

IAG explains the Anglo-Hispanic plan

The inaugural annual capital markets day of IAG (the new holding company for British Airways and Iberia) took place in Madrid earlier this month. One of the more interesting elements of the day was to see the fusion of the disparate Anglo-Hispanic cultures; given that the management of the new holding company is equally split between representatives of the formerly independent national flag carriers (with Willy Walsh firmly in command as CEO) the flavour of the presentations cleverly mixed Iberia's former fondness for "directors' five year plans" with BA's predilection for firm financial targets. Further, most of the (male) members of the British Airways contingent were sporting uncharacteristic facial hair growth in line with the Movember movement and in sympathy for Colin Marshall, BA's former CEO and Chairman.

The day encompassed presentations on the Group's financial targets; progress and plans for cost and revenue synergies from the merger of the two operating companies and integration of the Group; progress reports on developments at BA and Iberia. The Group stated as its prime strategic objectives:

- Leadership in the main hubs (i.e. London Heathrow and Madrid Barajas)
- Leadership across the Atlantic (both North and South)
- Stronger Europe-Asia position in critical markets
- Grow share of Europe-Africa routes
- Stronger intra-European profitability
- Competitive cost position across the business

Unlike the other two European majors in their strategy presentations IAG made no suggestion that it had any aim to maintain industry market share nor grow at the same rate as total demand.

Naturally the management would not say much about the possible acquisition of bmi – as they are still in negotiation with Lufthansa, and the regulators will still have a say – nor about the professed interest in the potential privatisation of TAP except that any acquisition would have to adhere to the fundamentals of these strategic objectives.

Seemingly leaving behind some of BA's former complex financial communications, the Group CFO Enrique Dupuy presented a simple headline target of a 50 €cent fully diluted earnings per share by 2015; which given consensus current year forecasts implies a €1bn improvement in operating profits over the next four years to give total annual operating profits of €1.5bn and a return on capital employed of about 12%; and this appears to be based on a modest 2.5% organic annual growth (accounting for 15% of the total improvement) and assumptions of fuel at \$120/bbl.

Synergy benefits are expected to provide 45% of this profit enhancement (of which 60% from cost and 40% revenue) and the remaining 40% from "profit improvement" measures. Intriguingly the IAG target in fact appears little changed from BA's previous plans – which it finally achieved

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at the top of the last cycle. This time there was no mention explicitly of a target through the cycle – although there appeared an implicit suggestion that the improvements planned would provide a permanent uplift to a sustainable level of profits.

On the balance sheet ratios the Group is targeting a net debt to EBITDA of less than three times (and gross debt of less than four times) implying gearing of below 50% net debt (including capitalised leases) to total capital. At the same time the Group is aiming for net free cash generation over the period – despite the fairly hefty capital spending plans as BA starts the long-haul fleet re-equipment with deliveries of 787s and A380s (see fleet table, page 4); and is hoping thereby to regain an investment grade rating.

In the short run – as other network carriers have reported – there is disappointing traffic weakness in Economy class (particularly in Spain), but premium traffic appears to be holding up well on long-haul routes. The Group continues to expect operating profits for the full year to end December of over €450m – double that of last year – but if weak consumer and business confidence continues to depress demand, IAG is ready to adjust capacity further. For 2012 quite reasonably the Group has little real visibility but the management guided for a 14% increase in fuel unit costs (based on \$1,030 jet/tonne), nonfuel unit costs flat year-on-year and an increase in capacity of 2.5% – mostly coming from British Airways' long-haul routes.

In summary the Group states that it:

- is focussed internally on generating synergies and improving competitiveness
- will allocate a prudent level of growth to markets to cement or develop leadership
- will actively manage the network portfolio to react quickly to underlying demand
- will reduce exposure to markets where it believes there is structural or irrational capacity
- and aims to transform the Group's profitability by being disciplined with capacity, and retain the synergy benefits and profit improvements for the shareholders.

Centre-led models and global platforms

IAG stated that the first year cost synergies had so far come in a bit better than anticipated (by about 15%) at around €30m and that the

Group was on track for an €80m saving in 2012. However, it has also raised its five year targets by around 10% beyond original concepts to some €270m. The Group is actively working to create a centre-led model for all “back office” functions – covering everything from common procurement (insurance, fuel, handling, catering, crew hotels), MRO (using Iberia's engineering expertise for insourcing some of BA's requirements but also line maintenance at stations, single group inventory), fleet purchasing (claiming a gain from moving the Iberia RFP for the A330 to Group level), resource “optimisation” (combining sales forces, integrating airport operations, and corporate centre functions). Underpinning much of this is development in IT to create a base platform for the group businesses. Seemingly more than the other two network groups in Europe, IAG is initially creating a single scalable “global services platform” into which other new acquisitions (if any) could easily be plugged – and IT is expected to provide 27% of the total cost savings by 2015.

For expected revenue synergies, the Group has again raised its initial forecasts – by nearly 50% to €230m over the five year period. This still seems to be more nebulous. Although both of the main hubs are on the edges of Europe, the management continues to point at the possibility of multi-hub routings and managing demand on medium-haul connections through Madrid and/or London onto the South and North Atlantic respectively. It is easy to understand the potential for BA to boost returns by coordinating through common connections in Latin America (where BA is relatively weak). However one of the charts presented suggested that over time the London and Madrid hubs were well positioned to attack Far East (where BA is relatively weak and IB not present) to Brazil markets in competition with the super-connectors in the Middle East as providing potential routings closest to the great circle path. Conveniently that idea ignores the fact that Air France-KLM and Lufthansa (who each have greater presence in the Far East) can claim exactly the same through their own hubs.

The two individual hubs are nevertheless quite strong. London is by far the strongest long-haul O&D market in Europe – present in six of the world's top ten O&D routes – and by far the largest European transatlantic gateway; and on the top long-haul routes out of Europe tends to have twice as many passengers as nearest

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Aviation Strategy

Analysis

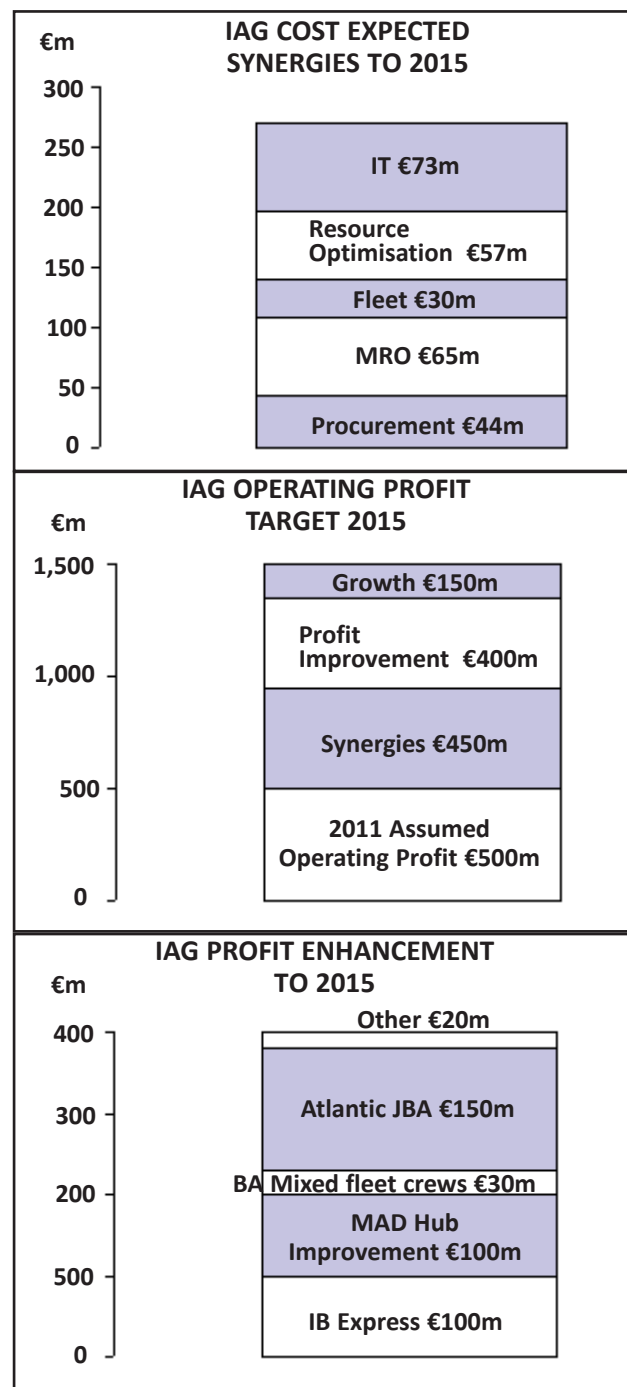
rivals. It is however severely constrained; and over time as BA has to sacrifice short-haul slots to (profitable) long-haul services, and as congestion delays are bound to increase, the attractiveness as a transfer hub is likely to deteriorate – although BA's Terminal 5 is now a definite competitive asset. As it stands there is almost a continuous wave pattern through the day; only 35% of total terminal passenger numbers at Heathrow connect (although nearer 45% of BA's own traffic).

Madrid Barajas meanwhile is Europe's fourth largest airport in terms of terminal passengers and has a leading position as Europe's gateway to Latin America. It is present in six of the top ten O&D routes on the South Atlantic – to Caracas, Buenos Aires, Lima, Mexico, Quito and Sao Paulo - (the others represented by Lisbon, Paris and London to Sao Paolo and Amsterdam to Paramaribo). With the opening of the third and fourth runways and the building of Terminal 4 and its satellite, Iberia was able to establish a five wave system and an increasingly efficient domestic and medium-haul feed - and now over 70% of Iberia's passengers connect.

One of the areas where the Group seems to have found greater revenue potential than originally expected is in Cargo. This again is one area where it is creating a common group platform that could in future be scalable with any new group acquisitions; and it was intriguing to see that it is now apparently worthwhile to operate widebodies occasionally between London and Madrid (using an Iberia A340/ BA 767) to provide belly-hold capacity to link the cargo potential of the two hubs (Far East to South America) – of course parcels don't care much how many times they have to transfer. Nevertheless IAG is in the process of creating a single group cargo operation (one point of sale, one strategy, one product range and one network) to attempt "to unlock commercial value". As the Group stands at the moment the freight operations have somewhat of a competitive disadvantage in comparison with the other two major network groups – with the English Channel and Pyrenees acting as natural barriers against required intra-European trucking operations.

A further area of integration to create scalability for future acquisitions is in the combination of the two frequent flyer rewards programmes. Unable to use the "Air Miles" brand outside the UK, the Group has re-branded the rewards cur-

rency to "Avios". The separate airlines will keep the names of their respective frequent flyer plans (Iberia Plus and Executive Club); but the rewards will be a single currency. The hope no doubt is that the success of the UK Air Miles programme as a multi vendor loyalty system with a reusable currency can be exported to other areas. The combination will provide 20 million members (of which 5.5 million are stated as being "active")



Operator	Aircraft Type	IAG GROUP FLEET				LOI	In Storage	2015 Fleet
		In Service	On Order	Options				
BA Cityflyer	E170	6			15		ns	
	E190	7		1			ns	
BA	737	19					ns	
	747	51				4	45	
	757					3	0	
	767	21					1	
	777	50	2	4			54	
	787		24	18			16	
	A318	2					2	
	A320 family	84	1	13		1	95	
	A380		12	7			9	
Iberia	A320	68	19	9		4	76	
	A330		8	8			16	
	A340	36		4			24	
OpenSkies	757	4					ns	
		348	66	64	15	12	372	
Vueling	A319	1					ns	
	A320	49	1				ns	
Total		398	67	64	15	12		

Source: Ascend Online

depending on operator and routing. (Interestingly BA itself has taken this theory to a revamp of its own website with the aim of treating it as a proper retail channel using retailer's techniques.)

The management stated an estimate of a net incremental annual benefit by 2015 of at least €150m – estimating that it has already achieved a near one percentage point increase in its share of the Atlantic premium market.

Although there was no public discussion of the woes at American Airlines, in private conversations

who between them provide 40% of flown revenue; and the company states that this makes it the third largest airline currency database.

Profit enhancements

IAG's immunised metal-neutral joint venture with American on the Atlantic (the "Joint Business") finally started earlier this year. The scope of the agreement covers a business with an estimated \$7.9bn of revenues, accounts for 20% of the Europe-US market (and 25% of the premium market), and includes 24% of IAG's total revenues (37% of BA's and 13% of IB's). One of the most important aspects of the JV is that it finally puts the group on a competitive level with Air France-KLM and Lufthansa; and that BA and American can at last open the joint venture routes to earn-and-burn opportunities for the joint 70 million frequent flyers.

While it could be expected that there could be passenger dissatisfaction at the differing quality of the on-board quality of service of the actual operating airline – especially in premium classes – IAG is hoping to take advantage to these very product differences in creating a series of price entry points in the distribution channels; and the greater the range of products on the shelf, the theory goes, the greater the returns. As an example: whereas before for a business class ticket from LHR to LAX BA would show up only once in the booking engines, now the joint venture could appear six times and at six different prices

management stated that they were not particularly concerned should AA have to file for Chapter 11 protection (after all it made no real difference to its rivals with similar concerns) especially since it would appear that IAG will currently be a net payer of cash to American as a balancing item under the JV agreement and therefore a vital part of the business that would remain. In addition, Chapter 11 would at least allow American to restructure.

Two other major planks of the profit enhancement plans relate to Iberia's performance in Madrid. For short-haul operations it has been under increasing pressure from LCC penetration at its home hub – and unlike for BA at Heathrow, there is still space for new entrants and no other cheaper airport within easy use. As part of the carrier's withdrawal from non-Madrid flying it had set up Clickair (now merged with Vueling) in Barcelona to retain presence in the Catalan capital and following the merger had started using Vueling for some feed services into Barajas. It has decided to establish a (relatively?) low cost operation as a separate and separately managed subsidiary – Iberia Express – under its own AOC.

It is planned to be a two class service using A320s (but with a higher density seating than Iberia's main line services) and provide feed. It will start operations in 2012 with an initial four aircraft (building to 13 by the year end) – and the aim is to increase the fleet by around ten aircraft a year. The Group hopes that this will add more than €100m to profitability by year four – pre-

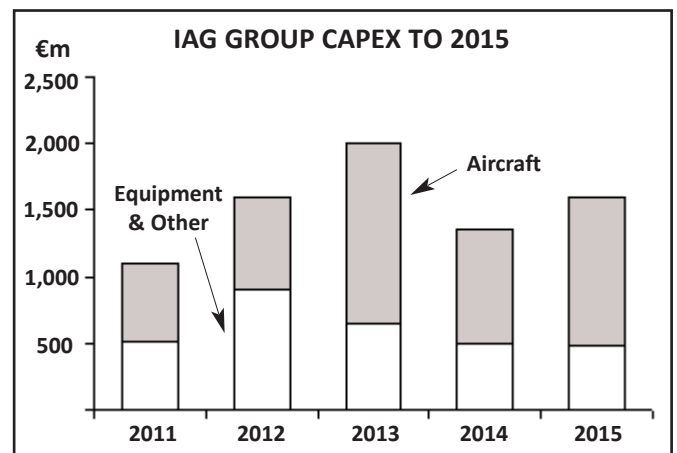
sumably through cost reduction more than anything else. They say they will recruit at “market rates” which suggests that there will be significant opposition from the Iberia pilot's union; and with no current collective agreement with the pilots (still in negotiation since the last one expired in December 2009) the likelihood of industrial action may be high.

In addition, the company sees a need to improve the performance of the Madrid hub itself. On long-haul operations it is to be taking delivery of A330s in part replacement of the expensive four engined A340s as an interim fleet “until the next generation of aircraft become available” – which will significantly help to reduce fuel burn. At Madrid Barajas itself it wants to “develop ... as a world class hub” and significantly improve short-haul turn-around times and minimum connection times by ten minutes or 20% (although here it is a bit stymied by the connection between T4 and T4S). It also needs to improve punctuality and has set itself targets of 85% on-time performance. The aim is that these measures will further add at least €100m to total profits by 2015. As part of this process it will be looking to a full re-branding of Iberia (the brand itself has hardly changed since the 1970s) – and will also introduce new state-of-the-art premium and non-premium seating on long-haul – in the anticipation that the brand renewal will help in providing a catalyst for change.

Future acquisitions?

Learning from the pioneers of intra-European cross-border mergers it is specifically establishing a framework that from the start can be scaled to slot in newcomers as and when necessary; and Willy Walsh's ambitions may not just be left to intra-European operations. He was adamant in stating that any acquisition would have to fit in with the stated strategic objectives.

The Group was probably a bit surprised that bmi was put on the table so quickly after BA had bought a bundle of winter slots from them at Heathrow; but Lufthansa has obviously given up any hope of being able to turn it around (see *Aviation Strategy*, October 2011). It may appear surprising that LH would think of selling it to one of its prime rivals in the industry – but BA is probably the only who can afford to take it on



and would buy it purely for the slots. Having had to sacrifice short-haul operations at LHR to long-haul ambitions because of the slot constraints at the airport, it alone would be able to merge the 10% of the airport slot base that bmi retains in with its own portfolio of slots, expand on long-haul and strengthen some of the short-haul feed it has foregone. The deal is still under negotiation and subject to regulatory approval – but at least until Brussels starts to consider network competition instead of the usual point-to-point concerns (and bmi has tended to avoid direct competition with BA) and gives up its predilection for supporting the three majors, approval seems likely.

The Group has stated interest in TAP when and if it comes up for privatisation – this at least would consolidate a strategic objective of retaining leadership on the south Atlantic with its strong presence in Brazil. However, it may come up against traditional cultural rivalry between Portugal and Spain, and with TAP firmly in the Star Alliance, an approach from Lufthansa may be more favoured. However, the Global Branded Alliances are in flux (and the final choice from LatAm is eagerly awaited by both oneworld and Star).

Other things being equal IAG should achieve the financial targets it has set itself. However, things are never that equal – and with the current low consumer and business confidence, threats to European economic performance through the Euro crisis, and fears of extended double-dip recession, the risks on the downside in the short term may be increasing.

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AirAsia X: Evolution of the long-haul LCC model

AirAsia X is the only long-haul LCC currently flying the European-Asia Pacific corridor. Established four years ago, it carried 1.9 million passengers last year throughout its network and recorded a net profit of \$26m on the back of \$414m revenue. It anticipates a revenue increase of more than 50% for 2011.

The airline is an associate of Asia's biggest short-haul low cost group, AirAsia. In July 2010 AirAsia X emerged as a stand-alone airline after a restructuring, which separated it from AirAsia's short-haul business operations. AirAsia has 16% share in the airline; AeroVentures, an investment vehicle owned by Tony Fernandes, Robert Milton of Air Canada and other entrepreneurs has 52%; the Virgin Group has a 10% interest via Corvina Holding; Orix Corp of Japan and Manara Ltd have 11% each.

This restructuring means AirAsia X has separate management, marketing operation, flight crew and premises, but continues to have use of the AirAsia brand and website via a 30-year brand licence agreement. The idea is to create a symbiotic relationship whereby both feed traffic across the short-haul and long-haul networks and share approach in promotions and marketing.

In August 2011 AirAsia and MAS, Malaysia's national carrier, announced a partnership called the 'Comprehensive Collaboration Framework', whereby a share swap deal was agreed between Tune Air, the owner of AirAsia, and Khazanah Nasional, the government backed investment arm owner of MAS. Tune Air Sdn Bhd bought a 20.5% equity interest in MAS, while Khazanah received 10% of AirAsia. Additionally, Khazanah was offered a 10% stake of AirAsia X, which is still undergoing negotiations.

Through this collaboration it is hoped that each of the Malaysian airlines will carve a distinct market, focusing on taking

on external competitors instead of challenging each other – MAS is to cater to the premium short/long-haul market, AirAsia the short-haul, low cost market while AirAsia X concentrates on the long-haul, low cost market.

Although the process has begun, the AirAsia X IPO listing is not expected until 2012 as the airline is awaiting the finalisation of the proposed Khazanah purchase. The airline, however, is not desperate to complete the IPO in the immediate future as it has more than US\$100m cash, and financing for next year's delivery of two A330-200s is almost in place. Timing, as always, is key, to the success of the IPO and market conditions are clouded by global economic uncertainty.

Fleet/Route network

The airline has a fleet of 11 widebody aircraft operating to 16 destinations mostly in the medium-haul sectors of Asia Pacific-Australia region. Two A340s are deployed on long-haul sectors to London and Paris.

Referencing its London route, AirAsia X's CEO Azran Osman Rani has admitted that, though the load factor averages in the high 70% - low 80%, the high fuel price environment makes the use of A340s "not economically sustainable". The airline intends to phase out its A340s, and in February 2011 it ordered three A330-200s, in an extended range version capable of flying Kuala Lumpur to Europe non-stop. The A330s are scheduled to be delivered in 2012, replacing the A340s and increasing the frequencies of the London and Paris routes.

The focus on serving more European destinations as well ultra long-haul operations to the US will only come once the A350s, of which 10 have been ordered, come into service from 2016.

Getting route approvals from the

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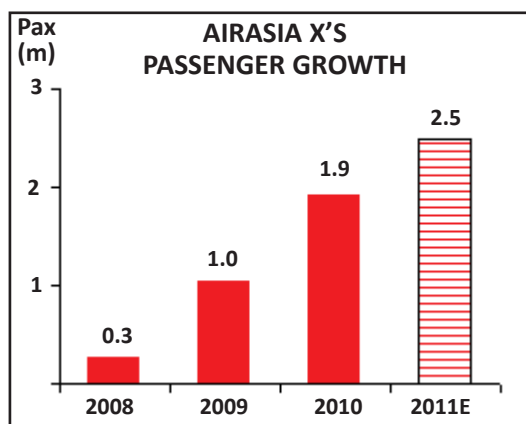
Malaysian government to its choice of destinations (some competing head-to-head with MAS) used to be the main obstacle to AirAsia X's growth plans. However, this seems to have been resolved now that the Malaysian government has committed to a more transparent aviation policy coupled with the MAS/AirAsia collaboration. In the summer AirAsia X was granted approval by the Malaysian government to fly to Istanbul, Beijing, Shanghai, Osaka and Jeddah – all potential high growth markets for the low cost model.

The airline is on track to achieve double digit growth this year - it recorded 43% passenger growth in the last three quarters (see chart on right), but it still has spare capacity within the existing fleet for further growth in 2012, which could allow the introduction of one or two further destinations (it has already announced a four-weekly Osaka service starting at the end of November). It plans to push up its aircraft utilisation to 17.5 hours a day.

For the medium term, the airline is focusing more on the Asia Pacific region, looking to expand into the high growth areas of China, Japan, Korea and Australia. Provided the MAS/AirAsia collaboration and demarcation works smoothly, AirAsia X should benefit: MAS will probably opt to concentrate on relatively few premium-heavy routes while AirAsia X would have a wide range of long-haul leisure destinations to choose from.

However, as it stands, one of its priority destinations, Sydney, has still not been awarded by the Malaysian authority after three years of protracted negotiations. Currently MAS monopolises the Kuala Lumpur-Sydney route with 14 flights a week. In contrast, Singapore has 49 flights per week operated by three airlines, Bangkok has 34 flights per week operated by four carriers and the Philippines has 10 flights per week operated by two airlines. While it is still early days for MAS/AirAsia collaboration, the softening relationship between these airlines may finally result in AirAsia X getting approval from the Malaysian authority for the Sydney route.

The rate of expansion in the following



12-18 months will be dictated by how they are prepared to source new airplanes (hence more debt) over and above their existing plans for deliveries of 17 A330-300s from 2013 onwards. AirAsia X may lease in, or it could deploy the displaced A340s on shorter, denser routes, with high latent demand for low cost service, such as Jeddah. At present, the airline is targeting a fleet of 30 aircraft in five years' time, although CEO Azran concedes this is a conservative figure.

Thinking outside the hub

In July 2011, AirAsia announced a partnership with ANA to set up AirAsia Japan based at Tokyo. AirAsia Japan plans to expand in the huge domestic market before developing international services around the Asia Pacific region.

Already, CEO Azran has signalled his intention for long-haul AirAsia X operations alongside the short-haul joint-venture operating at the Japanese hub - with flights across the Pacific in prospect. While it is still premature to discuss this possibility in detail, the experience of AirAsia's short-haul, multi-hub airline strategy within Southeast Asia points towards this evolu-

	In Service	On Order
A340-300	2	
A330-300	9	17
A330-200		3
A350-900	10	

tion, and a wider net of hubs which could eventually span the Far East, Australia and even the Middle East. However, to be able to replicate the multi-hub strategies of the short-haul AirAsia counterpart, the long-haul operation has to perfect its own operating model.

Managing costs

In 2010, AirAsia X reported a unit cost of USc 2.9/ASK (an increase of 0.2 cents from 2009 due to fuel), probably the lowest unit cost in the industry. The airline managed to reduce its non-fuel unit cost from USc 1.9/ASK in 2008 to 1.6cents/ASK in 2010.

Its cost strategy includes maximising utilisation at 17-18 hours a day by 24-hour scheduling, limiting aircraft parking at destination airports and staggering their schedules. It also has fewer crew per passenger relative to traditional airlines.

The airline does not believe fuel hedging can create a sustainable competitive advantage. AirAsia X's aim is to be the world's most efficient fuel consuming airline, thus providing significant structural advantage against their competitors irrespective of the cost of fuel.

The organisation's culture is aligned towards achieving this lowest fuel consumption rate strategy. Apart from using the brand new A330, fuel efficiency is achieved through operational discipline - managing aircraft weight, flight planning, maintenance and engine care, and optimal landing and taxiing techniques. Last year its A330-300 consumed 2.18 litres per seat per 100km, which it claims to be the lowest per seat consumption for wide-body aircraft.

Driving ancillaries

AirAsia X sees driving improvements in ancillary revenue as a natural hedge to the decline in yields as it pursues price-sensitive traffic volumes. The airline is targeting to grow its ancillary revenue share to 28% of total revenues, which would be a 4% increase from last year.

In a survey by Amadeus on ancillary revenues of 47 airlines worldwide, AirAsia X came top with ancillary revenue per passenger of €30 (see chart, page 9). It derived the majority of these revenues from checked baggage, onboard food and drinks, merchandising, seat assignments and travel insurance. There are also potential ancillary revenue from Inflight Entertainment (IFE).

Connecting innovations

To facilitate its growing self-connecting traffic, AirAsia X introduced the Fly-Thru service. The Fly-thru service bundles the two separate flights into single Passenger Name Record (PNR), allowing the transfer of bags and passengers between aircraft at KLIA without clearing customs/immigration. This service could encourage more connecting traffic from AirAsia/Air Asia X's Indian and Chinese network as these nationalities would no longer need to apply for a Malaysian visa to connect to AirAsiaX's long-haul destinations.

This seemingly unassuming step of transferring passengers across long/short-haul flights at hub airports, which is at the core of the network airlines' operational model, has evolved within AirAsia X's operation. Instead of being a cost centre, it has been turned into a profit centre. The airline charges RM60 (US\$19) for a connection between AirAsia X-AirAsia X flights or RM30 between AirAsia X-AirAsia flights. This should attract more long-haul transfer traffic on the UK-Australia market as well as stimulating LCC penetration in markets like Japan-South East Asia.

AirAsia X does not allow the connecting service to undermine its aircraft utilisation. Passengers who miss connecting flights are put on the next available flights for free, although staying true to its low cost ethos, there is no overnight compensation if the next flight requires an overnight stay. At the moment 11% of its bookings opt for this feature.

Premium seats only contribute 5% of revenue at present. However, on average three to four rows of economy seats are hardly utilised throughout the year, so the

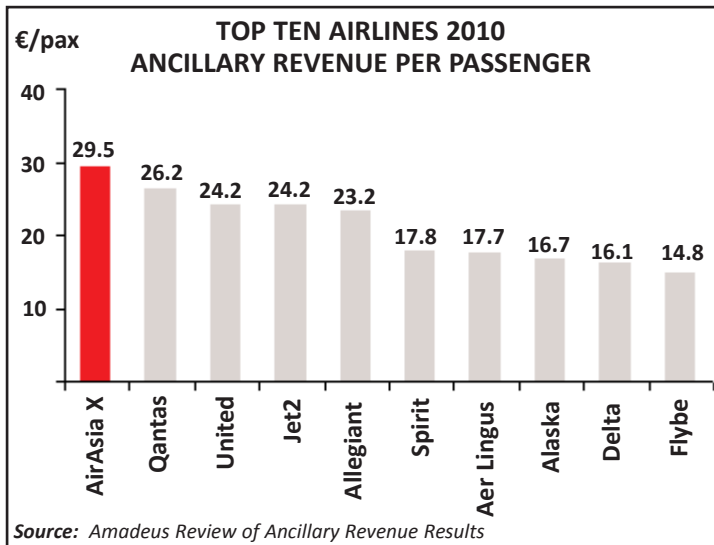
airline sees an upside in them replaced by premium, lie-flat seats (with no added frills) that could achieve 50-60% occupation. The value proposition of the lie-flat seat is that it costs a fraction of the price of a business seats on a traditional airline, giving AirAsia X a proper brand differentiation that attracts customers not usually associated with low cost airlines.

The new A330-200 replacing the A340s on London/Paris routes, while having 45 less economy seats, will have four more premium seats, 22 against 18. For the airline, the one-time investment for the premium seats with no increase in direct operating cost compared to normal economy seats makes economic sense.

The airline is not afraid of introducing complexity in its business model as long as it can generate revenue out of it or it can do it at a much lower cost compared to its competitors. Passenger feed to/from the short-haul operations of AirAsia and the push for higher paying premium passengers is vital in expanding the customer base and improving margins. And the AirAsia brand has launched its own version of a frequent flyer programme called BIG.

Some 20-30% of its passengers are connecting. On its longest route, Kuala Lumpur to London, this proportion can be as high as 50%. On this route 25% of passengers are UK nationals, 30% Malaysians, 15% other Europeans, 9% Australians and the balance from other Southeast Asian countries. In October, the airline shifted its London airport from Stansted to Gatwick, with the expectation of achieving better yields out of Gatwick. It found that the UK's APD tax in effect negated the cost advantage of operating from Stansted.

Currently the airline as well as the rest of the AirAsia Group operates from Kuala Lumpur Airport Low Cost Terminal. MAHB, KLIA's operator has set a target completion date of October 2012 for a new terminal, which will also be primarily dedicated to low-cost operations, with an initial capacity



of 30mppa, growing to 45mppa, doubling the existing main terminal's capacity of 20mppa, which has MAS as its main tenant. The new terminal could provide the airline with further advantages in streamlining and optimising its low cost hub operations.

Scot competition

In neighbouring Singapore, it was announced that Singapore Airlines are going to start a long-haul no frills, low fare subsidiary called Scoot in the middle of next year, which would be run and managed independently from its parent. The airline plans to start with four 777s increasing to 14 by 2016. Among the long-haul markets targeted are Australia and Asia in the initial phase before expanding further to Europe and possibly Africa.

SIA's announcement of this venture shows that the long-haul, low cost model is here to stay and is undergoing an evolutionary phase that cannot be ignored by traditional network carriers. AirAsia X sees the SIA decision as bolstering its own credibility. At the same time, the SIA challenge and Jetstar's growing long-haul operation could result in a new impetus for expansion at Air Asia X to consolidate its advantage as first-mover in the market.

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Brazil's Gol: Short-term struggles, long-term potential

Gol Linhas Aereas Inteligentes, Latin America's leading LCC, has plunged into losses this year due to fierce price wars in Brazil, higher labour expenses and adverse currency movements. However, the latest yield trends and industry capacity plans suggest a more rational 2012. What strategies is Gol deploying to ensure a return to profitability next year and success in the longer term in a changing competitive landscape?

This time last year, in the wake of its 2010 investor day in New York, Gol's financial outlook seemed very bright. The Sao Paulo-based carrier had recovered from its near-disastrous April 2007 acquisition of Varig after spending two years "getting back to basics" of being an LCC, rebuilding profit margins and repairing its balance sheet, while capitalising on the competitive strengths gained through the merger. Gol had almost attained its pre-Varig unit cost levels and dramatically improved its cash position (see *Aviation Strategy* briefing, December 2010). Gol posted a double-digit operating margin in 2010 - for the first time since 2006 - and looked set to improve earnings in 2011.

Alas, that was not to be. Intense competition in Brazil's domestic market, amid aggressive expansion by new entrants, has sent yields tumbling this year. On top of the rise in fuel prices, Gol has had labour cost pressures. And the weakening of the Brazilian Real against the US dollar in recent months has had significant negative impact on costs.

Gol has posted losses for the past two quarters and will also incur a loss in 2011. It is hard to believe that this former high-flyer (and an extremely well-managed LCC with great potential) was the only sizable airline in the Americas to report an operating loss for the September quarter (see chart on page 12).

On a positive note, the latest yield and

RASK statistics have hinted at a new positive trend. All the key players have indicated that they will maintain capacity discipline in 2012. So, there is reason to hope that, despite the likely slowing of GDP growth, 2012 will bring a more rational and profitable environment for airlines in Brazil.

However, knowing that the international investment community would treat such predictions with a healthy dose of scepticism, at its 2011 investor day in New York on October 26 Gol sought to draw attention to its excellent long-term growth opportunities. The airline brought along a top economist, Dr. Marcelo Nero from the Center for Social Studies in Brazil, to talk about the incredible "new middle class prospects" in Brazil. Gol's CEO Constantino de Oliveira Junior even invited Nero to the podium first, before any of the management presentations.

The Brazilian air travel market is seeing tremendous growth due to continued healthy GDP growth and rising incomes. Domestic RPKs doubled between 2005 and 2010, and the first nine months of 2011 saw 18.5% growth. A population segment known as "C class" has expanded rapidly, made up of many people who had not flown before. Tapping that new middle class, which has grown from 76m people in 2003 to 106m this year and is projected to expand to 130m-plus, is the cornerstone of Gol's strategy. Only 20m people currently fly in a population of 192m. Domestic passenger numbers could double, triple or even quadruple in the next 5-10 years. Then there will be the added boost provided by the major international sports events secured by Brazil - the World Cup in 2014 and the Olympics in 2016.

All of that adds up to significant growth opportunities for Brazil's airlines in the next decade or so. Gol is well positioned to tap those opportunities because of its competitive advantages, including formidable slot

holdings at the main airports, focus on short-haul flights, cost leadership, standardised fleet of 737NGs, largest e-commerce platform in Latin America and a strong loyalty programme.

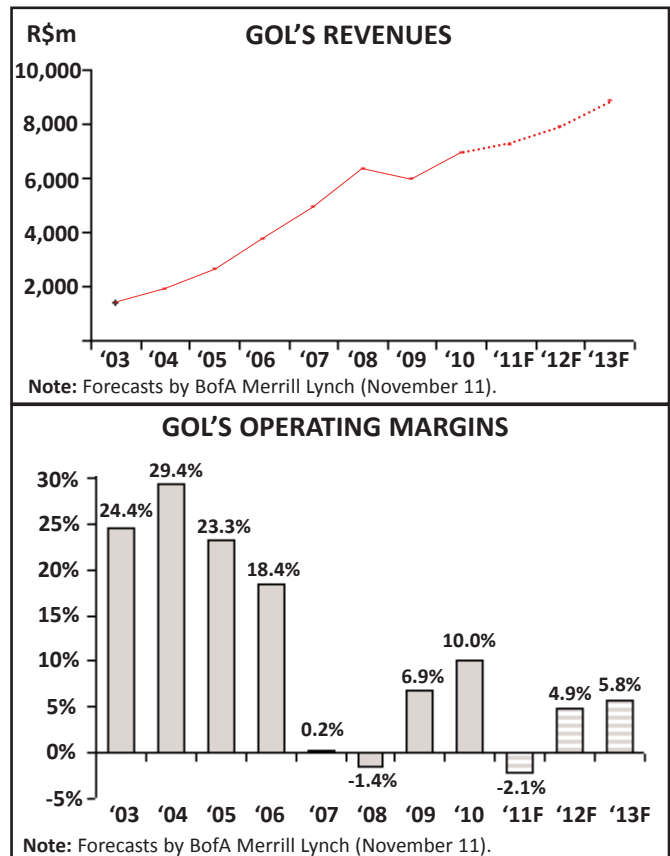
Of course, Gol is intensely focused on dealing with the near-term challenges as it seeks to return to profitability in 2012. First, it is determined to maintain capacity discipline: just 7% ASM growth this year, followed by a 0-4% growth in 2012. Second, even though its unit costs are still competitive, it has a new programme in place to reduce ex-fuel CASM in 2012. Third, Gol is determined to maintain strong liquidity and a healthy balance sheet. Its cash reserves now amount to almost 30% annual revenues, up from 11% two years ago. Fourth, Gol is seeking to grow higher-margin ancillary activities; revenues from those sources are projected to comprise at least 15% of total revenues by 2014.

Gol is also making moves to boost its market position in response to the impending LAN/TAM merger, which will create a dominant player in Latin America and a stronger competitor in Brazil (that deal is expected to close late in 1Q12). On the domestic front, Gol recently acquired Webjet, a Rio de Janeiro-based LCC with a 5% market share. On the international front, Gol has been forging codeshare deals with the most important global carriers that serve Brazil.

This year's challenges

Gol's main problem this year has been a sharp decline in domestic yields and RASK due to competition, even as healthy demand growth has continued and load factors have improved (given Gol's constrained capacity addition). But Gol has also seen significant cost pressures, especially in the fuel and labour categories, and has recorded sizable one-time items. And foreign exchange movements played havoc with the latest quarterly net results.

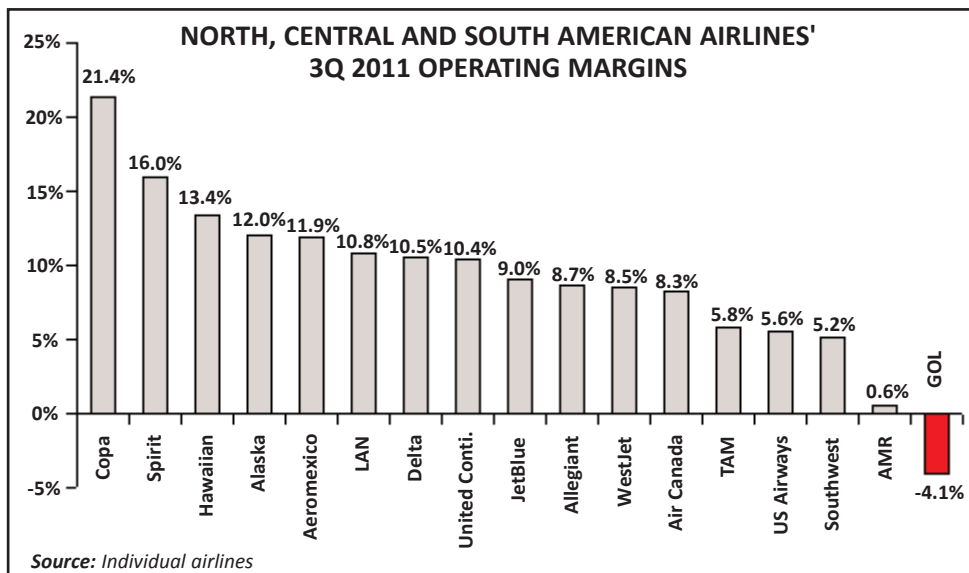
The first quarter was still strong for Gol, with yields remaining stable, revenues increasing by 9.6% and operating margin amounting to a healthy 10.2%. But the



subsequent onset of industry price wars – which caused average domestic air fares in May to plummet to the lowest level seen since records began in 2002 - led to dismal results in the second quarter. With its yield falling by 13.8% while fuel prices were up significantly, Gol recorded a R\$271m operating loss (17.3% of revenues) for the period.

The third quarter was still weak operationally. As yield declined by 7.6%, revenues inched up by 3.1% and operating costs surged by 19.7%, Gol reported an operating loss of R\$75m (4.1% of revenues). The main culprits on the cost side were fuel (up 28.5%), payroll costs (up 17.6%) and "other" costs (up 64.2%). The latter included some R\$50m of one-time expenses associated with restructuring and system improvements.

Gol reported a staggering R\$517m net loss for the September quarter (28% of revenues), compared to a profit of R\$110m (6% of revenues) a year earlier. But more than 90% of the net loss was due to a non-



According to Gol's figures, in 3Q the two airlines' domestic ASK growth rates were similar: Gol's up by 10.2% and TAM's up by 9.1% (compared to an industry increase of 14.2%). However, Gol's domestic traffic (RPKs) rose by 13.5%, compared to TAM's modest 4.8% increase. So, Gol improved its load factor and market share, but it did so at the expense of yield. TAM, by contrast, let its load factor and market

cash foreign exchange loss (R\$476.4m) recorded as a result of the Brazilian Real's depreciation against the US dollar during the quarter, which increased Gol's dollar-denominated liabilities (72.4% of its debt was dollar-denominated in the period). The dollar strengthened from R\$1.56 at the end of June to R\$1.85 at the end of September, an 18.6% increase. It was purely an accounting impact and of little concern at present, especially because Gol has stretched out its debt maturities.

In recent years Gol's net results have fluctuated wildly due to currency movements. For example, Gol had a R\$1.2bn net loss in 2008 (19.3% of revenues) when the Real fell sharply after the start of the global financial crisis. The situation was reversed in 2009, when the Real recovered by 34%, producing a R\$711m non-cash gain that boosted Gol's net profit to R\$891m (14.8% of revenues). Therefore Gol's results are best examined on an operating basis.

However, this year's third-quarter results were dismal even on an operating basis. By comparison, TAM had a modest positive operating margin of 5.8%, in part because it benefited from a much greater international exposure (40% of its revenues). TAM's international yield rose by 10.3% in the third quarter, though its domestic yield performance (up 2.2%) was also better than Gol's.

share slip but improved its yield – clearly a more profitable strategy.

Recent months have seen Gol attain a domestic market share lead for the first time. Between May and September, Gol's share of domestic RPKs increased by 3.5 points, from 35.4% to 38.9%. In the same period, TAM's domestic market share fell by more than six points, from 44.5% to 38.2%. The smaller carriers, especially Azul, took some of TAM's share.

Cost and capacity discipline

When disclosing the 2Q losses in August, Gol announced a new cost-cutting programme that aims to shave R\$650m from operating costs in 2012. That would be about 10% of the airline's 2010 operating costs. Under the plan, ex-fuel CASK would decline by R\$1.10 to R\$8.50.

As of early November, Gol had identified more than R\$500m of the planned savings, which would in theory bring ex-fuel unit costs below R\$9, which the management has indicated they would be happy with. The savings will come from revised contracts, lower lease expenses, lower maintenance expenses (through a new five-year MRO agreement signed with Delta earlier this year), fuel saving initiatives and suchlike.

However, attaining even the R\$9 target will not be an easy task because of inflation-

ary pressures and possible continued devaluation effects. Partly because of the volatility in currency movements, Gol decided not to revise its 2012 guidance when announcing the 3Q results. CFO Leonardo Pereira warned that if the adverse foreign exchange trends persist, Gol will have to be even more aggressive in pursuing cost reductions.

On the positive side, Gol's unit costs remain competitive relative to peers. According to Gol's own calculations, on a stage-length adjusted basis, its 3Q ex-fuel CASK of 5.4 US cents was 44% lower than LAN's 9.6 cents, 25% lower than TAM's 7.2 cents and 5% lower than Copa's 5.7 cents, but a little higher than Southwest's 5.2 cents.

Furthermore, as an LCC in a major growth market, Gol has to balance the cost cuts with the need to grow the business. Its best cost cuts are probably those that take the business model "back to basics" after the Varig acquisition. On that front, earlier this year Gol decided to get rid of the final six ex-Varig 767s, a fleet that it had reactivated a year or so earlier. Four of the aircraft had been operating charters, which Gol decided to discontinue because of the hike in fuel prices (the other two 767s were leased out). Gol had negotiated early returns for two aircraft and was working on the other four; disposing of the six will mean a US\$36m annual saving in lease costs.

On the network front, Gol terminated service to Bogotá in June. It had been a marginal route, with operating restrictions due to the airport's high altitude, and it was more profitable to deploy the 737-800s to domestic routes. Gol is now more focused on routes of three hours or less, where its low-cost advantage is more pronounced.

In September Gol implemented another organisational restructuring aimed at increasing synergies and efficiency. Among other things, it included reducing the number of departments. An important part of the restructuring was to make Smiles FFP a new business unit – the first step in the process of preparing it for growth (and eventual spinoff).

In recent months Gol has sought to reassure the investment community that it

will remain disciplined in respect to capacity addition. This may be more important than cost cuts, because capacity constraint means less likelihood of heavy fare discounting. The plan is to grow domestic ASKs (including Webjet's) by only 0-4% in 2012. Gol's management said in early November that they were currently in the middle of that range. It would be significantly less than demand growth, which Gol projects to be 2.5-3 times GDP growth in 2012.

Gol's current fleet plan for the next three years is conservative. The airline is scheduled to add just four 737-800s in 2012, two in 2013 and four in 2014, to bring the total 700/800 fleet to 125 by the end of 2014 (40 700s and 85 800s). There is little scope to squeeze more ASMs through increased utilisation now that daily aircraft utilisation already averages 13.8 hours (3Q), though the 71.5% system load factor could probably be improved. The 737-800 deliveries pick up in 2015, following a new order for up to 30 aircraft placed in 2010.

However, Gol's fleet plan for 2012 and beyond is currently under review in light of the Webjet acquisition (which is discussed in the section below). Webjet operates 24 older-technology 737-300s that are mostly on operating leases expiring in the next year or two, so there is a potential opportunity to quickly give it a modern fleet. Gol's leadership indicated in July that, from both the fuel and network perspective, they would like to replace the 737-300s with 737-700/800s within two years. However, new 700/800s from Boeing might not be available until 2016. Furthermore, Gol may be hesitant to make long-term fleet decisions in this very volatile FX/economic environment. So Gol must also be looking at the option of leasing.

Maintaining strong liquidity

The Varig acquisition brought Gol close to a liquidity crunch in early 2009: its cash reserves amounted to only 5% of annual revenues in March 2009. Although Gol was subsequently able to quickly raise funds from a variety of sources to dramatically

improve its liquidity, it seems that the experience prompted it to adopt much more conservative spending and balance sheet management policies.

To start with, Gol now has a minimum cash target of 25% of annual revenues. Despite this year's losses, it has managed to maintain a very strong cash position: R\$2,127m at the end of September - 29.6% of lagging 12-month revenues and 4.8 times the financial obligations due in the next 12 months. In the 3Q call CFO Pereira described maintaining strong liquidity as "a very important component of our strategy".

Another key component of the strategy is to maintain an "appropriate debt amortization profile with a low refinancing risk". This means refinancing any debt that Gol is not totally comfortable with well ahead of maturity dates. The company always works to eliminate any refinancing risk in the next three-year period. Accordingly, Gol's and Webjet's combined debt maturities for the next three years are modest: R\$260m in 2012, R\$81m in 2013 and R\$50m in 2014 (but jump to R\$632m in 2015).

Gol also plans to deleverage its balance sheet in the future. The latest leverage ratios have been negatively impacted by the currency movements. Gol's adjusted gross debt was 8.7 times EBITDAR at the end of September, compared to 5.6 a year ago. CFO Pereira said that he wanted this ratio back to "below 5 times" by the end of 2012.

The Webjet acquisition

In light of the impending LAN/TAM merger and TAM's announcement earlier this year that it planned to buy a stake in TRIP Linhas Aereas, Gol was fortunate to get an opportunity last summer to acquire Webjet Linhas Aereas – a move that will strengthen its domestic market position.

Following an MoU signed in July, the transaction quickly secured ANAC's approval and was completed in early October. Gol paid R\$70m for 100% of Webjet's capital stock (down from R\$96m originally) and assumed about R\$215m of debt. Webjet is now Gol subsidiary Varig's fully owned subsidiary. However, the air-

lines will not be able to combine operations until they secure approval from Brazil's antitrust commission CADE; in the meantime they can only codeshare.

Webjet is an LCC that was founded in 2005. It is Brazil's fourth largest airline, with R\$764m revenues in 2010 (around 10% of Gol's revenues) and a 5.6% domestic market share in September. Its network covers 16 cities in Brazil (compared to Gol's 59 cities in Brazil and 14 in other countries). Webjet was profitable last year, earning an operating margin of 5.4%. Gol's management described it as an "operationally efficient company with a highly motivated staff".

Webjet's small size will limit the benefits for Gol, but it also makes CADE approval likely. However, Gol's domestic market share has increased significantly since the deal was announced. Based on the May figures that were widely quoted in July, the combined Gol/Webjet 40.6% market share was comfortably below TAM's 44.4% share. But in September the combined Gol/Webjet 44.5% market share significantly exceeded TAM's 38.2%.

Gol originally estimated the synergies from the deal at R\$100m within two years. However, analysts have been sceptical of the operational or network synergies. JP Morgan pointed out in a July report that the LCC business models are very different (with Webjet utilising ageing aircraft economics and Ryanair-style unbundling) and that there do not appear to be any markets that Webjet serves that Gol otherwise could not.

Rather, the main attraction to Gol is Webjet's slots at key Brazilian airports – scarce assets in light of the country's airport capacity constraints. According to BofA Merrill Lynch, Webjet's slot holdings include 20 at Sao Paulo's Guarulhos, 16 at Rio's Santos Dumont, 8 at Rio's Galeao, 17 at Belo Horizonte's Confins, 13 at Brasilia and 12 at Porto Alegre's Salgado Filho.

BofA Merrill Lynch analysts also considered the Webjet acquisition to be a defensive move by Gol, given that Ryanair was reportedly eyeing Webjet for either a stake purchase or a deeper commercial partnership.

All analysts like the implications of the deal for industry capacity and pricing disci-

pline. JP Morgan noted the “potential removal of a domestic competitor at what appears to be favourable purchase economics”. Webjet had hoped to complete an IPO this year but evidently had to shelve it due to weak market conditions.

On the domestic front, in the past year or so Gol has also forged commercial partnerships with at least two regional carriers, NOAR Linhas Aereas and Passaredo Linhas Aereas.

Since Gol no longer has any plans to enter long-haul international markets, in the past two years it has forged a large number of codeshare deals with global carriers. It has been able to link with both SkyTeam and oneworld carriers, including both American and Delta, and both AF-KLM and Iberia, which account for the bulk of the US-Brazil and Europe-Brazil traffic, respectively. Gol’s leadership has said on many occasions that they do not see benefit in joining a global alliance, simply because Gol does not need support from alliance partners at foreign destinations because it does not fly long-haul.

Cautious optimism about 2012

Gol’s share price fell sharply in the summer when the magnitude of the second-quarter losses became known. But the airline managed to take advantage of that by instigating a buyback programme covering 10% of its outstanding shares, to create value for shareholders. That was followed by the announcement of a substantial new cost-cutting programme.

By the 3Q call in early November, Gol’s management was seeing the “beginning of a gradual and steady recovery in operating margins”. Gol’s yield had recovered by 7% in October, returning to the 20-cent level that analysts consider adequate – an improvement that Gol believes is sustainable. Furthermore, the management argued that the industry is showing signs of greater rationality going forward. Apparently all the major players in Brazil have indicated, for different reasons, that they would be conservative with capacity addition in 2012 – something that had never happened before.

Even though Brazil’s economic growth is

likely to slow in 2012 (Gol’s current forecast is 3-3.5%), domestic air travel demand will still increase at a healthy rate (2.5-3 times the GDP growth, in Gol’s prediction). That, in combination with constrained capacity addition, should create an environment of improving yields and profitability. Gol expects to “once again achieve operating margins in 2012 that are appropriate for its business model”.

Some analysts and investors remain sceptical and continue to see challenges ahead for Gol and the Brazilian market. But others have turned bullish. Notably, in October Gol’s two key US institutional shareholders, Wellington Management and Fidelity Investments, both increased their stakes in the carrier. And even after Gol’s share price had surged in October, in early November Morgan Stanley analysts upgraded their recommendation on the airline from “underweight” to “overweight”.

Many investors may view Gol as a long-term investment, given the special circumstances and tremendous potential offered by the Brazilian market. The domestic market is so large and dynamic that there is probably enough traffic for everyone. The World Cup and the Olympics will provide special stimulus in the medium term. The rapid rise of the C class is expected to continue for at least a decade or two. It is an untapped market that needs to be stimulated, and Gol is perfectly positioned to do that. Slot constraints at the main airports will limit smaller competitors. And many of the new entrants in Brazil today have professional managements that focus on providing returns to investors.

Perhaps the biggest concern is whether the aviation infrastructure will be there to support the demand growth. Some reports have suggested that Brazil’s airports will not be ready for the 2014 World Cup, but Gol’s CEO said recently that his understanding was that the investments were on track. Of course, the infrastructure provision needs to focus not just on the sports events but for the long-term.

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Longer term trends for jet values and rates

Aircraft values have generally managed to regain some of their losses incurred during the recession over the course of the last 18 months but sufficient weakness in the market remains as to dissipate some of the optimism. To some extent there currently exists an element of disconnect between the strength of the air transport structure and the wider economic climate. The extensive order book, rising production rates, increasing traffic levels, and limited availability of newer aircraft are all serving to indicate that the market recovery is in full swing. Load factors, while variable, are sufficiently strong, to ensure that airlines are able to maintain yields.

While there continues to be speculation that AMR will enter Chapter 11 to address its underlying cost structure, such a move would not likely have any impact on values, contrasting with a decade ago when a number of US airlines entered bankruptcy.

American has already announced that it will cut mainline capacity by 3% in the final quarter of this year. With a fleet of some 700 aircraft, should the 3% be directly translated into a reduction of the fleet this would equate to only some 20 aircraft. The carrier has already announced that it will seek to retire 11 757s during the course of 2012 but has also recently announced significant orders with both Airbus and Boeing for the A320neo and the 737MAX.

Entering Chapter 11 may result in further contraction of the fleet. The carrier operates more than 120 757s and the retirement of a number of them has been expected for some time though withdrawal would be over a number of years. American Airlines also still possesses some 200 MD82s and MD88s, none of which are in service, and these are already set

to be replaced with re-engined derivatives. The 777-200ER fleet is significant and these are ageing as are the 767-300ERs. These may be considered targets for replacement in the coming years though this will take time. Such is the diversity and size of the world's fleet that the contraction of one of the US majors no longer has such an impact on the level of availability. While wider confidence in the market may be affected by AMR entering Chapter 11 – still a possibility rather than a probability – values will only be impacted by the disposal of a number of aircraft in a short space of time. The fleet contraction of Japan Airlines only had a temporary effect on 747-400 values, for example.

In contrast to previous recessionary periods, problems being experienced by a few airlines no longer impinge on the market as a whole. However, the short-term difficulties of the global economy need to be taken into account in terms of the recovery of values. With the expectation of problems over the next few months, values are likely to remain stable rather exhibit any further rise.

The need for financial institutions to be cautious in valuing assets, both for existing equipment and for new deals, has made the acquisition of used aircraft that much more difficult. While sale and leasebacks, transactions between lessors, the acquisition of lease portfolios or investments in newly formed leasing companies are able to secure funding, selling or buying a six-year old aircraft with no attached lease is difficult. Available funding is being channelled to deals involving ECA (Export Credit Agency) backed transactions or Japanese Operating Leases (JOLs) which usually involve new aircraft. Lease rentals have improved slightly but competition among the growing proportion of the fleet owned by leasing companies means that rates remain competitive, thereby limiting opportunities for value improvement. In the case of narrowbodies there is increased awareness that aircraft that may be popular today, will not be in

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ten years time. This makes it necessary for pricing of used aircraft to be conservative. The limited improvement for new aircraft values translates into a fall for used aircraft, though any fall needs to be placed into the context of a normal five percent decline in value associated with straight line depreciation.

Consistency of cycles

Cycles, in terms of aircraft values, are not consistent in terms of form or duration. As the market is dynamic in nature, with constantly changing variables and relationships, drawing exclusively from historical data is fraught with danger. Cycles do not necessarily exhibit a peak but rather may feature a plateau. Similarly, a trough may not be represented by the classic "V" but rather by an elongated period of uninspiring value behaviour. Despite the difficulties of extrapolating the past into the future, the current cycle is showing some consistency with past events though the extent of the recovery will be more constrained due to differing market conditions.

Some data points may have shown that the peak of the previous cycle occurred in 1Q 2008 but such data is usually already out of date by the time it becomes available. While a sale figure may be agreed, documentation can take months to complete. Only then does the data enter the public domain, thereby creating a data lag of approximately three months. Consequently, the previous peak is considered to have occurred in 4Q 2007. By the time values reach the trough towards the end of this year, three years will have elapsed from the peak.

Previous cycles provide a clue rather than certainty to future events. The collapse in oil prices in 1986 saw rapid economic recovery. The increase in traffic, particularly in the international arena, was compounded by a shortage of capacity as manufacturers struggled to bring new aircraft such as the 747-400 and MD11 into service. The cyclic peak of 1990 saw values of DC10-30s nearly doubling within two years but another eight years were to elapse before the market saw a full recovery although the Asian Crisis caused some further problems. The low point for values was reached in 1995, a cycle notable for sustained production rates during the worst of

the crisis. Not until 1996 did delivery rates drop to a low point as manufacturers sought to enforce severe penalty clauses on customers considering order cancellations. Maintaining pre-downturn production rates during a market decline can delay an upturn.

However, during the early 1990s production rates, expressed as a percentage of the total fleet, was in excess of 6% compared to some 5% today. Production rates should perhaps be more compared with fleet size rather than absolute production levels although utilisation levels have generally increased. Values finally reached a plateau in 1998 rather than a peak during this cycle before starting to decline in the months preceding September 2001.

A three-year period elapsed between September 2001 and the subsequent low point for values, though the actual low was in late 2001 (when placing any value on aircraft was a theoretical exercise in view of the absence of market activity). There were however, already indications that values were starting to erode before September 2001. The subsequent problems associated with SARS and Bird Flu prevented a more rapid recovery during this cycle. Another three years were to elapse from 2004 through to 2007 before the peak in values was next recorded.

Although each cycle and each recovery period is different, a peak or plateau appears between three to five years after the cyclic trough. The current cycle has the potential to be of average duration e.g. six years elapsing between peaks. Recovery is expected to have reached a peak in 2013. Manufacturers are showing their willingness to meet demand for new aircraft despite a rise in storage levels. Values of older aircraft - the first and second generation Chapter 3 aircraft - are therefore the most exposed in this cycle. While newer aircraft are more favoured, market conditions will make it difficult to contemplate a significant increase in value. The development of updated narrowbodies will make the current range of aircraft less attractive even if lease rentals rise to compensate for lesser residual values. The best that can be expected is for values to exhibit a similar plateau as in the late 1990s. The introduction of new widebodies (787 variants and the A350) will make it

difficult to justify an increase in values of existing widebodies in view of their imminent replacement. The introduction of new models may cause operators to delay placing new orders thereby leading to shortage but in such an event, there will be a surplus of older equipment available to fill any void on a temporary basis.

Leasing rentals

Lease rentals were starting to register a rise at the end of 2010 but such increases - apart from some widebodies - has lost momentum more recently in the face of low interest rates. In the four years since the peak of 2007, lease rentals have fallen by more than 20% for those aircraft in production and to an even greater degree for many older examples. The fall in rentals is partly due to the fall in interest rates. The lessors had generally managed to retain their 15-20% margins during the recession but these margins are now being eroded as new deals at lower rates are secured. Nonetheless, in contrast to previous downturns, the lessors have been faced with fewer calls for renegotiation of existing leases and instead have preferred to take aircraft back and lease to other carriers. This is because the market structure has experienced a significant change -the stranglehold of the major carriers has been broken. There now are a myriad of operators around the world for whom leasing is the only means of acquiring aircraft. Lessors are no longer dependent on a few operators. Lessees are less able to renegotiate existing agreements because lessors are able to lease elsewhere, even if subsequent rentals to other lessees have had to become more realistic.

A problem for the lessors is that the maintenance of operating revenues has been at the expense of leases agreed before the recession. As these leases continue to expire, there has been little opportunity to place aircraft at the same levels with either existing or new lessees, undermining revenues. If all aircraft currently possessed by the lessors were re-leased at current market rates, the lessors would inevitably report losses rather than profits. Nonetheless, the proportion of premi-

um grade leases will continue to be eroded during the course of the next year. The lease rentals of older aircraft are only likely to experience a sizeable recovery due to shorter terms to the less financially secure operators.

The levels of availability continue to show relatively modest levels which can distort the perceived strength - or weakness - of the market. The number of aircraft actively being marketed today would seem to be at lower levels than during the depths of the market in 2002-2003. With a current fleet of some 20,000 jet aircraft, the 650 being advertised at the beginning of this year represents less than 3.5% of the fleet, suggesting a measure of equilibrium between supply and demand. But owners are simply not advertising aircraft because of the lack of demand, while others are undertaking direct re-marketing. The real level of availability is therefore much higher.

The relevance of parked or stored aircraft to used value behaviour has lost its significance as aircraft have reached the end of their service lives rather than be prematurely consigned to the parking lot. While the number of narrowbodies in storage has increased between the end of 2009 and 2010, the widebody total has experienced a significant reduction from just under 400 to approximately 300. The recovery in the fortunes of the widebody fleet is due in no small part to the delay to the service entry of the 787 and the expansion of Asian markets, which require widebody capacity.

MAX and neo

Boeing has finally made a decision on re-engining the 737, which inevitably raises questions as to how far values of the existing A320 and 737 aircraft will be impacted. The 737MAX, a designation that perhaps suggests that the latest iteration maximises the remaining opportunities of the 737 before having to opt for a clean sheet design, ends months, if not years, of speculation regarding the future of the 737. Service entry is scheduled for 2017, two years after the A320neo. Discussions concerning the next 737 have been ongoing for perhaps a decade or more, only recently taking on a more concrete form as Airbus opted for the A320neo. The re-

engining of the 737, like the A320, is a compromise and further development will need an all new structure. The selection of the CFM56 as the sole engine comes as little surprise. CFM previously contributed a sizeable portion of the development cost of the 737NG in return for sole status suggesting that a similar quid pro quo may be in place for the 737MAX.

Inevitably, the re-engining of the 737, as with the A320neo, will result in compromises. Boeing indicates that the 737MAX will be more efficient than the A320neo but much depends on the assumptions used. As with any operating cost calculation, much depends on the parameters of the individual operators and both manufacturers employ airline analysts to assess actual operating costs on individual routes for prospective customers. Both the A320neo and 737MAX have similar operating efficiency today, consequently, the duopoly that exists will likely persist into the next decade with each manufacturer securing an approximately equal share of the spoils. The 496 commitments announced for the 737MAX suggest healthy interest in the Boeing upgrade. Being second to launch after a period of dithering is not necessarily a disadvantage.

The launch of the 737MAX is expected to cause some anxiety for those with an interest in asset values of the existing A320 and 737NG family members. Historically, values of an existing product line have been adversely affected when a replacement aircraft has been launched though the major part of any decline has been more notable in the period immediately before and after the service entry of the new programme.

The degree to which values of existing products will be impacted depends on the operating cost differential. A double digit improvement in fuel efficiency does not lead to the same reduction in overall operating costs. On shorter sectors the fuel component of direct operating costs is that much less than on long-haul. The capital cost of acquiring new aircraft will partially outweigh the fuel efficiency improvement.

The launch of the A320neo has set the scene for the behaviour of values of existing equipment. While backlogs are long, there

will be little appetite for customers to pay more for existing aircraft particularly as the service entry of the new products approaches. The service entry of the first A320neo is now only four years away. There will likely be an opportunity for values of new aircraft to be delivered this year and next, to register a modest improvement as a result of exceptional demand but thereafter, there will not be any impetus for a rise. The value of a 737NG delivered in 2015 is therefore likely to be the same, if not less, than the value of a 737NG when delivered in 2013.

Once the A320neo and 737MAX enter service, the values of these products will likely remain stable in the short term due to limited availability. An approximate US\$3-4 million differential in the capital cost will not be sufficient to prevent deterioration in the value of the existing product. Aircraft being delivered will likely be used just as much as replacement as growth capacity and will therefore displace existing equipment. A higher price of fuel will accelerate this replacement process thereby causing values of existing products to fall that much faster. The expected future decline in values of existing products needs to be seen in the context of prevailing forecasts. Many future value projections will have already compensated for the introduction of a re-engined aircraft. Consequently, the service entry of the new product has already been compensated. The danger lies if the existing future value forecasts for the existing 737NG is reduced still further simply as a result of investor anxiety. There will however, be some forecasts that have failed to see a reduction in future values in the coming years because of current demand and it is these that may need to be adjusted downwards.

By the end of this decade the product lines of the manufacturers will have undergone a radical change causing long-term market values of current types to experience significant change. The technology offering significant improvements in efficiency in the narrowbody segment may seem distant but ten years ago production of the 737-300 had only just ended, the E-Jets had yet to enter service, the four engined A340-600 was under development and the trijet MD11 was still being produced.

Jet values and lease rates

The following tables reflect the current values (not “fair market”) and lease rates for narrowbody and widebody jets. Figures are provided by The Aircraft Value Analysis Company (see following page for contact details) are not based exclusively on recent market transactions but more reflect AVAC’s opinion of the worth of the aircraft.

These figures are not solely based on market averages. In assessing current values, AVAC bases its calculations on many factors such as number of type in service, number on order and backlog, projected life span, build standard, specification etc. Lease rates are calculated independently of values and are all market based.

NARROWBODY VALUES (US\$m)									
	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A318 (CFM)	26.8	17.7			717-200	9.7	7.3		
A319 (IGW)		25.6	19.7		737-300 (LGW A)				3.2
A320-200 (IGW)		32.1	23.7	9.8	737-400 (LGW A)				3.1
A321-200 (LGW)		36.8	26.0		737-500 (LGW A)				2.6
					737-600 (LGW)	17.6	11.8		
					737-700 (LGW)	27.3	20.3		
					737-800 (LGW)	32.9	24.9		
					737-900			18.0	
					757-200 (RB 211)			14.7	9.0
					757-200ER (PW)			15.8	9.9
					757-300 (LGW)			16.8	
					MD-82				1.3
					MD-83				1.7
					MD-87				1.3
					MD-88				1.7
WIDEBODY VALUES (US\$m)									
	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A300B4-600				3.8	747-400 (PW)			39.8	17.7
A300B4-600R				7.4	767-200 (CF6)				3.7
A310-300 (IGW)				5.2	767-300 (CF6)				7.8
A330-200			50.4		767-300ER (LGW)			25.6	13.5
A330-300 (IGW)			40.6		777-200 (PW)			35.7	
A340-300 (LGW)			31.5		777-200ER	108.9	86.7	64.5	
A340-300 (HGW)			36.2		777-300		71.9	50.7	
A340-300ER			38.1		787-8	103.4			
A340-500 (IGW)		66.3							
A340-600 (IGW)		67.7			MD-11P				13.6
A380-800	196.1								

Source: AVAC
Note: As assessed at end-October 2011; mid-range values for all types

Aviation Strategy

Lease rates

NARROWBODY LEASE RATES (US\$000s per month)

	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A318 (CFM)	236	172			717-200	139	111		
A319 (IGW)		238	193		737-300 (LGW A)				74
A320-200 (IGW)		279	235	131	737-400 (LGW A)				63
A321-200 (LGW)		323	252		737-500 (LGW A)				55
					737-600 (LGW)	146	115		
					737-700 (LGW)	257	201		
					737-800 (LGW)	280	232		
					737-900		159		
					757-200 (RB 211)		153		131
					757-200ER (PW)		165		144
					757-300 (LGW)		166		
					MD-82				50
					MD-83				54
					MD-87				43
					MD-88				57

WIDEBODY LEASE RATES (US\$000s per month)

	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A300B4-600				118	747-400 (PW)			408	258
A300B4-600R				103	767-200 (CF6)				94
A310-300 (IGW)				111	767-300 (CF6)				119
A330-200			520		767-300ER (LGW)			300	226
A330-300 (IGW)			451		777-200 (PW)			382	
A340-300 (LGW)			419		777-200ER	931	791	648	
A340-300 (HGW)			452		777-300		678	537	
A340-300ER			464		787-8	805			
A340-500 (IGW)	726				MD-11P				171
A340-600 (IGW)	726								
A380-800	1,754								

Source: AVAC

Note: As assessed at end-October 2011; mid-range values for all types

AIRCRAFT AND ASSET VALUATIONS

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Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Air France/ KLM Group YE 31/03	Apr-Jun 09	7,042	7,717	-676	-580	-9.6%	-8.2%	63,578	50,467	79.4%	18,703	106,800
	Jul-Sep 09	8,015	8,082	-67	-210	-0.8%	-2.6%	66,862	56,141	84.0%	19,668	105,444
	Oct-Dec 09	7,679	8,041	-362	-436	-4.7%	-5.7%	61,407	49,220	80.2%	17,264	105,925
	Year 2009/10	29,096	31,357	-2,261	-2,162	-7.8%	-7.4%	251,012	202,453	80.7%	71,394	104,721
	Apr-Jun 10	7,301	7,469	-168	939	-2.3%	12.9%	60,345	49,283	81.7%	17,623	102,918
	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
Apr-Jun 11	8,947	9,153	-206	-283	-2.3%	-3.2%	66,531	53,931	81.1%	19,653		
British Airways YE 31/03	Year 2008/09	15,481	15,860	-379	-616	-2.4%	-4.0%	148,504	114,346	77.0%	33,117	41,473
	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%	11,527	56,159
	Apr-Jun 11	5,951	5,678	273	135	4.6%	2.3%	53,425	42,635	79.8%	13,288	56,649
	Jul - Sep 11	6,356	5,842	514	401	8.1%	6.3%	55,661	47,022	84.5%	14,553	57,575
Iberia YE 31/12	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 YE 31/12	Jan-Mar 09	6,560	6,617	-58	-335	-0.9%	-5.1%	44,179	32,681	74.0%	15,033	106,840
	Apr-Jun 09	7,098	7,027	71	54	1.0%	0.8%	49,939	38,076	76.2%	18,142	105,499
	Jul-Sep 09	8,484	8,061	423	272	5.0%	3.2%	56,756	46,780	82.4%	22,164	118,945
	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
	Apr-Jun 11	10,967	10,636	331	433	3.0%	3.9%	68,763	53,603	78.0%	28,147	118,766
	Jul- Sep 11	11,430	10,616	814	699	7.1%	6.1%	73,674	60,216	81.7%	30,408	120,110
SAS YE 31/12	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
	Apr-Jun 11	1,793	1,648	145	88	8.1%	4.9%	9,848	7,494	76.1%	7,397	15,264
	Jul-Sep 11	1,642	1,565	77	33	4.7%	2.0%	9,609	7,579	78.9%	6,928	15,375
Ryanair YE 31/03	Year 2008/09	4,191	3,986	205	-241	4.9%	-5.7%			81.0%	58,559	
	Apr-Jun 09	1,055	844	211	168	20.0%	15.9%			83.0%	16,600	
	Jul-Sep 09	1,418	992	426	358	30.0%	25.2%			88.0%	19,800	
	Oct-Dec 09	904	902	2	-16	0.2%	-1.8%			82.0%	16,021	
	Year 2009/10	4,244	3,656	568	431	13.5%	10.2%			82.0%	66,500	
	Apr-Jun 10	1,145	992	152	120	13.3%	10.5%			83.0%	18,000	7,828
	Jul-Sep 10	1,658	1,150	508	426	30.7%	25.7%			85.0%	22,000	8,100
	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	
	Apr-Jun 11	1,661	1,418	245	201	14.7%	12.1%			83.0%	21,300	
Jul-Sep 11	2,204	1,523	681	572	30.9%	25.9%			87.0%	23,000		
easyJet YE 30/09	Apr-Sep 08	2,867	2,710	157	251	5.5%	8.7%	32,245	28,390	88.0%	24,800	
	Year 2007/08	4,662	4,483	180	164	3.9%	3.5%	55,687	47,690	85.6%	43,700	6,107
	Oct 08-Mar 09	1,557	1,731	-174	-130	-11.2%	-8.3%	24,754	21,017	84.9%	19,400	
	Year 2008/09	4,138	3,789	93	110	2.3%	2.7%	58,165	50,566	86.9%	45,200	
	Oct 09 - Mar 10	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	
	Year 2010/11	5,548	5,115	432	362	7.8%	6.5%	69,318	61,347	88.5%	54,500	

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

Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Alaska	Jan - Mar 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
Jul - Sep 11	1,198	1,055	143	77	11.9%	6.4%	12,469	10,787	86.5%	6,709	11,859	
American	Jan - Mar 10	5,068	5,366	-298	-505	-5.9%	-10.0%	59,296	46,187	77.9%	20,168	77,800
	Apr - Jun 10	5,674	5,478	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
Jul - Sep 11	6,376	6,337	39	-162	0.6%	-2.5%	64,269	54,552	84.9%	22,674	80,600	
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	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
	Apr - Jun 11	9,153	8,672	481	198	5.3%	2.2%	96,785	81,054	83.7%	42,918	82,347
Jul - Sep 11	9,816	8,956	860	549	8.8%	5.6%	101,807	87,702	86.1%	44,713	79,709	
Southwest	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
	Apr - Jun 11	4,136	3,929	207	161	5.0%	3.9%	50,624	41,654	82.3%	27,114	43,805
Jul - Sep 11	4,311	4,086	225	-140	5.2%	-3.2%	53,619	43,969	82.0%	28,208	45,112	
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 Pro-forma FY 2010	Oct-Dec 10	8,433	8,515	-82	-325	-1.0%	-3.9%	100,201	82,214	82.0%	35,733	80,800
	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
Jul - Sep 11	10,171	9,236	935	653	9.2%	6.4%	107,236	91,494	85.3%	38,019	80,500	
US Airways Group	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
Jul - Sep 11	3,436	3,256	180	76	5.2%	2.2%	36,357	30,911	85.0%	20,655	31,327	
JetBlue	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
	Apr - Jun 11	1,151	1,065	86	25	7.5%	2.2%	15,193	12,379	81.5%	6,622	11,609
Jul - Sep 11	1,195	1,087	108	35	9.0%	2.9%	15,856	13,409	84.6%	7,016	11,443	

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

Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
ANA YE 31/03	Year 2006/07	12,763	11,973	790	280	6.2%	2.2%	85,728	58,456	68.2%	49,500	32,460
	Year 2007/08	13,063	12,322	740	563	5.7%	4.3%	90,936	61,219	67.3%	50,384	
	Year 2008/09	13,925	13,849	75	-42	0.5%	-0.3%	87,127	56,957	65.4%	47,185	
	Year 2009/10	13,238	13,831	-582	-614	-4.4%	-4.6%	83,827	55,617	66.3%	44,560	
	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 YE 31/12	Year 2007	9,661	8,670	991	900	10.3%	9.3%	102,462	81,101	79.8%	23,250	19,840
	Jan-Jun 08	5,443	5,461	-18	-71	-0.3%	-1.3%	56,949	45,559	80.0%	12,463	
	Year 2008	11,119	12,138	-1,018	-1,070	-9.2%	-9.6%	115,478	90,975	78.8%	24,959	18,718
	Jan-Jun 09	3,988	3,725	263	119	6.6%	3.0%	55,750	43,758	78.5%	11,938	18,800
	Year 2009	8,640	7,901	740	627	8.6%	7.3%	111,167	96,382	86.7%	24,558	18,511
	Jan-Jun 10	5,320	4,681	917	892	17.2%	16.8%	55,681	46,784	84.0%	12,954	
	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 YE 31/03	Year 2005/06	19,346	19,582	-236	-416	-1.2%	-2.2%	148,591	100,345	67.5%	58,040	53,010
	Year 2006/07	19,723	19,527	196	-139	1.0%	-0.7%	139,851	95,786	68.5%	57,510	
	Year 2007/08	19,583	18,793	790	148	4.0%	0.8%	134,214	92,173	68.7%	55,273	
	Year 2008/09	19,512	20,020	-508	-632	-2.6%	-3.2%	128,744	83,487	64.8%	52,858	
Korean Air YE 31/12	Year 2006	8,498	7,975	523	363	6.2%	4.3%	71,895	52,178	72.6%	22,140	16,623
	Year 2007	9,496	8,809	687	12	7.2%	0.1%	76,181	55,354	72.7%	22,830	16,825
	Year 2008	9,498	9,590	-92	-1,806	-1.0%	-19.0%	77,139	55,054	71.4%	21,960	18,600
	Year 2009	7,421	7,316	105	-49	1.4%	-0.7%	80,139	55,138	68.8%	20,750	19,178
	Year 2010	10,313	8,116	120	421	1.2%	4.1%	79,457	60,553	76.2%	22,930	
Malaysian YE 31/12	Year 2006	3,696	3,751	-55	-37	-1.5%	-1.0%	58,924	41,129	69.8%	15,466	19,596
	Year 2007	4,464	4,208	256	248	5.7%	5.6%	56,104	40,096	71.5%	13,962	19,423
	Year 2008	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 YE 30/6	Year 2007/08	14,515	13,283	1,232	869	8.5%	6.0%	127,019	102,466	80.7%	38,621	33,670
	Jul-Dec 08	6,755	6,521	234	184	3.5%	2.7%	63,853	50,889	79.7%	19,639	34,110
	Year 2008/09	10,855	10,733	152	92	1.4%	0.8%	124,595	99,176	79.6%	38,348	33,966
	Jul-Dec 09	6,014	5,889	124	52	2.1%	0.9%	62,476	51,494	82.4%	21,038	32,386
	Year 2009/10	12,150	11,926	223	102	1.8%	0.8%	124,717	100,727	80.8%	41,428	32,490
	Jul - Dec 10	7,176	6,832	344	226	4.8%	3.1%	66,821	54,592	81.7%	22,948	32,369
Singapore YE 31/03	Year 2005/06	6,201	5,809	392	449	6.3%	7.2%	109,484	82,742	75.6%	17,000	13,729
	Year 2006/07	9,555	8,688	866	1,403	9.1%	14.7%	112,544	89,149	79.2%	18,346	13,847
	Year 2007/08	10,831	9,390	1,441	1,449	13.3%	13.4%	113,919	91,485	80.3%	19,120	14,071
	Year 2008/09	11,135	10,506	629	798	5.6%	7.2%	117,789	90,128	76.5%	18,293	14,343
	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 YE 31/12	Year 2006	5,647	5,331	316	338	5.6%	6.0%	79,383	60,276	75.9%	31,490	18,872
	Year 2007	6,770	6,264	506	558	7.5%	8.2%	85,257	66,986	78.6%	34,830	19,334
	Year 2008	7,627	7,902	-275	-1,350	-3.6%	-17.7%	88,078	66,013	74.9%	34,250	19,972
	Year 2009	7,523	6,718	805	710	10.7%	9.4%	95,489	73,374	76.8%	39,840	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 YE 31/12	Year 2006	5,808	5,769	39	26	0.7%	0.4%	97,044	69,575	71.7%	49,200	45,575
	Year 2007	7,188	6,974	214	272	3.0%	3.8%	109,733	81,172	74.0%	56,910	45,474
	Year 2008	7,970	8,912	-942	-690	-11.8%	-8.7%	112,767	83,184	73.8%	58,240	46,209
	Year 2009	8,022	7,811	211	48	2.6%	0.6%	123,440	93,000	75.3%	66,280	50,412
	Year 2010	11,317	10,387	930	857	8.2%	7.6%	140,498	111,328	79.2%	76,460	
China Eastern YE 31/12	Year 2006	3,825	4,201	-376	-416	-9.8%	-10.9%	70,428	50,243	71.3%	35,020	38,392
	Year 2007	5,608	5,603	5	32	0.1%	0.6%	77,713	57,180	73.6%	39,160	40,477
	Year 2008	6,018	8,192	-2,174	-2,201	-36.1%	-36.6%	75,919	53,754	70.8%	37,220	44,153
	Year 2009	5,896	5,629	267	25	4.5%	0.4%	84,422	60,918	72.2%	44,030	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) YE 31/12	Year 2008	796	592	203	-142	25.5%	-17.9%	14,353	10,515	73.3%	9,183	4,593
	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..

Aviation Strategy

Databases

EUROPEAN SCHEDULED TRAFFIC

	Intra-Europe			North Atlantic			Europe-Far East			Total long-haul			Total International		
	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %
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
Sept 11	31.7	23.9	75.6	22.6	19.5	86.3	17.6	14.6	82.8	57.8	48.8	84.4	87.9	71.7	81.5
Ann. change	6.5%	7.3%	0.6	9.6%	8.0%	-1.3	14.7%	11.2%	-2.6	11.0%	9.9%	-0.9	9.4%	8.9%	-0.3
Jan-Sept 11	265.4	190.0	71.6	188.9	156.5	82.8	152.8	122.4	80.1	502.1	409.6	81.6	757.4	592.8	78.3
Ann. change	6.9%	8.7%	1.2	11.1%	8.7%	-1.8	14.7%	9.8%	-3.6	11.6%	9.2%	-1.8	10.0%	8.8%	-0.9

Source: AEA.

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	17 Nov	Aviation Capital Group	20 x 737-800	
	15 Nov	Qatar Airways	2 x 777F	
	14 Nov	Oman Air	6 x 787-8	
	13 Nov	Emirates A/L	50 x 777-300ER	plus 20 options
Airbus	17 Nov	Hawaiian Airlines	5 x A330-200	
	15 Nov	Qatar Airways	50 x A320neo, 5 x A380	
	15 Nov	Aviation Capital Group	30 x A320neo	
	14 Nov	ALAFCO	50 x A320neo	plus 30 options
	08 Nov	Frontier A/L	60 x A320neo, 20 x A319neo	CFM LEAP-X
	27 Oct	JetBlue	40 x A320neo	
	25 Oct	Air Pacific	3 x A330-200	
	20 Oct	TAM Airlines	22 x A320neo, 10 x A320	

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

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