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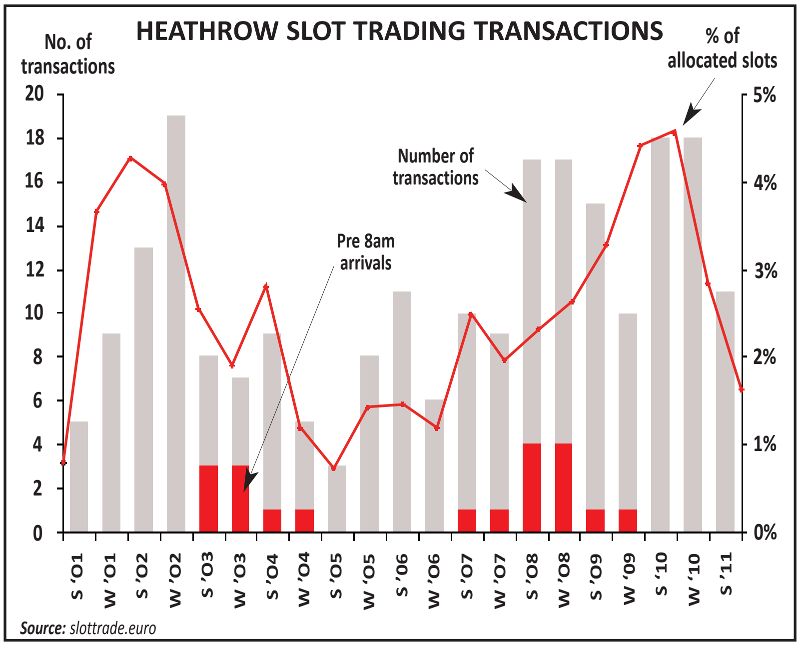
European slot reform

At IACA's (International Air Carriers' Association, representing some 30 European leisure-oriented carriers) annual meeting in Madrid in March, one of the main concerns on the agenda was the EC's proposed changes to the slot allocation rules in a new Airport Regulation Package. This proposal is predicated on the idea that since airport capacity in Europe will be insufficient to cope with growth, a market mechanism should be introduced to encourage more efficient use of resources. According to Eurocontrol, currently five major European airports are at saturation – Heathrow, Gatwick, Düsseldorf, Orly and Frankfurt (even with the new runway?). By 2030, even with a possible 40% planned increase in airport capacity, 19 of the top European airports will be more than full – and under one scenario by then it is estimated that half of all European flights will be subject to serious congestion delays.

Under the current system, slots are allocated to airlines under an administrative system, established under an EC Regulation of 1993. Slots are allocated separately for winter and summer IATA seasons. A minimum of five slots allocated at the same time on the same day of the week during a season forms a series of slots. If an airline uses a series of slots at least 80% of the time it can retain the same slot series for the next comparable season under a grandfather clause; if more than 20% of a series is unused for whatever reason it is returned to a pool for reallocation – the



Source: slottrade.euro

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80:20 "use it or lose it" rule. In an attempt to encourage new entrants, 50% of the available pool is first allocated to new operators at that airport, and then to existing operators on a first come first served basis.

The EC has decided it wants to update the system. The main proposal is to change the "use it or lose it" rule to 85:15 but at the same time extend the concept of a series of slots to 15 weeks in summer and 10 in winter. The EC says that this is designed to impose a stricter discipline on airlines to ensure that capacity is used efficiently: a slot series removed under the "use it or lose it" rule would be longer and therefore more attractive for competing carriers seeking year round operations.

However, doing so may lead to undesirable side effects: carriers may feel forced to operate uneconomical flights merely to ensure that the grandfather right to a slot series is not lost. The increase in the ratio could have a particularly damaging impact on the charter sector – although in the proposal the EC suggests that it will have special rules in force for particularly seasonal traffic patterns.

Also, there is dissatisfaction in the success of the new entrant rules. Under the current regime 50% of pool slots should be made available to new entrant carriers – defined as those operating less than two rotations a day and for intra-European routes less than two rotations on a particular city-pair with up to two incumbents. Further, a new entrant cannot have more than 4% of total slot capacity at the airport.

There has not been a consistent allocation of the rules throughout Europe (with very few slot coordinators interpreting the 50% as absolute) while slots granted under the new entrant rules have unnecessary conditions attached. In many cases those granted under the rules had in any case been relinquished within two years (and therefore returned to the pool for further redistribution). The new proposals are for the new entrant rules to be relaxed, but they will now apply to airline groups not just individual AOCs (so, for example, easyJet would not be able to use easyJet Switzerland to gain new entrant slots at Orly).

Meanwhile, having for years objected to the idea of slot trading at Heathrow and Gatwick (the only active market in Europe) the EC finally accepted that it could be a reasonable idea after the EU-US Open Skies agreement in 2008. The EC now appears not merely to be trying to ensure a Community-wide legal framework for slot trading between airlines (in some countries in the EU such as Spain, or for that matter at Orly, it is specifically banned) but also actively to encourage it.

It aims to introduce greater transparency. The London slot trading market is still grey, with no requirement to report the type of transaction (sale or lease) nor the monetary consideration or side agreements involved (although the slot coordinator has set up a good slot trade facilitation system in slottrade.aero) By having a transparent market with published indications of transaction values, it believes it may encourage airlines to review the actual value of non-performing slots. Although not specifically stated, the EC is considering direct slot trades (or transfers) between airlines – rather than the rather cumbersome current method of applying for a junk slot and swapping that for the slot you really plus a financial consideration.

This system could be extended to other airports in Europe – but in many cases airlines will have to wait for changes in local legislation (and in some countries the acceptance of a definition of slot ownership). In the medium term it may re-enliven activities at Paris Orly and Düsseldorf – like Heathrow airport with good real O&D demand but severely constrained by annual movement caps – but may have limited impact elsewhere.

A more disturbing element in the proposals is not necessarily that it will reinforce the independence of slot coordinating committees (not a bad idea) but more that it might encourage mergers across EU boundaries and even suggest the establishment of a single Slot Coordinator responsible for slot allocation at all EU airports – another monopoly supplier being the last thing this industry needs.

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Gol and TAM: Domestic growth curtailed

Even though Brazil's economic recovery has been unexpectedly sluggish this year, GDP growth in the 3% region should still result in domestic air travel demand expanding by close to 10% in 2012. Moreover, this year is seeing a healthy pricing environment in Brazil – a rare positive that reflects disciplined capacity addition by the main carriers.

Yet Gol and TAM, which enjoy a domestic duopoly with a 79.4% combined market share in March, are not making profits even on an operating basis. Gol, with its balance sheet issues, is potentially in deeper trouble and is now scrambling to scale back expansion, slash costs and raise capital.

The airlines are feeling the effects of multiple negative factors: sharply lower domestic travel demand resulting from higher fares, high fuel prices, increases in labour and other cost categories, and the Brazilian Real's continued depreciation against the US dollar (which has increased their dollar-denominated liabilities).

Gol and TAM have both sharply curtailed their growth plans this year. In the first quarter, their domestic ASKs increased by only 3.6% and 4.5%, respectively. In 2012 Gol and TAM now expect their capacity to decline by 2% and 7%, respectively.

This has resulted in a strong pricing and yield environment – something that usually benefits airlines. But the Brazilian market is highly price-sensitive. Domestic traffic growth has decelerated from 16% in 2011 to 7.3% in 1Q12, with March only seeing 1.3% growth. Gol's domestic RPKs declined by 10.1% and TAM's by 7.8% in March. Load factors plummeted, Gol's by as much as 4.5 points to 64.3%.

Gol is now expected to post operating losses for both the first and second quarters. While TAM has benefited from a more robust international segment, it too is expected to merely break even on an operating basis in 1Q.

Lower cash flow generation, negative currency developments and the late-2011 Webjet acquisition have weakened Gol's balance sheet. Although Gol is still believed to have adequate cash reserves (31% of annual revenues at year-end), its liquidity could deteriorate in the seasonally weak June quarter especially if fuel prices remain high. Citing such concerns, Fitch downgraded Gol's credit ratings in early April.

Gol's management is now focused on cost-cutting – not an easy task for an LCC that already has lean operations. A programme is under way that aims to reduce costs by R$35m (US$19m) in 2012, building to R$135m (US$71m) annually by 2014. The carrier has even announced some workforce reductions.

In December Gol secured a very useful US$100m investment from Delta, in return for a 3% stake, a board seat, an exclusive codesharing agreement and two 767s. In recent weeks there has been speculation in Brazil that Delta is in talks to raise its stake to 20% - the maximum foreign investment currently permitted in Brazilian airlines (though the limit may be increased to 49%). Gol has denied any such talks, but some analysts have argued that it would benefit from a greater contribution from Delta to management and strategic decisions.

In a major strategy shift, Gol announced recently that its Varig unit would re-enter the Brazil-US market, initially with service to Miami. One problem is that the 737's range limitations necessitate that the Sao Paulo-originating flights stop in Caracas, raising questions about profitability. The move reflects a desire to diversify revenues and may also be a response to the LAN/TAM merger, which is expected to close in June.

In light of the new demand environment in Brazil, some analysts are concerned about the capacity addition by the smaller carriers, which now have over 20% of the domestic market. Carriers like Azul, TRIP and Avianca Brazil continue to expand at a heady pace. As battle lines are drawn in response to LAN/TAM, AviancaTaca is talking of bringing US$4bn of aircraft to its Brazilian unit over the next few years. However, unlike Gol and TAM, so far at least the smaller carriers have not seen any deterioration in load factors. Azul's and Avianca Brazil's 79-80% load factors in March suggest that they continue to grow profitably.

By Heini Nuutinen
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A potential US Airways-AMR merger: The best option for American?

US Airways' unprecedented labour deals with American's key unions have added drama and potential complications to AMR's Chapter 11 proceedings. What will happen next? Would an eventual merger with US Airways be a good option for AMR?

US Airways, the nation's fifth largest carrier, and American's three major unions (TWU, APFA and APA) announced on April 20 that they had agreed on terms that would govern the unions' collective bargaining agreements in the event that there is a merger between the two airlines. This was an unexpected and stunning development, given that AMR's management is working on a standalone business plan and has made it clear that it would consider consolidation only after Chapter 11. Airline unions do not usually support mergers. The deal was announced just as AMR's management was due to begin arguing its case in court for abrogating existing labour contracts under Section 1113 of the US Bankruptcy Code.

There is no merger deal on the table. AMR currently has exclusive rights until late September to propose a reorganisation plan. But US Airways confirmed in its 1Q earnings call on April 25 that it is proceeding on a possible combination. Having won the support of employees, US Airways is now focusing on persuading AMR's creditors of the merits of such a deal.

Many people now see an eventual AMR-US Airways merger as a highly likely outcome. In an April 20 research note, JP Morgan analyst Jamie Baker ascribed it a 75% probability. A potential AMR-US Airways combination now looks much more promising than it did in the past. And AMR's management could surely not implement a standalone business plan without the cooperation of labour.

Why this is happening

The deal between US Airways and AMR's unions reflects, first of all, AMR's bad labour relations. The workforce is deeply unhappy. AMR's workers made steep concessions in 2003 to avert bankruptcy and in subsequent years saw top executives collect huge bonuses. The unions have been in fruitless contract negotiations since 2008 and now face job losses and having to make further concessions in bankruptcy.

Second, the deal reflects US Airways' ambitions and aggressive style. CEO Doug Parker, who took over at the helm when America West Airlines (AWA) and the old US Airways merged in 2005, is a vocal proponent of consolidation and has aggressively tried to involve US Airways in further mergers. A hostile bid to acquire Delta out of bankruptcy failed in early 2007 and Delta later combined with Northwest. Multiple merger explorations with United also came to nothing and United picked Continental instead.

As the smallest of the major hub-and-spoke carriers in the US, with a primarily domestic network that is more heavily exposed to Southwest than any other carrier's, US Airways probably needs a merger for its long-term survival.

Third, the April 20 developments were possible because on February 1 AMR's management put forward a standalone business plan that has been widely criticised as weak and uninspiring. Many people fear that the plan would not enable AMR to stay competitive. Some of AMR's unsecured creditors immediately began calling for the company to explore alternative options, such as a merger with US Airways or another carrier, that they felt might lead to a better recovery of their claims.

The standalone plan calls for $3bn in financial improvements by 2017, including $2bn in cost savings (of which $1.25bn would come from labour) and $1bn in revenue enhancements. The key elements are to renew and optimise the fleet, build network scale and alliances, and modernise brand, products and services. AMR wants to invest an average of $2bn annually in new aircraft. The "cornerstone" strategy would continue, with the five key markets seeing a 20% increase in departures over the next five years. There would be more international flying.

The verdict on the proposed cost reductions has been broadly favourable: perhaps exactly what AMR needs to make its costs broadly comparative with those of Delta and United. The $1.25bn labour cost cuts, when added to the $1.8bn of labour concessions American secured in 2003, are roughly in line with the cuts implemented by competitors in Chapter 11.

But the revenue side of the plan has been widely criticised for doing little to solve the basic problem, arising from a network that is smaller and less attractive than United's and Delta's. American has been losing corporate market share to the two larger merged carriers; it needs to reverse that trend.

In recent years AMR's management has been presenting the "cornerstone" strategy and the transatlantic and transpacific joint ventures (with IAG and JAL) as the remedies to its lagging revenue performance. But those benefits have been slow to materialise – something that AMR already took a lot of stick for last summer (see *Aviation Strategy*, July 2011). To see those same items as the centrepiece in the post-Chapter 11 business plan, with no substantial extras (other than a fleet overhaul), was frustrating to AMR's creditors, leading to accusations that the new plan was just "more of the same".

Furthermore, AMR has had to back off from terminating its defined benefit pension plans (which will be frozen instead) in response to pressure from PBGC, the US agency that protects corporate pensions. This was a major setback in the carrier's quest to shed obligations; it will mean having to raise new capital to cover the incremental pension costs.

The dissatisfaction with the standalone plan opened the door for US Airways to make its aggressive early move. If the merger becomes a reality, AMR's management has only itself to blame.

What is US Airways offering?

While there is no merger offer on the table, CEO Doug Parker's April 20 letter to US Airways employees and the statements and comments made by AMR's unions give a broad picture of what US Airways has in mind.

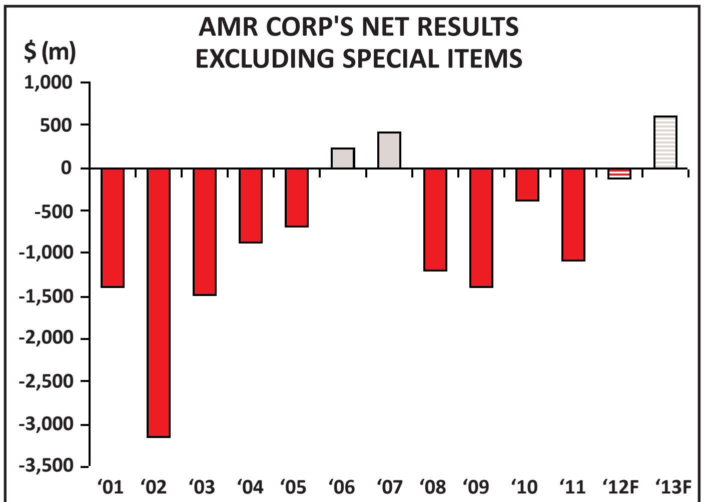
Parker wrote about creating a "preeminent airline with the enhanced scale and breadth required to compete more effectively and profitably". The intention would be to "put our two complementary networks together" and "maintain both airlines' existing hubs".

AMR's three unions, which represent about 55,000 frontline employees, said in a joint statement that they confirmed their support of a possible merger, which they said would be the "best strategy and fastest option to complete AMR's restructuring". It would "avoid a lengthy and contentious 1113 process".

AMR's unions have reportedly also said that the combined carrier would be branded American Airlines, would be based in Fort Worth, Texas (AMR's headquarters) and would remain in oneworld. But the obvious implication is that the unions want US Airways' management to take over and run AMR.

Obviously a key aspect of the deal is that AMR's unions would be treated better than under the standalone plan. The merger would preserve at least 6,200 of the 13,000 union positions that American proposes eliminating under the standalone plan. The merged entity would provide "competitive, industry-standard compensation and benefits" and "improved job security and advancement opportunities" for all employees. Parker said that US Airways employees could expect "enhancements to the compensation and benefits currently in place".

The Wall Street Journal reported (citing APA as the source) that AMR pilots have been promised an immediate 5.5% raise, followed by 3% hikes annually for five years, after which the contract would revert to an average of the compensation at United and Delta. Even though the US Airways plan includes higher productivity measures, because of merger growth and new aircraft, there would be no AMR pilot furloughs. This compares with AMR's latest offer to the pilots of a 1.5% annual raise for five years, 400 furloughs and $370m in annual concessions (more flying hours, elimination of premium pay, reduction in medical benefits and removal of restric-



Note: Forecasts by Bank of America Merrill Lynch (April 19)

tions on codesharing and regional flying).

AMR's flight attendants would get an immediate 2.5% raise, followed by 1.5% annually for five years, and they would maintain their current vacation and sick-leave policies. Instead of furloughs, there would be voluntary buyouts – an option that AMR, which wants to eliminate 2,300 jobs, has refused. AMR's mechanics and ground workers (TWU) might see only half of the 8,500 job cuts AMR is proposing.

The rationale is that the revenue and cost synergies generated by the merger would allow US Airways to pass some of those benefits to AMR's employees. US Airways executives said on April 25 that the merger could yield at least $1.2bn in annual cost savings and revenue benefits, even with less labour cost savings than AMR is proposing and including improved pay and benefits for US Airways workers.

According to AMR's unions, the merger would be "based on growth" and AMR's orders for narrowbody aircraft would proceed. AMR confirmed in bankruptcy court last month that it wanted to keep the firm orders for 460 Boeing and Airbus narrowbodies placed in July 2011 (which secured $13bn of lease financing on attractive terms) and earlier orders for 787s and 777s.

In addition to eliminating 13,000 union jobs (15% of the workforce), AMR plans to cut another 1,200 non-union positions. But the original labour proposals have been sweetened in two important respects. First, there was the decision to freeze rather than terminate the traditional pension plans. Second, when filing the Section 1113 motions at the end of March, AMR outlined an attractive employee profit-sharing plan, which would begin paying out immediately as new labour deals are signed and would pay from the first dollar of profit (as opposed to only when profits reach $500m, as with the current plan).

Many positives, much risk

The idea of a possible US Airways-AMR merger has been mostly well-received in the financial community and in the airline industry, though many observers have cautioned about the risks involved and the potential negative repercussions if US Airways tries to interfere this early in AMR's Chapter 11 process.

In the past it was often argued that AMR would not gain very much from a merger with US Airways. S&P made the point last year that US Airways' route network, which focuses on leisure destinations or second-tier business markets, would not fit into American's business strategy, which focuses on major business markets in the US and building closer ties with airline partners overseas.

The network synergies are not as compelling, at least from American's perspective, as in the Delta-Northwest and United-Continental mergers. S&P wrote in an April 20 report: "Those combinations created broad route networks with a strong presence on transatlantic and transpacific routes, which we believe enabled these two merged airlines to win business travellers from American in recent years".

But US Airways does have a robust domestic network and hubs (especially in the East) that could provide valuable feed to AMR and its global partners. Its major connecting hubs in Philadelphia and Charlotte and its strong position at Washington DCA would all help AMR.

JP Morgan analysts argued in an early-March research note that AMR's standalone plan "fails to adequately address the decade-long marginalisation of its domestic network" and suggested that US Airways might be just the right partner. Based on their analysis, AMR has fallen to fourth place in the largest non-hub Eastern and Western markets, though it maintains number two rank in the Midwest. A US Airways-AMR combination would likely rank second in the East and number one in the Midwest. The analysis found that US Airways and AMR overlap in just 13 domestic markets.

US Airways has made some smart strategic moves to enhance its network in the past year or two. First, it has invested more aggressively in European growth – a highly successful strategy that has led to strong RASM improvement. Second, in what almost mirrors AMR's cornerstone strategy, US Airways has sought to focus its flying in places where it has a competitive advantage. This summer 99% of its capacity will touch its four hubs (Charlotte, Philadelphia, Phoenix and Washington DCA) or the Shuttle. Full implementation of the "Focus on Four" strategy is possible because this year US Airways is finally able to implement the unique LGA/DCA slot swap that it agreed with Delta in 2009.

Notably, unlike American, US Airways has not lost corporate market share to Delta and United. This reflects its number one position in all of its key markets and its strong presence on the Eastern seaboard.

So, US Airways could conceivably give AMR that little bit of extra scale that AMR needs to compete on an equal basis with Delta and United for corporate contracts and business traffic.

A US Airways-AMR union would probably be palatable to regulators, certainly more so than a Delta-AMR combination. The merged entity would have a 22% domestic market share, on par with UAL's and Delta's.

Many equity analysts would enthusiastically welcome a US Airways-AMR merger, because they see it as the best outcome also for the US airline industry. AMR's standalone plan is very unpopular because it is based on growth and from the stock-market's perspective, could jeopardise industry capacity discipline.

TOP TEN US AIRLINES IN 2011

	By revenue $ (m)	By RPMs (bn)
United Continental	37,110	207.5
Combined AMR+US Airways	*37,034*	*207.7*
Delta	35,115	192.8
AMR	23,979	136.4
Southwest	16,596	97.6
US Airways Group	13,055	71.3
JetBlue	4,504	30.7
Alaska Air Group	4,318	25.0
Hawaiian	1,651	10.1
Spirit	1,071	8.0
Allegiant	779	5.6

Source: *Individual airlines*

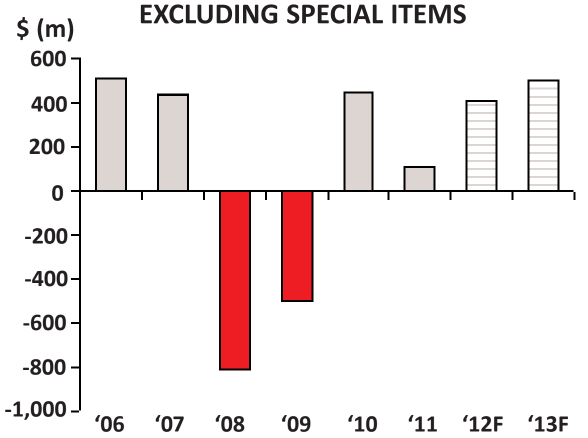
The result would be three top US carriers of roughly equal size. JP Morgan's Jamie Baker commented that almost 90% of US domestic capacity would then be controlled by the Big Three and Southwest, up from roughly 50% in 2005. Baker wrote: "Four airlines with 90% market share represent the optimal industry structure and should allow for consistent return generation going forward".

From the point of view of the rest of the world, if there needs to be one final merger in the US involving the large carriers, US Airways-AMR would probably be the most favoured combination. It would avoid an upheaval of global alliances. It would make it unnecessary for IAG to invest in AMR – something that IAG probably would prefer not to do given that it has just purchased bmi, is hoping to bid for TAP (for very good strategic reasons) and may soon come under pressure to invest in JAL. IAG CEO Willie Walsh reportedly said on April 21 that BA and IAG intended to remain on the side-lines in respect to AMR's reorganisation.

In the early-March research note, JP Morgan estimated that adding US Airways' Philadelphia hub and potentially Charlotte to oneworld would net BA/IAG 33 new Eastern US cities that AMR does not presently serve.

There is also the intriguing possibility that a US Airways-AMR deal on the table might help break the deadlock in US Airways' own union negotiations. Seven years after the 2005 merger with America

US AIRWAYS GROUP'S NET RESULTS EXCLUDING SPECIAL ITEMS



Note: 2012 and 2013 are Thomson/First Call consensus estimates as of April 13.

West (AWA), US Airways still has not integrated the two pilot and flight attendant groups (the pilots cannot agree on seniority list integration). In the past many people felt that combining that with AMR's very difficult labour relations could be a recipe for disaster. But the higher salaries at AMR and the better job security and opportunities at a merged entity might break the seven-year deadlock.

One analyst suggested that it might actually be easier to plan for integrated operations for US Airways-AMR while the "East" and "West" pilot groups were still separate at US Airways.

On the negative side, there is the question of how much a merger deal with US Airways – or just US Airways' early meddling – would reduce AMR's potential Chapter 11 cost savings. It seems that a merger could help address AMR's revenue problem, but a standalone Chapter 11 restructuring without interference from third parties (which Delta, Northwest and United all enjoyed) would be the best way to solve AMR's cost problem. The main reason AMR is in bankruptcy is to close the cost gap with the larger competitors and to restructure its debt and other obligations. AMR has already had to back off from terminating its defined-benefit pension plans.

In its report S&P expressed concern that a reorganised AMR or a US Airways-AMR combine "could be at a continuing competitive disadvantage to United and Delta". Because of that and other uncertainties related to a potential merger, the agency said that it was not sure if it would rate a merged entity any higher than US Airways' current B- corporate rating (which is one notch lower than UAL's and Delta's B ratings).

S&P mentioned another potential danger: "Even if a merger does not occur, a bidding war for the support of American's unions could force AMR to accept less labour and retiree obligations savings, thus reducing AMR's earnings and cash flow generation".

Then again, US Airways and AWA executed a successful merger while the old US Airways was in bankruptcy. Fitch Ratings suggested in an April 20 report that "a potential combination while AMR is still in bankruptcy would enable US Airways management to use the Chapter 11 process to maximise the potential of the merged entity".

US Airways' financial turnaround

Some of AMR's creditors and constituents may have held somewhat negative preconceptions about US Airways. There is a perception that the carrier is desperate for a merger. There is the track record of failed merger attempts. There are the labour issues. Just three years ago US Airways was close to a liquidity crisis, keeping AMR company at the top of the "endangered carriers" list.

However, US Airways has staged an impressive financial recovery in the past two years. It has kept its non-fuel costs in check, restored operational performance, raised significant funding and improved its balance sheet. Its pretax margins are now on par with the top carriers, if adjusted for fuel hedging (which US Airways does not do).

In addition to the smart network actions, US Airways has benefited enormously from the past few years' industry restructuring, domestic capacity cuts and the move to develop lucrative new ancillary revenue streams. With domestic capacity discipline set to continue in 2012 and beyond, US Airways' earnings prospects are promising.

As a result, US Airways' top executives have repeatedly stressed in recent months that US Airways does not need to participate in consolidation. They feel that the airline is now well positioned on a standalone basis, though they are of course "always interested in studying potential value-enhancing opportunities".

The main negatives with US Airways concern its balance sheet: high debt levels, weaker liquidity than its peers (unrestricted cash 15% of annual revenues at year-end 2011) and substantial looming debt maturities in 2014 (which the company expects to refinance). US Airways would not find it as easy as some of its peers to raise capital to fund a merger, though it expects to be able to do it.

What happens next?

AMR's CEO Tom Horton dismissed the April 20 developments in a letter to employees on April 23 with references to "nonbinding arrangements with our unions" and to parties who are "working their own agendas at our expense". AMR's management remains focused on a standalone plan and will consider consolidation only after Chapter 11, which it currently hopes to exit by year-end 2012.

On April 23 AMR also began making its case to the bankruptcy court on why it should be allowed to terminate existing labour contracts and impose new terms. The unions are scheduled to present their case in May. The judge's final decision is expected in early June, though throughout this period AMR and the unions are expected to continue trying to reach consensual agreement. As an interesting development on April 23, TWU agreed to send AMR's latest contract proposal to members for a vote. However, the union continues to support the US Airways deal as an alternative.

AMR has exclusive rights to present a reorganisation plan until September 28, and that period could be extended until the end of May 2013 (maximum 18 months from the Chapter 11 filing). However, creditors could petition the court at any time to terminate the exclusive right if they feel that better alternative deals are in the pipeline.

So the judge and the unsecured creditors' committee (UCC) are now effectively in control over which plans will be considered, though any merger would also need the support of AMR's management and board of directors.

Having secured the support of three of the nine UCC members (the unions), US Airways is expected to try to win the support of the other six UCC members, while working on the details of the merger plan. The other members are Boeing, Hewlett-Packard, PBGC and three financial institutions that represent financial creditors.

It is impossible to predict how the other UCC members might respond. All are looking for the best possible deal on debt repayment. Some have wanted AMR to explore possible merger opportunities. Some may feel that they will get the best deal from the standalone plan. Some may prefer to wait before exploring alternative plans. JP Morgan analysts said that they were almost certain the other UCC members would have preferred US Airways to wait and make a bid later in the Chapter 11 process.

So it is not clear when and how US Airways might present a merger proposal. One thing is certain though: it will not be a hostile bid. US Airways executives said recently that one thing they had learned from the Delta experience was that they could not do it alone. "An outright hostile transaction won't work. Just having the most value creation isn't enough."

Of course, there could also be surprises in store, such as a Delta bid for US Airways – something that in principle would be acceptable to US Airways. Or AMR's management, known for wanting to do deals on its own terms, could make a run for JetBlue or Alaska (two airlines it has mentioned). Or there could be no more major mergers. As US Airways executives pointed out recently, because the US airline industry is already much more stable, the final round of consolidation that many are clamouring for "does not have to occur".

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AirAsia: Facing IPO challenges in 2012

In relative terms 2011 was a challenging year for the AirAsia group, thanks to tough economic conditions, higher fuel costs and increasing competition from Asian LCCs and full service airlines alike. The result was net profit falling by almost half at the core Malaysian airline, a postponement of planned IPOs for Thai and Indonesian subsidiaries, and an AirAsia X retreat from Europe and India. Can Asia's largest LCC bounce back in 2012?

Malaysia AirAsia is where the AirAsia group began (back in 2001 – see *Aviation Strategy*, March 2008), and today it operates a fleet of 56 A320-200s to 49 destinations across the Asia/Pacific region in 14 different countries.

In 2011 Malaysia AirAsia saw a 13% rise in revenue to RM4.5bn (US$m1.5bn), when a 7% increase in capacity was met by a 13.7% rise in traffic, with load factor up by 4.8 percentage points to 80.7%. However, while operating profit was up 12% to RM$1.2bn (US$0.4bn), net income fell 46.8% to RM564m (US$188m) thanks partly to forex losses on currency translation.

At Malaysia AirAsia fuel consumed rose just 4% in 2011 but the average fuel price paid per barrel increased 36%, and as can be seen in the table, (page 11), Malaysia AirAsia's fuel costs per ASK rose by a third in 2011 compared with 2010, and while AirAsia managed to cut costs in other categories and increase productivity, its overall unit cost rose by 15%.

The airline introduced a fuel surcharge in May last year but this hasn't managed to claw back enough of the extra fuel costs incurred. AirAsia says that a US$1 rise in the price of a barrel of oil can be offset by an increase in ancillary income per passenger of RM0.77 (25 US cents), but last year the Malaysian carrier managed just a 2% rise in ancillary revenue per passenger (compared with respective increases of 29% and 11% at Thai and Indonesia AirAsia) to RM45 (US$15). Average fares fell marginally, from RM177 to RM176 (US$59).

Last August Tune Air - the 26.3% shareholder of Malaysia AirAsia that is co-owned by AirAsia CEO Tony Fernandes - agreed a share swap with Khazanah Nasional, the Malaysian sovereign wealth fund that owns most of Malaysian Airline System (MAS), whereby Tune Air acquired a 20.5% stake in MAS from Khazanah, while Khazanah in turn acquired 10% of AirAsia from Tune Air. It was a deal that puzzled some analysts: although MAS is a fierce rival it is also loss-making, and while the share swap would ease competition between the two airlines at best, it might divert AirAsia management attention in Malaysia, and at worst AirAsia might be dragged into propping up MAS financially. The future of the share swap deal is in jeopardy with opposition from unions, the Malaysian government and Competition Commission mounting and a corporate announcement from MAS is imminent.

Of the three main areas of operation for the AirAsia group, Malaysia remains by far the most important in terms of passengers carried (see chart, page 11), followed by Thailand and Indonesia. But the Malaysian market is more mature for AirAsia, with passengers carried rising by (a still respectable) 12% in 2011 year-on-year (to 18 million), compared a 20.3% rise in Thai AirAsia passengers and a 27.8% increase in Indonesia AirAsia passengers.

Delayed IPOs

Both Thai AirAsia and Indonesia AirAsia had planned to undertake IPOs in 2011, but these were postponed due to the global recession and volatility in stock markets.

Malaysia AirAsia holds a 49% stake in Thai AirAsia, with 50% owned by Asia Aviation (a company controlled by the airline's Thai management) and 1% owned by

AIRASIA COST BREAKDOWN BY SUBSIDIARY, 2011									
Cost/ASK	Malaysia		%	Thailand		%	Indonesia		%
US Cents	2010	2011	change	2010	2011	change	2010	2011	change
Employees	0.48	0.60	25%	0.49	0.52	6%	0.49	0.51	4%
Fuel	1.62	2.15	33%	1.71	2.27	33%	1.73	2.25	30%
User charges	0.51	0.46	-10%	0.73	0.71	-3%	0.51	0.47	-8%
Maintenance	0.12	0.11	-8%	0.37	0.39	5%	0.46	0.43	-7%
Aircraft lease costs	0.09	0.10	11%	0.95	0.97	2%	0.83	0.83	0%
Depreciation	0.70	0.72	3%	0.05	0.03	-40%	0.03	0.05	67%
Other	0.38	0.35	-8%	0.20	0.20	0%	0.11	0.21	91%
Total cost/ASK	**3.90**	**4.49**	**15%**	**4.50**	**5.09**	**13%**	**4.16**	**4.75**	**14%**

Tassapon Bijleveld, Thai AirAsia's CEO. Based in Bangkok and with bases at Chiang Mai and Phuket, Thai AirAsia serves 23 destinations domestically and in China, India, Cambodia, Indonesia, Malaysia, Myanmar, Singapore and Vietnam with a fleet of 25 A320-200s.

Passengers carried at Thai AirAsia rose by a fifth to 6.9 million in 2011, with load factor breaking through the 80% level after a 21% rise in capacity was beaten by a 25% rise in RPKs. But like its sister airlines, Thai AirAsia struggled to convert increasing revenue into better profitability, although at least this went in the right direction in Thailand. A revenue rise of 33% in 2011 to THB15.9bn (US$0.5bn) translated into a 5% rise in operating profit to THB1.9bn (US$65m) and a 1% increase in net profit, to THB2bn (US$68m).

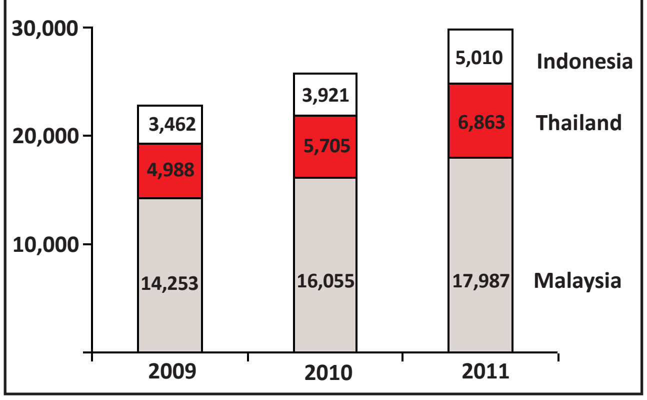
The Thai subsidiary has launched a raft of new domestic and international routes so far this year, including services to Chongqing in China and Chennai in India, but Thai AirAsia needs capital to underpin growth and finance fleet expansion to 48 aircraft by 2016 (with five more A320s being delivered this year). An IPO for Thai AirAsia was supposed to happen by the end of 2011, but this was postponed until the first quarter of 2012, and now the plan is to carry it out in the third quarter of this year, with up to US$200m of fresh capital being raised. At some point Thai AirAsia will face competition from an LCC from Thai Airways International, which was going to be a joint venture with Tiger Airways but which Thai Airways says it will now launch on its own.

Malaysia AirAsia owns 49% of Jakarta-based Indonesia AirAsia, which was launched in late 2004 with local entrepreneurs. It operates to 14 domestic and international destinations (in Malaysia, Singapore, Australia and Thailand) from Jakarta and two other main bases, at Bali and Bandung, with a fleet of 17 A320-200s, having disposed of its last few 737-300s.

Indonesia AirAsia's revenue increased by 34% in 2011 to IDR3,705bn (US$426m), with passengers carried up 28% to 5 million. Load factor fell by just 0.1% year-on-year to 76.9%. However, operating profit fell 52% to IDR 150bn (US$17m), and net profit plunged 87% to IDR62bn (US$7m) – again thanks primarily to rising fuel costs.

Indonesia AirAsia is currently adjusting its strategy by reducing its dependence on international routes, which accounted for 70% of all services last year. They will be eased back to around 60% by 2015 as the airline refocuses slightly on a strategy to "re-enter the Indonesian domestic market, which has high growth potential given the rapidly rising incomes of the Indonesian middle classes". However, as elsewhere, AirAsia's airline in Indonesia is facing greater challenges from competitors – pri-

AIRASIA PASSENGERS CARRIED BY SUBSIDIARY



marily from Jakarta-based Lion Air (which has 74 aircraft) and Citilink, the nine aircraft strong LCC of Garuda Indonesia.

Indonesia AirAsia plans to raise US$200m with its IPO, which will now occur in the second quarter following the postponement from last year. And similar to the Thai carrier, the money raised in the Indonesian IPO will be used to bankroll an increase in the fleet to 21 by the end of 2012 and 34 by the end of 2015.

While there is still room for growth in its three core markets (and most particularly Indonesia and Thailand), it's clear that the rate of growth in those markets is maturing, and so the AirAsia group is looking for new markets to enter.

New subsidiaries

Despite being founded back in 2010, a series of delays (most critically in gaining an AOC) postponed the launch of AirAsia Philippines until the end of March this year, when two A320s started operating on two domestic routes (to Kalibo and Davao) out of a base at Clark airport, just outside Manila. AirAsia has a 40% stake in the airline, which is a partnership with three Philippine entrepreneurs - Marianne Hontiveros, Antonio Cojuangco and Michael Romero - and which plans eventually to operate international services to Thailand, South Korea, Indonesia, Singapore, Macau, Hong Kong and mainland China. Two more A320s will join the fleet later this year, and the airline has targeted a fleet of 14 aircraft by 2015, all of which will be leased.

A similar business model will be followed when AirAsia Japan launches later this year – probably in August. It's a joint venture between AirAsia (49%) and All Nippon Airways (51%) that will operate out of Tokyo Narita and which will initially serve domestic routes only before expanding onto international services in the fourth quarter, most probably to South Korea, China or Taiwan. If these go well then there are ambitions to start long-haul services to destinations such as Thailand, Indonesia and Australia in 2013, using a fleet of up to 10 A330s.

Until this year Japan has never had a significant LCC, and AirAsia believes that a high propensity to travel in Japan combined with high disposable income will make AirAsia Japan an instant success. However, although ANA will not compete against AirAsia Japan, the new airline will indirectly face competition from Peach Aviation, ANA's LCC that started operations in March this year out of Kansai airport in Osaka.

And to make matters more complicated for AirAsia, Qantas is now accelerating the launch of its Japanese LCC, to be called Jetstar Japan. The airline is a joint venture between Qantas, JAL and Mitsubishi, and it had been going to launch in the fourth quarter of 2012 - but this is now being brought forward to July. It will initially operate domestic routes between Tokyo, Osaka, Sapporo, Fukuoka and Okinawa with three A320s, eventually building a fleet of 24 aircraft within a few years. Jetstar is already AirAsia's closest LCC rival, having launched joint venture airlines in Singapore, New Zealand and Vietnam.

As yet there are no plans for AirAsia to formally establish a subsidiary in Singapore, although this is a "virtual hub" for the group already, with 12 routes out of Changi and with AirAsia planning to launch more routes out of Singapore.

Other moves

For the moment the Philippines and Japan will be the focus of new subsidiary growth in Asia, as potential forays elsewhere have come to nothing. Last October an agreement by AirAsia to purchase 30% of VietJet (made back in February 2010) lapsed, and AirAsia states it had no intention of renewing the deal. The plans for a LCC in Vietnam had run into substantial regulatory problems, including a lack of permission from the Vietnamese government for using the AirAsia brand in the country, which are believed to originate from political opposition to a foreign airline investing in the domestic aviation business.

AirAsia has also been monitoring the possibility of launching a subsidiary in

Australia, where domestic airlines are allowed to be majority-owned by foreign companies. However, AirAsia executives say this is not a priority in the short- or even medium-term.

AirAsia is also looking at opportunities in the Indian market, though for the time being this is in terms of new routes rather than launching a local start-up. It's the south of India that AirAsia is particularly interested in – a five times a week service between Bangkok and Chennai started in March this year, and further AirAsia routes to Kochi, Hyderabad and Bangalore are under consideration to add to the 50-plus flights a week already operating to Kuala Lumpur, Bangkok and elsewhere.

Also on AirAsia's radar for a subsidiary is – somewhat surprisingly – the Middle East. In February Tony Fernandes, AirAsia group CEO, said that the Gulf region would be an ideal location for a subsidiary as the area is dominated by full service airlines and has few LCCs, and has the added advantage of being a destination for Islamic pilgrim visitors and tourists, plus many thousands of low paid foreign workers employed in the Gulf states.

However, while the current penetration of LCCs into the Gulf region is low (around a 12% market share compared to 25% globally and 20% in the Asia/Pacific region), it is growing, with Air Arabia (with 27 aircraft) – the first LCC in the region, launched in 2003 – now joined by flydubai (23 aircraft). Added to this, full-service airlines in the regions are looking to launch their own LCCs, or have tentative plans for one; for example, Qatar Airways talks about launching a LCC out of Doha (see *Aviation Strategy*, December 2011).

This means a key challenge for AirAsia will be finding a suitable Gulf hub airport, though of course a joint venture with a full-service airline might be the ideal solution here for AirAsia. Apparently AirAsia is already in talks with potential partners in the Middle East region, and the path for AirAsia will no doubt be made easier by the launch of a Middle Eastern subsidiary of The Tune Group, co-founded by Tony Fernandes and the parent of Tune Air. It launched a subsidiary out of Doha, Qatar, in February this year, with a local partner, and although its focus will be Tune Hotels and Tune Money financial services, the Tune Group's foray into the region will help open doors for AirAsia.

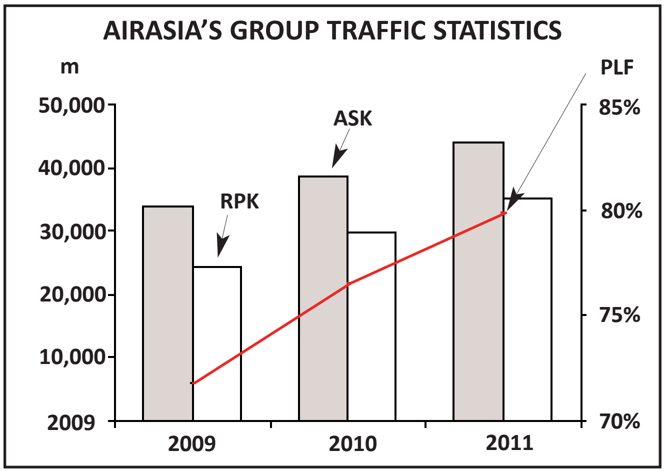
The establishment of a subsidiary and a hub in the Gulf region might also have the added benefit of giving AirAsia X a better and more sustainable chance of serving the European market it has just withdrawn from - although Fernandes says that's a minor consideration when looking at an AirAsia subsidiary in the Middle East region.

AirAsia X retreats

Although formally not part of the AirAsia group, Malaysia AirAsia owns 16% of AirAsia X (with another 48% owned by Aero Ventures, controlled by Tony Fernandes and others), the Kuala Lumpur-based LCC that operates nine A330s and two A340s on long-haul routes on a point to point basis. In 2011 AirAsia X saw a 31.5% rise in passengers carried, to 2.5 million, RPK growth of 36.2% outpaced ASK growth of 30%, resulting in a 3.6 percentage rise in load factor, to 80.1%.

However, AirAsia X has found that truly long-haul flights are problematical – costs per ASK rise not just because of fuel but because it has proved difficult to attract premium passengers, who are needed to push up average yield. This is partly due to customer perception and partly due to business travellers being unhappy with low frequencies.

That's why earlier this year AirAsia X suspended its routes into its European network (London Stansted and Paris) as well as to Mumbai and Delhi in India (though it also cited poor demand). Azran Osman Rani, the CEO of AirAsia X, says that the London route was "bleeding millions a month". It is now concentrating on the Asia/Pacific region, where it currently serves 13 destinations. AirAsia X's network will now refocus on destinations up to a maximum of seven or eight hours' flying time from its Kuala Lumpur base, although the airline is carrying a review of all its existing routes,



and a Kuala Lumpur-Christchurch route was closed in March.

AirAsia X operates a fleet of 11 A330s and A340s. The two A340-300s that AirAsia X used on the European sectors are on lease until 2015, but they will not be operated on other AirAsia X scheduled services and so the airline is looking to find a sub-lessor. In addition two A330-200s that were due to be delivered this year were also earmarked for European routes, and AirAsia X is now trying to swap these order slots for A330-300s, of which the carrier already has 17 on outstanding firm order, for delivery over the next four years. In addition AirAsia X has 10 A350s on order, although they will not arrive until 2017 at the earliest, and AirAsia X says their future is not affected by the decision to pull out of Europe.

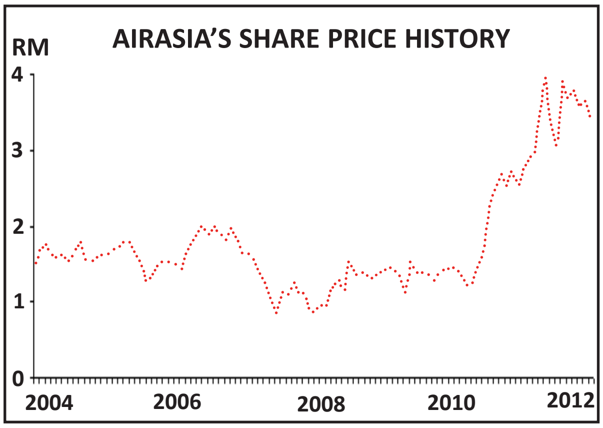
That's a lot of capacity coming into AirAsia X, although the airline appears confident those aircraft can be deployed successfully on new services in the Asia/Pacific region, plus extra frequencies on existing routes. For example, AirAsia X is adding a fourth Australian destination this April with the launch of a daily route between Kuala Lumpur and Sydney's Kingsford Smith airport. However the airline is facing increasing competition from medium-haul LCC rivals such as Qantas's Jetstar, the Philippine-based Cebu Pacific Air, Indonesia's Lion Air and Singapore Airlines' Scoot – although Fernandes contemptuously dismisses Scoot as having "a really dumb name" and says it will not offer any serious competition to AirAsia.

AirAsia X is also looking for an IPO in the second half of this year, but only after the (hopefully successful) listings of AirAsia airlines in Thailand and Indonesia, which would give a good pointer to AirAsia X over the timing and pricing of its own IPO. The intent to float AirAsia X has been around since 2010, but the decision to refocus on Asian routes will need to be explained to investors.

AirAsia X says it recorded a net loss in 2011 (it reported a RM132.6m net profit in 2010), although financials have not yet been released other than a 47% rise in revenue in 2011, to RM1.9bn (US$0.6bn) and without significant progress towards profitability it's difficult to see how an AirAsia X IPO could be carried out successfully this year. Maybe a pointer comes from AirAsia X's decision in March to postpone a planned US$200m Islamic bond issue, which is now on hold until new aircraft start arriving in 2013. Given the pull back from Europe and the need for fewer aircraft, this may free up enough financial "wriggle room" for AirAsia X to postpone its IPO to 2013, particularly if the AirAsia IPOs in Thailand and Indonesia prove troublesome.

The IPO test

The AirAsia group focus in 2012 is on getting those IPOs in Thailand and Indonesia away successfully, as further postponements would prove embarrassing. Those IPOs are needed to fund fleet expansion - the group has a staggering 277 aircraft on order (nominally assigned to Malaysia AirAsia), with 77 A320-200s already on backlog being joined by an order for 200 A320neos placed last year (and apparently AirAsia is considering converting some of those classic A320 orders into neo models as well). The group is receiving 20 new A320s in 2012, of which 17 are coming direct from Airbus and three from lessors. New aircraft being delivered will drop to 13 in 2013 before gradually ramping up to 19 in 2015 and then remain at or around the 20 aircraft a year level all the way to 2025, before falling to nine in 2026.



The volume of aircraft that will arrive over the next 15 years will generate both operational questions (in terms of finding enough profitable routes and markets to put them onto) and financial challenges. AirAsia's total debt at the end of 2011 was RM7.7bn (or some US$2.6bn), and after offsetting cash balances the net debt was RM5.7bn (US$1.9bn), which gives net gearing of 1.43x. That's actually fallen from 3.5x as at the second quarter of 2009, and the other good news is that cash and cash equivalents totalled RM2bn (US$0.7bn) at the end of 2011, compared with RM1.5bn a year earlier. But though strong at present, AirAsia's finances will be stretched in meeting new capex commitments, and successful IPOs at the subsidiaries will go a long way towards opening up new funding avenues.

Successful IPOs should also boost the recent rise in AirAsia's share price. As can be seen in the chart, on left, after listing on the Kuala Lumpur stock exchange in November 2004, Malaysia AirAsia's shares had performed poorly for many years, but the price broke out in mid-2010 and has been rising ever since (and is well above the RM3 mark as at April).

Despite the reduction in net profits for 2011 at the core Malaysian subsidiary, AirAsia remains by far the leading LCC in the Asian region, and with the exception perhaps of AirAsia X, which needs to prove that a new Asia-focussed strategy can be implemented successfully, the AirAsia group is well placed to continue steady expansion through the decade. The key operational challenge will be to keep load factors up as the new capacity comes on board - at a group level AirAsia almost broke through the 80% load factor mark in 2011 (see chart, page 14).

A problem AirAsia may face is the "Branson question". On the 10th anniversary of the airline, in December last year, there was speculation that CEO Tony Fernandes may leave the airline, directly fuelled by his statement that "there will be a new CEO, my time is coming to an end soon", although the airline was quick to say that Fernandes has no plans to retire any time soon.

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		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Air France/	Jul-Sep 09	8,015	8,082	-67	-210	-0.8%	-2.6%	66,862	56,141	84.0%	19,668	105,444
KLM Group	Oct-Dec 09	7,679	8,041	-362	-436	-4.7%	-5.7%	61,407	49,220	80.2%	17,264	105,925
YE 31/03	**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	
Note: FY 31/12	Apr -Sep 11	18,600	18,240	360	-257	1.9%	-1.4%	137,282	114,846	83.7%	40,605	102,516
Proforma	**Year 2011**	**34,109**	**34,602**	**-493**	**-1,131**	**-1.4%**	**-3.3%**	**264,895**	**217,169**	**81.8%**		**102,012**
British Airways	**Year 2009/10**	**12,761**	**13,130**	**-369**	**-678**	**-2.9%**	**-5.3%**	**141,178**	**110,851**	**78.5%**	**31,825**	**37,595**
YE 31/03	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
YE 31/12	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
	Year 2011	**22,781**	**22,105**	**676**	**735**	**3.0%**	**3.2%**	**213,193**	**168,617**	**79.1%**	**51,687**	**56,791**
Iberia	**Year 2009**	**6,149**	**6,796**	**-647**	**-381**	**-10.5%**	**-6.2%**	**62,158**	**49,612**	**79.8%**		**20,671**
YE 31/12	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	**Year 2009**	**31,077**	**30,699**	**378**	**-139**	**1.2%**	**-0.4%**	**206,269**	**160,647**	**77.9%**	**76,543**	**112,320**
YE 31/12	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
	Year 2011	**40,064**	**38,920**	**1,143**	**-18**	**2.9%**	**0.0%**	**268,939**	**207,536**	**77.2%**	**106,335**	**120,055**
SAS	**Year 2009**	**5,914**	**6,320**	**-406**	**-388**	**-6.9%**	**-6.6%**	**35,571**	**25,228**	**70.9%**	**24,898**	**18,786**
YE 31/12	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
	Oct-Dec 11	1,507	1,559	-51	-308	-3.4%	-20.5%	9,019	6,446	71.5%	6,788	14,958
	Year 2011	**6,386**	**6,286**	**100**	**-260**	**1.6%**	**-4.1%**	**37,003**	**27,174**	**73.4%**	**27,206**	**15,142**
Ryanair	**Year 2009/10**	**4,244**	**3,656**	**568**	**431**	**13.5%**	**10.2%**			**82.0%**	**66,500**	
YE 31/03	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	
	Oct - Dec 11	1,139	1,099	39	20	3.4%	1.8%			81.0%		
easyJet	Apr-Sep 08	2,867	2,710	157	251	5.5%	8.7%	32,245	28,390	88.0%	24,800	
YE 30/09	**Year 2007/08**	**4,662**	**4,483**	**180**	**164**	**3.9%**	**3.5%**	**55,687**	**47,690**	**85.6%**	**43,700**	**6,107**
	Oct 08-Mar 09	1,557	1,731	-174	-130	-11.2%	-8.3%	24,754	21,017	84.9%	19,400	
	Year 2008/09	**4,138**	**3,789**	**93**	**110**	**2.3%**	**2.7%**	**58,165**	**50,566**	**86.9%**	**45,200**	
	Oct 09 - Mar10	1,871	1,995	-106	-94	-5.6%	-5.0%	27,077	23,633	87.3%	21,500	
	Year 2009/10	**4,635**	**4,364**	**271**	**240**	**5.9%**	**5.2%**	**62,945**	**56,128**	**87.0%**	**48,800**	
	Oct 10 - Mar 11	1,950	2,243	-229	-181	-11.7%	-9.3%	29,988	26,085	87.0%	23,900	
	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.

		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	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%**	**44,636**	**36,758**	**82.4%**	**23,334**	**11,696**
	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
	Oct - Dec 11	1,044	930	114	64	10.9%	6.1%	11,745	9,950	84.7%	6,083	11,807
	Year 2011	**4,318**	**3,869**	**449**	**245**	**10.4%**	**5.7%**	**47,679**	**40,284**	**84.5%**	**24,790**	**11,840**
American	**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
Delta	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
	Year 2011	**35,115**	**33,140**	**1,975**	**854**	**5.6%**	**2.4%**	**377,642**	**310,228**	**82.1%**	**163,838**	**78,392**
Southwest	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
	Oct - Dec 11	4,108	3,961	147	152	3.6%	3.7%	50,368	40,524	80.5%	27,536	45,392
	Year 2011	**15,658**	**14,965**	**693**	**178**	**4.4%**	**1.1%**	**194,048**	**157,040**	**80.9%**	**103,974**	**45,392**
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
United	**Year 2009**	**16,335**	**16,496**	**-161**	**-651**	**-1.0%**	**-4.0%**	**226,454**	**183,854**	**81.2%**	**81,246**	**43,600**
	Jan - Mar 10	4,241	4,172	69	-82	1.6%	-1.9%	53,023	42,614	80.4%	18,818	42,800
	Apr - Jun 10	5,161	4,727	434	273	8.4%	5.3%	58,522	49,319	84.3%	21,234	42,600
	Jul - Sep 10	5,394	4,859	535	387	9.9%	7.2%	61,134	52,534	85.9%	22,253	42,700
United/Continental	Oct-Dec 10	8,433	8,515	-82	-325	-1.0%	-3.9%	100,201	82,214	82.0%	35,733	80,800
Pro-forma FY 2010	**Year 2010**	**34,013**	**32,195**	**1,818**	**854**	**5.3%**	**2.5%**	**407,304**	**338,824**	**83.2%**	**145,550**	**81,500**
	Jan - Mar 11	8,202	8,168	34	-213	0.4%	-2.6%	96,835	75,579	78.0%	32,589	82,000
	Apr-Jun 11	9,809	9,001	808	538	8.2%	5.5%	104,614	87,296	83.4%	37,000	81,100
	Jul - Sep 11	10,171	9,236	935	653	9.2%	6.4%	107,236	91,494	85.3%	38,019	80,500
	Oct - Dec 11	8,928	8,883	45	-138	0.5%	-1.5%	97,707	79,610	81.5%	34,191	82,700
	Year 2011	**37,110**	**35,288**	**1,822**	**840**	**4.9%**	**2.3%**	**406,393**	**333,977**	**82.2%**	**141,799**	**81,600**
	Jan - Mar 12	8,602	8,873	-271	-448	-3.2%	-5.2%	97,112	75,809	78.1%	32,527	83,700
US Airways Group	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	30,871
	Year 2010	**11,908**	**11,127**	**781**	**502**	**6.6%**	**4.2%**	**138,107**	**111,996**	**81.1%**	**79,560**	**30,871**
	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
	Oct - Dec 11	3,155	3,047	108	18	3.4%	0.6%	33,393	27,352	81.9%	19,857	31,548
	Year 2011	**13,055**	**12,629**	**426**	**71**	**3.3%**	**0.5%**	**139,483**	**114,777**	**82.3%**	**80,572**	**31,548**
	Jan - Mar 12	3,266	3,207	59	48	1.8%	1.5%	34,032	26,970	79.2%	19,822	31,186
JetBlue	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
	Oct - Dec 11	1,146	1,063	83	23	7.2%	2.0%	15,168	12,472	82.2%	6,693	11,733
	Year 2011	**4,504**	**4,182**	**322**	**86**	**7.1%**	**1.9%**	**59,917**	**49,402**	**82.5%**	**26,370**	**11,733**
	Jan - Mar 12	1,203	1,114	89	30	7.4%	2.5%	15,346	12,726	82.9%	6,853	11,965

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

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
ANA	Year 2006/07	12,763	11,973	790	280	6.2%	2.2%	85,728	58,456	68.2%	49,500	32,460
YE 31/03	Year 2007/08	13,063	12,322	740	563	5.7%	4.3%	90,936	61,219	67.3%	50,384	
	Year 2008/09	13,925	13,849	75	-42	0.5%	-0.3%	87,127	56,957	65.4%	47,185	
	Year 2009/10	13,238	13,831	-582	-614	-4.4%	-4.6%	83,827	55,617	66.3%	44,560	
	Year 2010/11	15,889	15,093	796	269	5.0%	1.7%	85,562	59,458	69.5%	45,748	33,000
Cathay Pacific	Year 2007	9,661	8,670	991	900	10.3%	9.3%	102,462	81,101	79.8%	23,250	19,840
YE 31/12	Year 2008	11,119	12,138	-1,018	-1,070	-9.2%	-9.6%	115,478	90,975	78.8%	24,959	18,718
	Year 2009	8,640	7,901	740	627	8.6%	7.3%	111,167	96,382	86.7%	24,558	18,511
	Year 2010	11,522	10,099	1,813	1,790	15.7%	15.5%	115,748	96,548	84.0%	26,796	21,592
	Year 2011	12,635	11,929	706	706	5.6%	5.6%	126,340	101,535	79.3%	27,581	
JAL	Year 2005/06	19,346	19,582	-236	-416	-1.2%	-2.2%	148,591	100,345	67.5%	58,040	53,010
YE 31/03	Year 2006/07	19,723	19,527	196	-139	1.0%	-0.7%	139,851	95,786	68.5%	57,510	
	Year 2007/08	19,583	18,793	790	148	4.0%	0.8%	134,214	92,173	68.7%	55,273	
	Year 2008/09	19,512	20,020	-508	-632	-2.6%	-3.2%	128,744	83,487	64.8%	52,858	
Korean Air	Year 2006	8,498	7,975	523	363	6.2%	4.3%	71,895	52,178	72.6%	22,140	16,623
YE 31/12	Year 2007	9,496	8,809	687	12	7.2%	0.1%	76,181	55,354	72.7%	22,830	16,825
	Year 2008	9,498	9,590	-92	-1,806	-1.0%	-19.0%	77,139	55,054	71.4%	21,960	18,600
	Year 2009	7,421	7,316	105	-49	1.4%	-0.7%	80,139	55,138	68.8%	20,750	19,178
	Year 2010	10,313	8,116	120	421	1.2%	4.1%	79,457	60,553	76.2%	22,930	
	Year 2011	11,094	10,678	416	-89	3.7%	-0.8%	84,285	64,483	76.9%	22,934	
Malaysian	Year2006	3,696	3,751	-55	-37	-1.5%	-1.0%	58,924	41,129	69.8%	15,466	19,596
YE 31/12	Year 2007	4,464	4,208	256	248	5.7%	5.6%	56,104	40,096	71.5%	13,962	19,423
	Year2008	4,671	4,579	92	74	2.0%	1.6%	52,868	35,868	67.8%	12,630	19,094
	Year 2009	3,296	3,475	-179	140	-5.4%	4.3%	42,790	32,894	76.9%	11,950	19,147
	Year 2010	4,237	4,155	82	73	1.9%	1.7%	49,624	37,838	76.2%	13,110	
	Year 2011	4,549	5,300	-751	-825	-16.5%	-18.1%	52,998	39,731	75.0%	13,301	
Qantas	Year 2007/08	14,515	13,283	1,232	869	8.5%	6.0%	127,019	102,466	80.7%	38,621	33,670
YE 30/6	Year 2008/09	10,855	10,733	152	92	1.4%	0.8%	124,595	99,176	79.6%	38,348	33,966
	Year 2009/10	12,150	11,926	223	102	1.8%	0.8%	124,717	100,727	80.8%	41,428	32,490
	Year 2010/11	14,842	14,200	642	249	4.3%	1.7%	133,281	106,759	80.1%	44,456	32,629
Singapore	Year 2005/06	6,201	5,809	392	449	6.3%	7.2%	109,484	82,742	75.6%	17,000	13,729
YE 31/03	Year 2006/07	9,555	8,688	866	1,403	9.1%	14.7%	112,544	89,149	79.2%	18,346	13,847
	Year 2007/08	10,831	9,390	1,441	1,449	13.3%	13.4%	113,919	91,485	80.3%	19,120	14,071
	Year 2008/09	11,135	10,506	629	798	5.6%	7.2%	117,789	90,128	76.5%	18,293	14,343
	Year 2009/10	8,908	8,864	44	196	0.5%	2.2%	105,674	82,882	78.4%	16,480	
	Year 2010/11	10,911	9,956	955	863	8.8%	7.9%	108,060	81,801	75.7%	16,647	
Air China	Year 2006	5,647	5,331	316	338	5.6%	6.0%	79,383	60,276	75.9%	31,490	18,872
YE 31/12	Year 2007	6,770	6,264	506	558	7.5%	8.2%	85,257	66,986	78.6%	34,830	19,334
	Year 2008	7,627	7,902	-275	-1,350	-3.6%	-17.7%	88,078	66,013	74.9%	34,250	19,972
	Year 2009	7,523	6,718	805	710	10.7%	9.4%	95,489	73,374	76.8%	39,840	23,506
	Year 2010	12,203	10,587	1,616	1,825	13.2%	15.0%	107,404	86,193	80.3%	46,420	
China Southern	Year 2006	5,808	5,769	39	26	0.7%	0.4%	97,044	69,575	71.7%	49,200	45,575
YE 31/12	Year 2007	7,188	6,974	214	272	3.0%	3.8%	109,733	81,172	74.0%	56,910	45,474
	Year 2008	7,970	8,912	-942	-690	-11.8%	-8.7%	112,767	83,184	73.8%	58,240	46,209
	Year 2009	8,022	7,811	211	48	2.6%	0.6%	123,440	93,000	75.3%	66,280	50,412
	Year 2010	11,317	10,387	930	857	8.2%	7.6%	140,498	111,328	79.2%	76,460	
China Eastern	Year 2006	3,825	4,201	-376	-416	-9.8%	-10.9%	70,428	50,243	71.3%	35,020	38,392
YE 31/12	Year 2007	5,608	5,603	5	32	0.1%	0.6%	77,713	57,180	73.6%	39,160	40,477
	Year 2008	6,018	8,192	-2,174	-2,201	-36.1%	-36.6%	75,919	53,754	70.8%	37,220	44,153
	Year 2009	5,896	5,629	267	25	4.5%	0.4%	84,422	60,918	72.2%	44,030	45,938
	Year 2010	11,089	10,248	841	734	7.6%	6.6%	119,451	93,153	78.0%	64,930	
Air Asia (Malaysia)	Year 2008	796	592	203	-142	25.5%	-17.9%	14,353	10,515	73.3%	9,183	4,593
YE 31/12	Year 2009	905	539	366	156	40.4%	17.3%	21,977	15,432	70.2%	14,253	
	Year 2010	1,245	887	358	333	28.8%	26.7%	24,362	18,499	75.9%	16,050	
	Year 2011	1,464	1,072	392	185	26.8%	12.6%	26,074	21,307	81.7%	17,986	

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

EUROPEAN SCHEDULED TRAFFIC

	Intra-Europe			North Atlantic			Europe-Far East			Total long-haul			Total International		
	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %
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
2011	349.6	248.8	71.2	248.5	205.4	82.7	204.9	163.3	79.7	670.3	544.9	81.3	1,006.8	785.0	78.0
Feb 12	24.2	15.9	65.7	16.2	11.7	72.5	15.9	12.5	78.4	50.2	38.9	77.5	73.7	54.3	73.7
Ann. change	1.3%	5.3%	2.5	1.7%	6.7%	3.4	6.7%	5.0%	-1.3	6.1%	8.2%	1.5	4.9%	7.8%	2.0
Jan - Feb 12	49.7	32.3	65.1	34.3	25.6	74.8	32.9	25.9	78.5	105.1	82.7	78.7	153.4	114.3	74.5
Ann. change	0.5%	5.5%	3.1	0.8%	5.1%	3.0	4.6%	3.0%	-1.2	4.5%	6.4%	1.3	3.4%	6.3%	2.0

Source: AEA.

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	09 April	Transaero Airlines	4 x 787-8	
	02 April	TAAG Angola	3 x 777-300ER	plus 3 purchase rights
Airbus	11 April	Garuda Indonesia	11 x A330-300	RR Trent 700 engines

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

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