 2008**	**796**	**592**	**203**	**-142**	**25.5%**	**-17.9%**	**14,353**	**10,515**	**73.3%**	**9,183**	**4,593**
YE 31/12	**Year 2009**	**905**	**539**	**366**	**156**	**40.4%**	**17.3%**	**21,977**	**15,432**	**70.2%**	**14,253**	
	Year 2010	**1,245**	**887**	**358**	**333**	**28.8%**	**26.7%**	**24,362**	**18,499**	**75.9%**	**16,050**	

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 %
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
2010	332.3	232.6	70.0	224.2	188.1	83.9	180.2	150.0	83.2	604.1	500.4	82.8	922.7	752.8	78.7
May 11	31.0	22.3	71.8	22.4	18.9	84.4	17.0	12.9	75.9	56.6	45.2	79.8	86.2	66.3	76.9
Ann. change	6.8%	8.3%	1.0	10.9%	10.7%	-0.1	12.7%	9.1%	-2.5	11.0%	10.3%	-0.5	9.3%	9.3%	0.0
Jan-May 11	138.1	92.9	67.3	95.6	74.8	78.2	81.6	63.4	77.6	265.1	207.9	78.4	398.0	297.5	74.7
Ann. change	8.4%	10.9%	1.5	13.6%	10.3%	-2.4	15.0%	9.1%	-4.2	12.9%	9.5%	-2.4	11.5%	9.7%	-1.2

Source: AEA.

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	20 June	Qatar Airways	6 x 777-300ER	
		MIAT Mongolian A/L	2 x 737-800, 1 x 767-300ER	
	21 June	Norwegian	15 x 737-800	
		Aeroflot	8 x 777-300ER	
		Malaysia Airlines	10 x 737-800	exercised options
Airbus	26 July	IAG	8 x A330-300	
	01 July	Garuda Indonesia	4 x A330-300	
	23 June	Air Asia	200 x A320neo	
		GoAir	72 x A320neo	
		Skymark A/L	2 x A380	
	22 June	LAN A/L	20 x A320neo	
		IndiGo	150 x A320neo, 30 x A320	
		ALAFCO	6 x A350-900	
	21 June	TransAsia A/W	6 x A321neo	
	20 June	SAS	30 x A320neo	
		Saudi Arabian A/L	4 x A330-300	
		GECAS	60 x A320neo	

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

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IBAN: GB33MIDL40043791256904
Sort code: 40 04 37 Account no: 91256904

Invoice address (if different from delivery address)

Name ________
Position ________
Company ________
Address ________
____
____
Country ________ Postcode ________

PLEASE RETURN THIS FORM TO:
Aviation Economics Ltd.
James House, 22/24 Corsham Street
London N1 6DR
Fax: +44 (0)20 7490 5218
VAT Registration No. 701 7809 47