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Legacy subsidiaries: Quest for a successful model

Legacy carriers have all tried to react to the competitive threats of lower cost new entrant competitors by creating their own lower cost subsidiaries. Over time, as the LCC phenomenon has spread round the world, this reaction has developed in various ways; but rarely successfully.

In the US the network majors tried to establish in-house LCC subsidiaries - some of them several times. They all failed. It may have been that the attempts to establish the likes of Song (Delta) or Ted (United) were just attempts at union-bashing, ill-fated attempts to reduce costs fast enough to compete in some way with low fares of the point-to-point competition; an interim measure while putting off the opportunities available under Chapter 11 bankruptcy protection to reduce employee costs throughout the group operations.

In Europe the early reactions were also to join the LCC revolution with separately branded subsidiaries: British Airways' Go being a brand new start-up; KLM's buzz a spin-off from its regional British subsidiary Air UK. Neither of these were integrated into mainline operations. The logic, such as it was, was that these subsidiaries could close the operating cost gap on the new entrants but would also have a huge advantage in capital costs because of the halo effect of their parents – totally wrong, as it turned out.

BA disposed of Go in the fear that it had created an animal that would cannibalise its own core traffic; it was subsequently acquired by easyJet to give the Luton based carrier a leg up in development towards becoming one of Europe's largest carriers. Buzz equally went to Ryanair for similar reasons. Both acquisitions were financially painful for the acquirers.

Lufthansa by contrast gradually acquired a majority stake in germanwings and was happy to treat it as an entirely separate brand within its portfolio of disparate airline products. It also allowed it to compete directly with its main Lufthansa brand, albeit on non-hub flying. Air France got into the game late, probably underestimating the incursion of easyJet into its home bases at CDG and Orly. It established Transavia France as a 'leisure based' carrier using the expertise of the KLM's moderately successful transavia.com. Alitalia tried with Volare. SAS has been trying to make sense of Blue 1.

None of these in-house subsidiaries have been successful; primarily perhaps because the parent companies had no real interest in allowing them to grow outside their home country (and away from the limitations of national based unions) in the

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way that easyJet, Ryanair and Wizzair have been able to do; partly because of an overwhelming belief in their core brand dissuaded them from allowing the subsidiaries to grow too fast and cannibalise the core activities.

The LCC revolution took decades to cross the Atlantic, but as in the case of the development of many product ideas, only a few years to get to Asia. Now the focus is in the Far East; where the LCC business model and the reaction to it is developing in new ways. With ownership restrictions still in place, the start-up LCCs have (with collusion in various degrees of usefulness from nation states) been able to establish minority owned branded subsidiaries in other countries in the region to develop a regional brand awareness.

AirAsia, for example, based in Malaysia, has established subsidiaries in Thailand, Indonesia to allow it to create a Southeast Asian network. It plans to open AirAsia Japan in partnership with ANA in 2013. Distances within South East Asia between major centres are also far longer than comparative routes in the US or Europe; and AirAsia compounded the problem for the legacy carriers by establishing AirAsia X as a separate long-haul low cost model. In doing so it created as if almost by chance its own unbundled network model allowing self-transfer at the low cost terminal at Kuala Lumpur.

In Australia, Qantas appears to have created a new type of in-house low cost subsidiary; again one that could possibly be described as union-bashing. Following the demise of Ansett and near collapse of Air New Zealand, and the emergence of new low cost competition (Virgin Blue, now Virgin Australia), it seems to have caught its unions napping when it established Jetstar in 2004. The official story at the time may have been that this low cost fully owned subsidiary would only be used on 'leisure' routes - notably naturally low yielding routes into and out of the Northern Territories and Gold Coast, which were unsuited to Qantas' high cost structure.

The unions seem to have rationally accepted that it also made sense for Jetstar to operate longer haul leisure routes out of Japan, which again made little sense for Qantas. Virgin Blue also seems to have dismissed the development as one which as with similar moves in the US was bound to fail once the unions discovered what was going on.

However, Qantas has treated its low cost subsidiary as a fully fledged subsidiary, coordinated within the Qantas Group; and been willing to foster it as a fully integrated new brand. Qantas and Jetstar bid internally for resources on a route by route and flight by flight basis: the one proving the potential for the greatest group returns being allocated the opportunity to operate the flight. Importantly the two brands do not compete, but work together in complement. Distribution systems are linked: both carriers cross-sell each others' services. This can lead to both carriers operating the same route (they overlap on 32 routes overall) but the process is designed to ensure that inter-brand competition and demand cannibalisation is minimised while maximising group returns. Jetstar participates in the QF and partners' FFPs; and code share agreements with common partners.

Jetstar too has been used to access cross-border brand development as such as AirAsia. It has built up 50% owned Jetstar Asia, based in Singapore - possibly allowing it to access slightly lower employment costs and more efficient crewing. It also has a 30% stake in Jetstar Pacific based in Vietnam - although it is currently limited to domestic services. It recently established Jetstar Japan in partnership with oneworld alliance partner JAL - initially designed to operate domestic routes (it started operations in June this year with three A320s and plans for a 21 strong fleet) it will undoubtedly go international before long. It has also announced plans to start Jetstar Hong Kong in a joint venture with China Eastern - the first LCC to be based in Chep Lap Kok - which, AOC permitting, is set to start operations next year.

Also, it has the domestic New Zealand operations and increasing involvement in trans-Tasman routes - all notoriously and historically difficult to operate efficiently. In all these Jetstar has the advantage of

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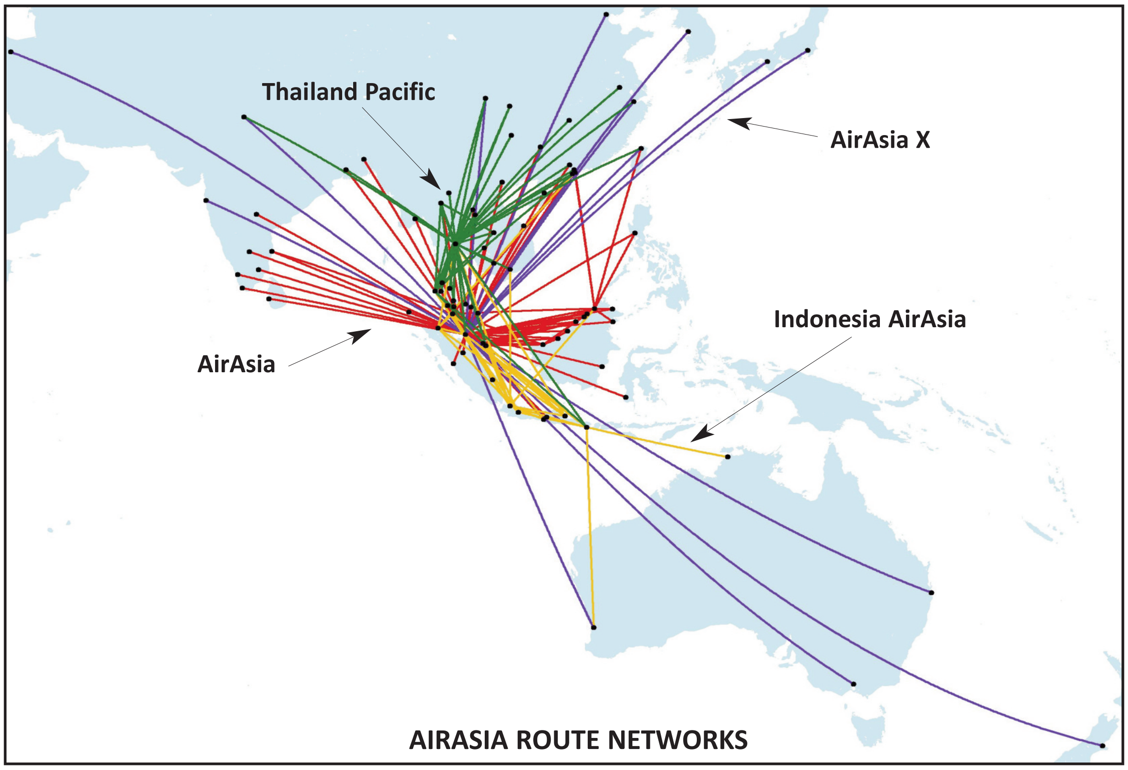


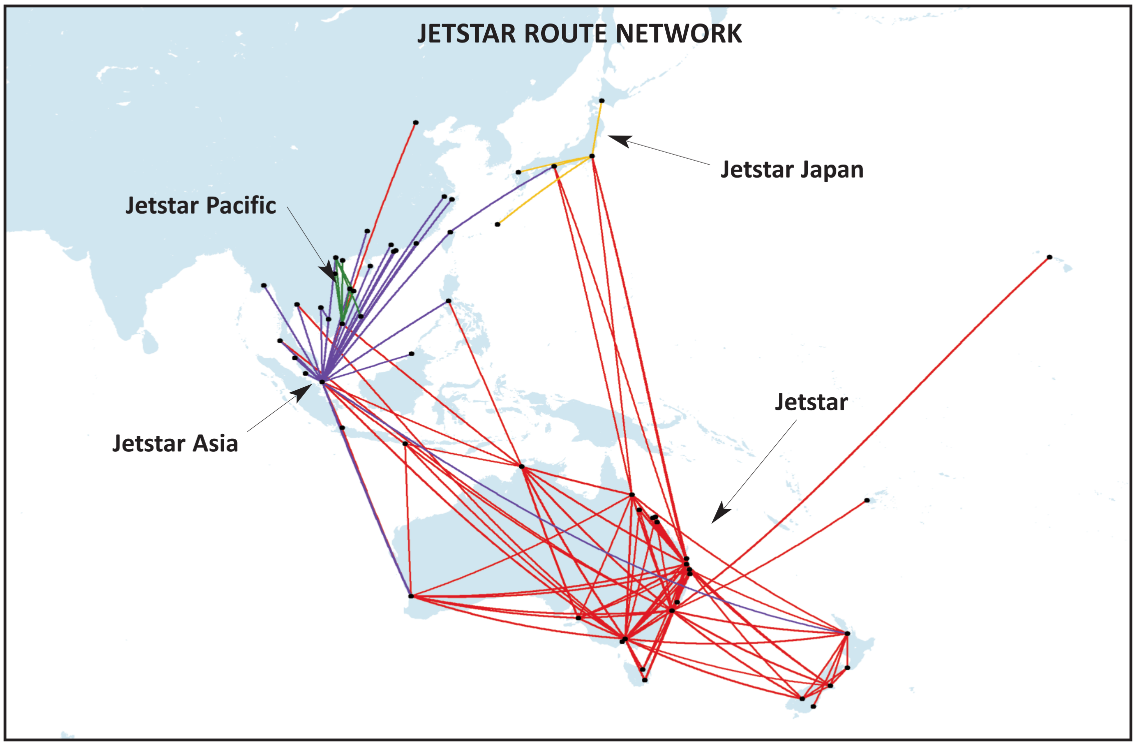
AIRASIA ROUTE NETWORKS

being able to access the Qantas Group fleet, order book, and financial resources; and it may perhaps be assumed that the parent group sees greater shareholder returns from allocating its capital to its new brand.

These moves have spurred a splurge of legacy carriers' responses in the region. SIA has set up Scoot (although it has operated its own single aisle leisure carrier Silk Air for many years). This is operating hand-me-down 777s and is designed to attack the "burgeoning market" for medium- to long-haul intra Asian low fares demand. JAL, as mentioned, has set up a joint venture with Jetstar. All Nippon is apparently creating two new LCCs - associate company Peach (which started operations in March 2012) in partnership with two other Japanese investment companies, and AirAsia Japan as a joint venture with AirAsia using the Malaysian company's know how. Thai, being attacked on the one hand by AirAsia Thailand, and on the other thwarted by plans to develop a joint venture low fares in-house operator in conjunction with Tiger has set up its own short-haul LCC Thai Smile. Cathay notably has yet to offer any response.

Is the Jetstar model successful? In the first half of the group's financial year ended June 2012 Jetstar achieved operating profits of AUD147m (US$146m) up by 3% on the year before, while Qantas mainline returned AUD66m, down by 60% on the year before level (although admittedly impacted by the effects of strike action of an estimated AUD194m). Jetstar produced a third of group capacity in the first half and carried 64% of the total number of passengers. Of course the published figures come under criticism - basically referring to transfer pricing in the group accounts - but on published figures it may appear that Jetstar's unit operating cost of 4.1cents/ASK is at least 30% below that of its sister company - before accounting for stage length differences.

Qantas may have been lucky in establishing and developing Jetstar. It appears to have its unions unawares, and Virgin Blue strategically seems to have dismissed the competitive potential on the basis that the QF unions would eventually squash it. The recent unrest among the mainline carrier's unions may not completely have gone away. Along with the austerity restructuring of QF long-haul mainline



operations and the distrust of the published figures may suggest an exacerbation of weakened industrial relations.

Could Qantas' development of Jetstar successfully be replicated in Europe, Asia or elsewhere?

Lufthansa has an apparent need to maintain a reasonable level of non-hub flying - direct flights that do not touch its main hubs at Frankfurt or Munich - in order to maintain its brand attractiveness to corporate clients in Federal Germany. Having found that its germanwings subsidiary had lost the equivalent of the German passenger departure tax per passenger in 2011, and facing deep losses on its non-hub flying, it has increasingly used the LCC to infill routes on its domestic and European services. However, while it thinks that it may have a slightly lower cost advantage at germanwings it is still bound by the national union negotiations within Germany. Until it can develop germanwings bases or subsidiaries outside Germany it is unlikely to be able to establish significantly lower cost operations away from the German unions.

Air France-KLM (faced with medium-haul losses of €750m in 2011) is concentrating on rewriting contracts with its French mainline unions. It is also trying to make more use of the Transavia France as infill, while also trying to develop low cost regionally based operations within the mainline brand on intra-European services. It has the same problems as Lufthansa.

Iberia on the other hand has set up Iberia Express - a move which more closely resembles the union-bashing techniques of the US legacy carriers - with a medium term aim of creating a fleet of 40 A320s operating separately from but in close coordination with the Iberia mainline hub operations at Madrid Barajas. The result so far seems to have exacerbated a lasting stand-off between the Iberia unions and management.

Of all the legacy carriers' responses to LCC incursion, Qantas' Jetstar uniquely seems to be working - at least for the moment. It may involve a lot of smoke and mirrors; it may also be a uniquely Australian, and irreplicable, solution.

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United's merger challenges, American's merger explorations

Somewhat ironically, in recent months United Continental Holdings (UAL) – the result of the October 2010 merger between United and Continental - has been experiencing terrible merger integration problems just as American, which has been in Chapter 11 since November 2011, is effectively being forced into considering a merger with US Airways.

Of course, these developments are totally unrelated. But UAL's problems serve as a reminder that airline mergers are risky affairs. They are extremely difficult to execute, involve considerable pain, offer only long-term benefits and should only be considered if the potential rewards are substantial (as they probably are in UAL's case).

Many of the issues that UAL has been experiencing this year resulted from an over-ambitious IT/reservations systems switchover in early March. UAL has been plagued by computer glitches, soaring customer complaints, poor operational performance, weak RASM growth, rising CASM, deteriorating profit margins and labour strife so extreme that the pilots voted on July 17 in favour of a strike (a symbolic gesture since the federal mediators had not released them from contract talks).

Industry observers have been alarmed that UAL is having such difficulty integrating the two subsidiaries. JP Morgan analyst Jamie Baker wrote in a July 26 research note that some investors were so concerned that they had asked: "Is there a possibility that UAL will emerge as this decade's AMR?"

The investors are not worried about a liquidity crisis or another bankruptcy; rather, they fear that United could be on a path of gradual decline and would eventually emerge as an "industry laggard" similar to what AMR was in the last decade. JP Morgan analysts said that they did not expect that to happen, but they called for a "more aggressive management stance" at UAL to help restore operational performance and profit margins.

But it has not all been bad news. In early August UAL and ALPA, which represents pilot groups at both United and Continental, reached in-principle agreement on a joint pilot contract – an important step forward on the integration front. Last month United announced its long-awaited narrowbody decision: a $14.7bn, 150-aircraft order for 737 MAX9s and 737-900ERs. Earlier this year UAL was able to finance some of its new deliveries with an $892m bond deal that had a record-low 4.38% blended interest rate.

The key questions for United now are: Can it quickly fix the operational and service issues, and at what cost? Will its unit costs soar as a result of the pilot deal, which was facilitated by Delta's recent industry-leading contract?

At American, the pilots' overwhelming rejection of the company's "last, best and final" contract offer on August 8 dashed the management's hopes of reaching consensual labour agreements and completing the Chapter 11 restructuring by year-end. The resulting labour strife and delays make an eventual merger with US Airways even more likely than before.

UAL's integration challenges

In contrast with Delta and Northwest, which integrated their computer systems in stages (with relatively smooth results), United and Continental decided to do it all at once. The idea behind the "big bang" systems cutover was to limit the hassle to customers to the shortest possible period.

UAL executives have called it "the single largest technology migration in the history of aviation". CEO Jeff Smisek explained recently that the carrier "added new stress to the system by simultaneously converting to a single passenger service system, implementing hundreds of new processes and procedures, rerouting aircraft across our network, and harmonising our maintenance programmes".

While the conversion to a single passenger service system (Continental's "Shares") was successful, after the cutover numerous issues emerged that frustrated customers and booking agents, resulting in a surge of customer complaints and probably the loss of many frequent flyers to competitors. The transition to a single maintenance system resulted in extensive flight delays and cancellations. The switchover to a single revenue accounting system led to yield management problems and lower RASM.

It was a critical integration milestone that was supposed to drive significant merger synergies in 2012. Instead, the outcome was so messy that United has only incurred additional costs. Many of the issues lingered on for months and some have still not been resolved.

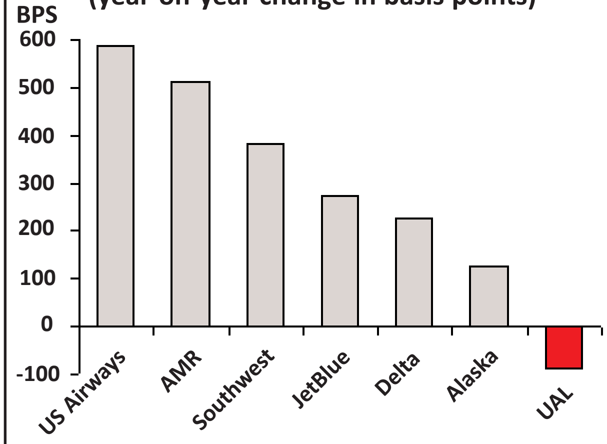
In May UAL came worst of 15 major carriers in all four key service metrics – on-time performance, cancellation rate, misplaced bags and consumer complaints – in the DoT's monthly rankings.

United's unit revenue growth has also continued to trail that of the industry. According to BofA Merrill Lynch analyst Glenn Engel, UAL's 2.9% PRASM growth in the second quarter was 3.5 points below the major carriers' average increase. The gap was similar to that seen in the first quarter. In addition to the integration issues, the RASM underperformance reflects United's relatively heavy exposure to the large-corporation segment, which has begun to show some weakness due to the global economic slowdown.

Revenue synergies from the merger were supposed to boost United's RASM performance this year. Instead, United is now expected to be the only one of the top seven US carriers to see unit revenues decline in the current quarter. It is also expected to have the industry's smallest RASM increase in the fourth quarter.

The fiercest battles between the top three US airlines are for corporate customers and elite-status FFP members. Reports suggest that Delta has definitely gained market share of those segments. United has won some market share from AMR because of the latter's bankruptcy, but AMR recently claimed that it had captured frequent flyers from United because of the merger integration issues. That said, UAL continues to win new corporate accounts thanks to the larger combined network and the extra sales efforts mounted since the merger; its executives said that revenue from corporate accounts rose by 16% in the second quarter.

TOP US AIRLINES' 2Q12 EBIT MARGIN CHANGES (year-on-year change in basis points)



Source: *JP Morgan*

Smisek said in UAL's second-quarter call on July 26 that the airline was intensely focused on restoring its operational integrity "in fairly short order". The "aggressive effort" under way includes increasing airport and maintenance staffing levels and adding back the spare aircraft that were removed earlier as part of the maintenance systems harmonisation.

But fixing the woes is adding to the cost pressures UAL is feeling this year. In addition to the substantial one-time integration charges, unit costs will increase as labour contracts are harmonised and capacity declines modestly. UAL's ASMs are slated to decline by up to 1.5% in 2012, and non-fuel CASM is expected to rise by 2.5-3.5%.

UAL reported ex-item operating and net profits of $781m and $545m, respectively, for the second quarter, down 15.3% and 20.3% on the year-earlier period. Revenues rose by 2.4%. Net special charges amounted to $206m, including $137m of integration items and $76m costs associated with a voluntary employee severance programme.

The operating and ex-item net margins were a respectable 7.9% and 5.5%, respectively. But analysts pointed out that UAL was the only major US airline whose profit margins declined in the latest period.

While UAL is expected to remain profitable (like its peers, it is enjoying an unprecedented multi-year profit run), the merger-related problems mean that it is likely to be the only carrier to see earnings dip in 2012. In 2013, however, analysts cautiously hope that UAL will outperform the rest of the gang.

UAL had an ample $8.2bn in unrestricted liquidity, or 22% of last year's revenues, at the end of June, giving it flexibility as it integrates and manages its debt maturities. Its ROIC exceeded 10% on a trailing 12-month basis.

The proposed joint pilot contract at United includes agreement on all the major economic issues. When finalised, the deal will be subject to approval by the governing boards of the two pilot groups and ratification by members. The next step would be talks on seniority list integration – a contentious subject, but UAL's two pilot groups have agreed to submit the matter to binding arbitration if they cannot agree on a list. The pilot negotiators estimated that the contract could be in place by the end of this year and a single seniority list by next spring. Getting these deals done is crucial, because UAL will then be able to freely allocate crews and aircraft across the network – important for achieving the full synergies.

Both sides have made it clear that the industry-leading contract that Delta's pilots ratified in late June paved the way for the deal at United, which provides improvements in pay, work rules, job protection and benefits, to compensate for the concessions that both pilot groups made in the last decade. One union leader was quoted saying that the deal was "on par with Delta from a pay-rate perspective".

The Wall Street Journal reported that CEO Smisek himself acknowledged in a memo to pilots in May that the Delta agreement "raises the market pay for commercial airline pilots and effectively sets a new competitive standard for pilot pay". He pledged that United would be responsive to the Delta terms and needed to "adjust our current contract proposal to be competitive".

United recently gave Aer Lingus 90 days' notice to terminate their longstanding codeshare agreement on the Washington-Madrid route, which is operated by Aer Lingus. That "outsourcing" had been a particular bone of contention with the pilots.

It does sound like a potentially very expensive pilot deal. But, in return for industry-leading pay, UAL could secure important concessions, such as a significant relaxation in the pilots' scope clause that would allow more large regional jets to be operated by commuter affiliates.

The Boeing narrowbody order demonstrated that, unlike American, United sees benefits in ordering from just one manufacturer. The July order included 100 737 MAX9s (plus 100 options), for delivery from 2018, and 50 737-900ERs (plus 60 options), from late 2013. United's 270-plus firm orders also include 50 787s and 25 A350XWBs. The 787 is expected to begin commercial service in October (following delivery in September), initially between UAL's US hubs, then on Houston-Lagos and in 2013 to launch Denver-Tokyo.

AMR's growing merger certainty

AMR's management wants to restructure independently and earlier made it clear that it would consider consolidation only after emerging from Chapter 11. However, the airline's standalone business plan has been widely criticised as weak and uninspiring. US Airways took advantage of that and succeeded in winning the support of AMR's very unhappy workforce for a possible future AMR-US Airways merger. In an unprecedented move, US Airways in April announced tentative agreements with American's three key unions that would give them better terms than what AMR is offering in the event of a merger taking place (see *Aviation Strategy*, April 2012).

In May key creditors and bondholders put pressure on AMR to consider alternatives to the standalone business plan. AMR signed a "protocol" with its nine-member unsecured creditors' committee (UCC) to explore strategic options, including a possible sale. Those options would be considered side-by-side with the standalone plan.

In July AMR's CEO Tom Horton presented plans to reach out to at least five potential merger partners (Alaska, Frontier, Virgin America, US Airways and JetBlue). This "search" officially kicked off on July 27 when AMR sent out confidentiality agreements.

But the problem is that only US Airways seems to be interested (and many of the others are also too niche).

AMR has indicated that it would also consider offers from private equity firms, other US legacies and even foreign carriers. Delta is believed to be considering a bid, though many regard it as unlikely because it would probably not pass regulatory muster. IAG is reportedly considering buying a small stake to protect the alliance, if invited to do so by its partner.

In the meantime, US Airways' CEO Doug Parker has continued to publicise the merits of an AMR-US Airways union. US Airways cannot yet bid for AMR, because AMR currently has exclusive rights until December 28 to propose a reorganisation plan. However, US Airways could take a merger bid directly to the UCC, and the UCC could at any point seek to have the court revoke AMR's exclusive rights.

AMR's management has strived to complete the Chapter 11 restructuring quickly, so that it could present the standalone plan during the exclusivity period. It has made good progress with debt, lease and facilities restructuring. Also, AMR has outperformed the industry in terms of RASM in recent months, amid signs that the "cornerstone" and alliance/JV strategies are at last producing dividends. AMR even achieved a small $95m ex-item net profit in the second quarter – its first positive result in that period since 1997.

On the labour front, AMR also seemed to be on the home stretch in terms of securing consensual agreements adding up to around $1bn of annual cost savings (negotiated down from the original $1.25bn). By early August all seven TWU unions had ratified their agreements. The flight attendants conclude their voting on August 19.

But the pilot vote ruined the management's plans. The rank-and-file rejected the contract with a 61% majority, even though the terms represented a significant improvement over the original proposals (including, among other things, modest pay increases, elimination of furloughs and a 13.5% equity stake in the company).

All of the unions still strongly support a potential US Airways bid. But the union leaderships had urged members to approve AMR's final offers as an "insurance policy", to avoid harsher court-imposed terms and because it was seen by many as the shortest path to a merger with US Airways. The thinking was that the sooner AMR gets the restructuring done, the sooner a plan from US Airways can be considered.

The pilot vote reflected the deep anger and frustration with the management that had simmered since AMR's workers granted $1.6bn of voluntary concessions in 2003, the six-year length of the contract and other factors. Many pilots felt that approving the deal would be akin to endorsing the management. The vote led to an immediate resignation of the APA president at the request of the union's board.

The court was expected to approve AMR's request to reject the pilots' existing contract on August 15, but it is not certain that AMR will impose the sort of "draconian" terms that some people have suggested. The main thing is that the two sides need to resume negotiations on a long-term contract – without one AMR would not be allowed to exit Chapter 11.

Analysts have predicted that the main impact of the pilot vote is to delay everything – the filing of AMR's restructuring plan, consideration of a possible US Airways bid and exiting Chapter 11. However, the delay may work in US Airways' favour. This is because, as one analyst suggested, the pilots have little to lose and could drag out the contract negotiations. A mutually agreed deal may not be possible. A bid by US Airways could win strong creditor support if it facilitated a pilot contract and more stable labour relations at AMR.

One of the many odd aspects of US Airways' involvement here – and something that requires further clarification – is that US Airways still operates with two separate pilot groups following the 2005 merger with America West. How could US Airways bring labour peace to AMR if it cannot integrate its own workforce? But there is the intriguing possibility that an AMR-US Airways deal on the table might help break the deadlock in US Airways' own union negotiations.

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LAN-TAM merger: Latam Airlines launches into tough climate

Chile's LAN and Brazil's TAM closed their long-awaited European-style merger deal on June 22, creating Latam Airlines Group S.A., the region's first "world-class global airline group". With low costs, a highly diversified business model, dominant position regionally and minimal network overlap between the airlines, Latam could be a perfect vehicle for tapping Latin America's promising long-term growth potential.

But Latam faces many short/medium-term challenges. First of all, the global economic climate is dismal, while fuel prices remain high. There is much uncertainty about the resolution of Europe's troubles.

Brazil, Latin America's largest air travel market, has seen a dramatic slowing of economic and air traffic growth this year, while competition domestically has continued to increase. TAM saw its earnings fall sharply in the first and second quarters and, like its main rival Gol, has been scrambling to scale back growth plans.

LAN, in turn, is affected by a cargo slump this year, reflecting weaker demand and increased competition in that segment. Cargo accounts for as much as 24% of the Chilean carrier's revenues. Partly because of it, LAN has posted lacklustre results for the past two quarters.

As an added setback, LAN has lost its investment-grade international credit ratings. When the merger closed Fitch assigned LAN/Latam a junk-grade "BB+" rating, down two notches from LAN's former "BBB" rating, essentially because TAM has a weaker credit profile, including a heavier debt load.

Since Brazil and cargo are two key areas where Latam hopes to grow and obtain merger synergies, analysts fear that slowdowns in those areas could delay integration efforts and make the promised synergies harder to achieve. The ratings downgrade will mean higher financing costs at a time when the airlines have significant aircraft deliveries scheduled in the near-term.

When the merger plans were announced in August 2010, the economic environment was very different. LAN and TAM were keen to act quickly to take advantage of the robust conditions that existed in many Latin American countries. They also wanted to combine from positions of strength.

But it took the airlines almost two years to complete the transaction, compared to the original target of 6-9 months (which probably was a little ambitious). Regulatory delays were partly to blame. The deal went through a thorough antitrust scrutiny, though the authorities ruled in a reasonably timely fashion (Chile's TDLC took eight months and Brazil's CADE gave its final decision three months later, in December 2011). But it was clear that the airlines themselves also struggled to put together and close what was an extremely complex transaction.

LAN and TAM face the challenging task of integrating operations. Even back in 2010 many sceptics argued that it could not be accomplished successfully. First, LAN-TAM is not a full takeover; the airlines will maintain separate operating certificates, brands, headquarters, governance structures, values and culture. Second, the ownership/control structure is unusual because of the involvement of two families (Chile's Cuetos and Brazil's Amaros) and because of the need to comply with Brazil's foreign ownership restrictions. Third, analysts have expressed concern about what they call a "culturally difficult" relationship between Brazilians and Chileans. It seems likely that execution risks for this type of merger are magnified in a tougher economic climate.

Finally, the global alliance decision, which Latam expects to make "in the coming months", will have negative repercussions regardless of which way it goes. For example, opting for oneworld (LAN's existing alliance and the most obvious choice) could have serious negative effects for TAM and the Brazilian market, which Latam regards as a top priority.

Not surprisingly, Latam has had an unenthusiastic reception in the investment community. The exchange offer for TAM's shares had to be extended by ten days to meet the required threshold. Most analysts have kept a "neutral" rating on Latam shares, amid concerns especially about Brazil, execution risk and the promised synergies possibly not materialising.

Then again, LAN and TAM already had relatively healthy stock market valuations, reflecting their traditional strengths. When the merger closed, Latam's $3.5bn market capitalisation made it the highest-valued airline in the world (running neck-and-neck with Air China).

Of course, Latam's longer-term prospects remain excellent. If the combine can integrate successfully while managing through the near-term economic challenges, it should be uniquely well positioned in both the passenger and cargo segments to benefit from robust demand growth in Latin America, boosted by surging disposable incomes and swelling ranks of middle classes.

Latam explained

LAN and TAM completed what is essentially a European (AF-KLM, BA-Iberia) style merger, though Avianca and Taca also used that model in 2009. The all-stock transaction consolidated the economic interests of LAN, TAM and their affiliates under a single parent entity, which will coordinate and align activities for all group holdings, so that they can integrate, capture synergies and offer "seamless passenger and cargo service across the continent and around the world". LAN and TAM will continue to operate as distinct airlines and their CEOs will have "real autonomy to run the business".

The deal was structured to comply with Brazil's laws that limit foreign ownership in airlines to 20% of the voting shares (which may be raised to 49% in the future). There was no change of control at either airline. While Latam now holds substantially all of TAM's total stock (economic interest), the Amaros retain 80% of TAM's voting stock.

The relations are governed by shareholder agreements. The controlling shareholders of LAN and TAM agreed to a governance model to "jointly manage all strategic decisions" relating to the alignment of Latam activity.

Of course, it was not a merger of equals; LAN acquired TAM. LAN became the holding vehicle of the combined operations, changing its name to Latam and retaining its listings on the Santiago Stock Exchange and on the NYSE. TAM's stock was delisted in Sao Paulo and New York. The transaction was carried out through an exchange offer, in which TAM's shareholders were invited to exchange each share they held for nine-tenths of a share in LAN. Those shares were converted to Latam depositary receipts, delivered in the form of BDRs in Brazil and ADRs in the US. About half of the Latam shares are now held by the public; the other half is held by four major investor groups, with the Cueto family having the largest stake (around 25%). Latam Airlines Group is headed by LAN's former CEO, Enrique Cueto, as CEO. TAM's vice-chairman Mauricio Rolim Amaro became the group's chairman.

Contrary to initial speculation, there never was much political opposition to the deal in Brazil. Also, the slot/route carve-outs imposed by the regulators were modest, reflecting the mere 3% overlap between the networks. LAN and TAM were required to cede two pairs of slots at Sao Paulo's Guarulhos Airport to airlines that wanted to operate Sao Paulo-Santiago flights; however, as of August 13 no airline had expressed interest in those slots.

Latam includes LAN Airlines and its affiliates in Peru, Argentina, Colombia and Ecuador; LAN Cargo and its affiliates (ABSA in Brazil, MAS Air in Mexico and Linea Aerea Carguera in Colombia); TAM S.A. and its units TAM Linhas Aereas, TAM Mercosur, TAM Airlines (Paraguay) and Multiplus S.A. (TAM's FFP).

The combination provides passenger services to some 150 destinations in 22

LATAM AIRLINES GROUP IN THE REGIONAL CONTEXT

	Latam	Gol	Avianca-Taca	Copa
2011 Revenue (US$bn)	$13.5bn	$4.5bn	$3.7bn	$1.8bn
2011 Passengers (m)	60.3	36.2	20.8	7.7
Destinations (YE 2011)	150	100	76	59
Aircraft (YE 2011)	310	121	94	73

Source: *LAN shareholder meeting presentation (April 2012)*

countries and cargo service to 169 destinations in 27 countries. At year-end 2011, the airlines had a combined fleet of 310 aircraft and some 51,000 employees. Last year LAN and TAM had combined revenues of $13.5bn and carried 60.3m passengers.

These statistics made Latam the first Latin American airline group to reach the world's "top 15" rankings in terms of both revenues and passengers. In the Latin American context, the merger has created a dominant player. In terms of 2011 revenues, LAN-TAM is three times as large as the second-ranked Gol and 35% larger than Gol, AviancaTaca and Copa combined (see table, above).

Latam accounts for about 40% of international passenger traffic within South America. The combine is the second-largest operator by passengers on South America-US routes (after American) and the third largest on South America-Europe routes.

Latam is, first of all, a response to the many large airline mergers and immunised alliances completed in recent years around the world, as well as the Avianca-Taca merger closer to home. Second, the merger is aimed at capitalising on and taking full advantage of Latin America's long-term growth potential. Third – and this was a key reason for LAN, the merger filled a gaping hole in the Chilean carrier's network: Brazil.

Because of Brazil's tight foreign ownership restrictions, LAN has not been able to establish an effective airline unit there – a strategy it has used successfully in other South American countries. Acquiring TAM was the perfect solution: it has given LAN not just entry but a very strong position in Brazil's domestic market, where TAM carried 38.7% of the passengers in May (slightly less than Gol/Webjet). Enrique Cueto recently described the Brazil access as an "historic opportunity", noting that 40% of Brazil's population (some 80m people) belong to a middle class that is just starting to travel by air.

LAN also saw great benefits in bringing TAM Cargo to its own cargo empire, which is already the largest in Latin America. Combining LAN's global cargo network and expertise with TAM's Brazilian market presence should mean some very attractive growth opportunities.

LAN has made it clear all along that this merger will be a growth vehicle. The airlines earlier talked about three initial primary growth areas for passenger operations following the merger: new services to Europe and Africa from Brazil, supported by increased feed from the Southern cone; new services to the US from Lima (Peru), supported by increased feed from Brazil; and new hubs that could connect to Europe and the US.

While cost savings are anticipated, the LAN-TAM union contrasts with the European mergers in that it is not aimed at cutting costs. The emphasis on growth will limit the need for headcount or aircraft reductions. Both LAN and TAM are already lean, with relatively low unit costs.

Anticipated synergies

LAN and TAM expect their combination to generate $600-700m additional annual pretax income, beginning in the fourth year. Some $170-200m synergies are expected in the initial 12 months, which would offset the $200m one-time costs that are mostly expected in year one.

The $600-700m target, which was announced in January 2012, is substantially more than the originally envisaged $400m annual synergies. The upward revision reflected updates and additional analyses carried out with the help of consultants. The synergy target accounts for 4-5% of combined 2011 revenues and is in line with other recent industry transactions.

About 60% of the synergies are expected to be generated by revenue increases (40% from passenger operations and 20% from cargo); the remaining 40% would come from cost savings.

LATAM - PROJECTED ANNUAL SYNERGIES OF US$600-700M	
Cargo revenue US$120-125m	• New service • Sharing of best practices
Pax revenue US$240-285m	• Network relevance $75-85m • New/increased connectivity $70-80m • New flights $45m • Partner airlines, increased utilisation $35-50m • FFPs $15-25m
Cost savings US$240-290m	• Airports $30-35m • Procurement $70-100m • Corporate $20m • IT $65-70m • Maintenance $20-25m • Sales $35-40m

On the passenger side, LAN and TAM are anticipating a $255-260m annual revenue boost resulting from the combination of their networks and the addition of new flights. Another $15-25m will come from the consolidation of their FFPs and the sharing of best practices in that area.

Combining TAM Fidelidade and LANPASS will create a powerful FFP, though the airlines have not yet indicated how that might be accomplished. Fidelidade is much larger and has been a listed company in Brazil since TAM spun it off in 2009. After the merger closed, LAN and TAM immediately began allowing passengers to earn and redeem miles/points over the complete networks and senior-level members to access all lounges and preferential services.

On the cargo side, LAN and TAM anticipate $120-125m in additional revenues attributable to new services and best practice sharing.

The $240-290m annual cost savings are slated to come from the following: consolidation of airport functions ($30-35m); leveraging economies of scale in contracts ($70-100m); streamlining of corporate overhead and some functions ($20m); efficiencies of common IT platforms ($65-70m); economies and efficiencies of scale in maintenance ($20-25m); and efficiency of combined sales and distribution processes ($35-40m).

As a result of the merger, Latam's revenues are nicely diversified, with international passengers accounting for 34%, Brazil domestic 27%, other domestic 11%, cargo 17% and loyalty programmes 6% of the combine's total revenues.

The scale benefits resulting from the merger include being in a stronger position to negotiate aircraft orders with the manufacturers and network agreements with large European and US airlines. The airlines will also enjoy more flexibility in terms of aircraft financing regimes.

There has been concern about potential execution risk arising from the unusual ownership structure, but the airlines have presented much evidence of their compatibility. They have a long history of collaboration. In 1998 LAN, TAM and Taca placed a joint order for Airbus aircraft in order to secure better prices – the reason they have similar aircraft in their fleets. They share the same values and strategic vision. The economic interests of the two families are supposed to be aligned, and there are the numerous shareholder agreements.

But it remains to be seen how well things will work if there is a need for painful measures. Most analysts expect at least delays in the execution of the merger. LAN's recent record in that respect is not very encouraging; in addition to the delays in closing the merger deal, the Chilean carrier has experienced difficulty and delays in turning around its LAN Colombia unit.

Of course, there are optimists and those that focus on the longer term. LAN's management team is regarded as the very best in the industry. LAN is famous for its diversified and flexible business model, and the addition of TAM should only strengthen those attributes. Together the airlines may be better positioned to deal with the effects of slower economic growth in their region.

Near-term financial challenges

LAN has a strong track record of profitability going back to the early 1990s, though it has seen earnings dip sharply during recessions. It has grown rapidly in the past decade, quadrupling its revenues from $1.4bn in 2001 to $5.7bn in 2011. The revenues are nicely diversified across several economies and LAN has less foreign currency mismatch between revenues and costs than the Brazilian carriers. LAN had double-digit annual operating margins in 2007-2010 and a very healthy 9.4% margin in 2011.

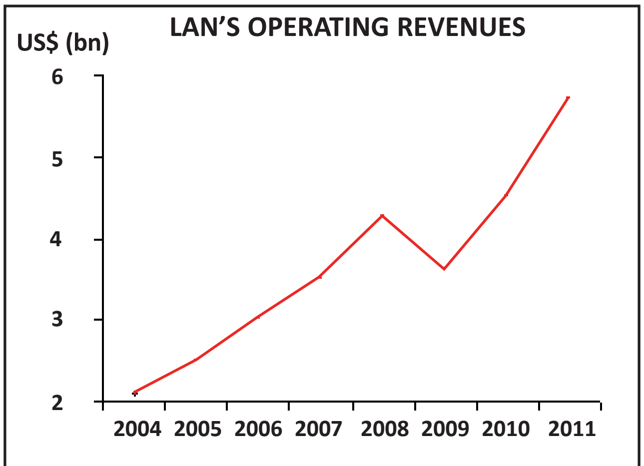
TAM, which is 37% larger than LAN in terms of 2011 revenues ($7.8bn) and 67% larger in passengers, used to be consistently profitable but has incurred annual net losses in two of the past four years (2008 and 2011). The losses were mainly due to the Brazilian real's depreciation against the US dollar, and TAM has continued to be profitable on an operating basis, albeit at lower margins than LAN. Last year's operating margin was 7.5%.

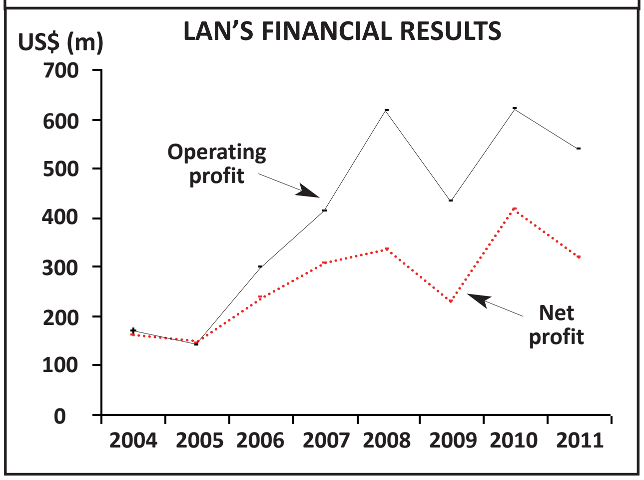
This year, however, TAM's results have deteriorated sharply as a result of higher fuel prices and weak domestic demand in Brazil. TAM only achieved a 2.3% operating margin in the first quarter and its net earnings fell by 22%. This was despite robust revenue trends in the international passenger segment.

The weak domestic demand has been mainly the result of higher fares. TAM and Gol have curtailed capacity growth, which has resulted in a healthier yield environment. This is usually a positive development for airlines, but the Brazilian market is highly price-sensitive. An added problem is that the smaller carriers, which now account for more than 20% of the domestic market, continue to grow rapidly.

TAM's second-quarter results were weak, despite a 14.3% improvement in domestic yield. The results were also grossly distorted by unfavourable foreign exchange developments, the marking-to-market of fuel hedges and other accounting adjustments. Operating margin was a negative 8.8%, reflecting a 16% surge in CASK due largely to the real's 23% depreciation. The staggering R$928m net loss included R$846m of foreign exchange losses.

Latam executives said that one of the key group objectives is to try to reduce the volatility of TAM's financial results caused by external factors such as foreign exchange and fuel hedges. The combine is considering moving TAM's aircraft to the

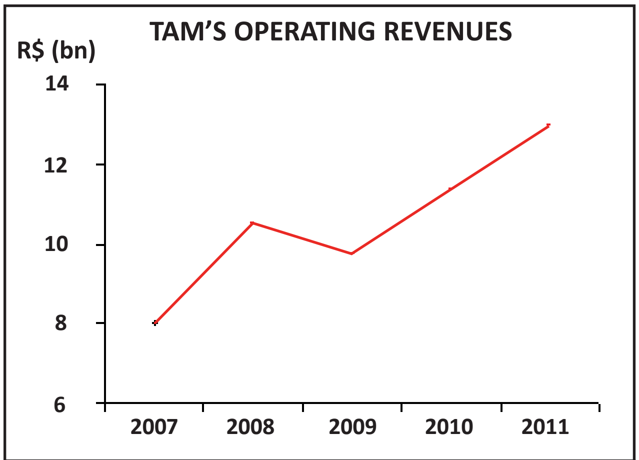


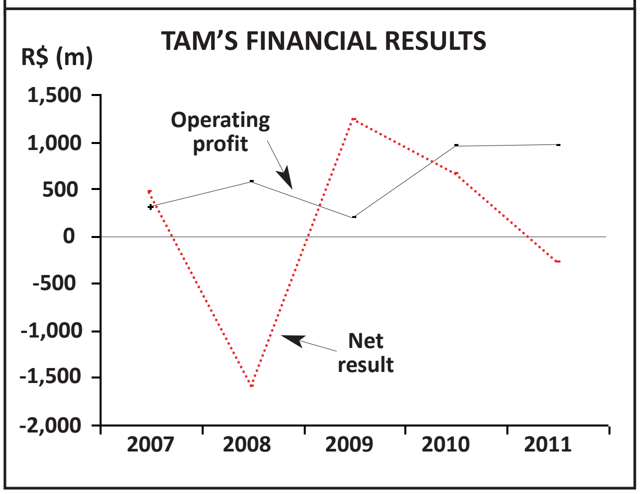


Latam balance sheet, where assets too are denominated in US dollars (eliminating the imbalance with costs) and financing all future aircraft deliveries at the group level. From next quarter, TAM's fuel hedges will switch to hedge accounting and all hedging will be done at the consolidated level.

But the biggest concern from Latam's point of view is the slowing economic growth in Brazil, which could have further dampening effect on travel demand. Brazil's GDP is expected to expand by just 2% this year, down from 2.7% growth in 2011. This could mean domestic air travel demand growing only in the mid-to-high single-digits in 2012, after 16-24% annual growth in 2009-2011.

Latam's strategy for TAM's domestic passenger operations is to maintain capacity discipline (ASKs down 2-3% in 2012) and try to boost profitability through higher load factors, better yield management and





cost and efficiency improvements. June and July already showed positive trends, with TAM's domestic traffic rising by 10% and load factor surging by 8.5 points to 81.4% in July. Latam executives attributed TAM's outperformance to better revenue management and pricing strategies and said that they were "optimistic about opportunities in the Brazilian market and expect significant improvements in the short-to-medium term".

LAN's operating and net profits also fell sharply in the second quarter, to $37m and $5m, respectively. Operating margin was only 2.6%. The weak results were blamed on a difficult environment in the cargo business, continued costs in the development of LAN Colombia and one-time payments to unions related to the completion of contract negotiations.

LAN has felt the effects of the euro-zone crisis and the global economic slow-down mainly in its cargo business, which has seen weaker demand (mainly in the southbound market to Latin America) and increased competition. LAN's passenger operations have continued to perform well, recording 14.4% revenue growth in the second quarter, compared to a 6% decline in cargo revenues.

The cargo slowdown concerns many analysts, but LAN has managed the situation well. It has not added any new freighters since January 2011, while belly-hold capacity has been effectively reduced by the higher passenger load factors. In the first quarter, LAN's cargo capacity was up by only 2.3% while traffic rose by 1.5%. In the second quarter, cargo ATKs fell by 3.3% and RTKs by 2.2%. In May LAN revised down its capacity plans for cargo: ATKs are now expected to grow by 3-5% in 2012, compared to 7-9% previously. LAN Cargo will take delivery of two new 777 freighters in September/October, but the aircraft are partly for replacement and will offer significant efficiency improvements over the 767Fs.

Among the first integration moves, Latam is consolidating LAN subsidiary ABSA Cargo's and TAM Cargo's Brazil operations. ABSA's two 767-300Fs are being transferred to TAM Cargo, which has a stronger brand in Brazil. In turn, TAM Cargo's international operations are being blended into LAN Cargo's and ABSA's operations. Latam is also investing to upgrade cargo infrastructure in Brazil. Latam hopes that these moves will improve the results of the Brazil cargo operations and increase the planned synergies.

The combined passenger traffic statistics that Latam reported for June and July offer cause for optimism. Passenger demand remains solid in the region overall. In July, Latam's system RPKs rose by 7.9%, consisting of 2.6% growth in international traffic, 24.7% growth in the group's "Spanish speaking operations" (Chile, Argentina, Peru, Ecuador and Colombia) and 10.1% growth in Brazil. International passenger traffic accounted for 49% of the Latam's total passenger traffic. Latam expects its system passenger capacity to increase by 3-

4% this year, made up of 12% growth at LAN and a 1-2% reduction at TAM.

In the short term, analysts expect substantial earnings volatility because of the integration process. The current consensus forecast is that Latam's earnings will decline from last year's 96 cents per ADR to 52 cents in 2012, subsequently rising to $1.27 in 2013.

Balance sheet considerations

The ratings downgrade by Fitch reflected not just TAM's higher debt levels but LAN's somewhat "constrained cash holdings". At the end of March, TAM's cash reserves were 13.4% and LAN's 4.7% (or 8.2% including credit facilities) of lagging 12-month (LTM) revenues. Fitch felt that LAN's credit metrics had deteriorated over the past two years as a result of the implementation of its strategic fleet plan.

But LAN still has a solid financial position, with practically no short-term debt and the potential to tap other liquidity sources. LAN's long-term debt relates mainly to aircraft financing and is at low interest rates, reflecting its former investment-grade credit rating.

According to Fitch, on a pro-forma basis, Latam had $12bn of combined lease-adjusted debt at the end of March. The adjusted debt/EBITDAR ratio was 5.2 times (LAN's was 4.7 and TAM's 5.7), which the rating agency considered "high". Fitch expects the ratio to deteriorate to 5.5-6 by year-end, as Latam takes on more debt, but after that merger synergies will help improve the ratio to 4.5 by year-end 2013.

Fitch calculated that LAN and TAM had a combined $1.5bn in liquidity at the end of March - 11.2% of LTM revenues or 0.9 times the total short-term debt of $1.7bn. The agency viewed this as "low for the rating category", though it noted the alternative sources of liquidity, including aircraft pre-delivery deposit funds of around $800m. Fitch does not expect Latam to improve its liquidity from the 10-15% range in the near term, as free cash-flow is likely to remain negative in 2012 and 2013 mainly because of the fleet spending.

Latam's leadership hopes to recover the investment-grade ratings "in a couple of quarters or maybe a year". But Fitch made it sound quite tough, indicating that "positive action" on the rating would only result from a combination of the following: reducing the debt/EBITDAR ratio to 3.5 or below; maintaining liquidity consistently around 25% of LTM revenues; having enough liquidity to cover at least two times the debt payments due in the next 24 months; and improving free cash-flow generation to neutral or positive.

In an effort to recover the rating, Latam has decided to cut dividends for a time. It is also evaluating obvious options such as selling a stake in Multiplus, the loyalty programme in which TAM still has a 73% stake. Other options include paying off debt, selling more shares or selling other assets. When asked in the 2Q call about the possibility of an equity offering, Latam's CFO responded that "maybe in the second half of 2013, if necessary".

Latam would really benefit from investment-grade ratings because both airlines have kept their substantial aircraft order books unchanged. LAN's plans are particularly aggressive: net addition of 43 aircraft in 33 months. LAN is looking to grow its fleet from 151 (including 14 freighters) in March 2012 to 194 by year-end 2014. In the same period, TAM will grow its fleet from 156 to 169 aircraft.

Fitch estimates the combined net aircraft capex at $7.9bn in 2012-2014, or $2.5-2.9bn annually – rather high even by global airline standards. Fitch did consider the plan ambitious but also felt that the risk was counterbalanced by LAN's great track record in correctly anticipating demand, its focus on profitability (instead of market share) and its flexibility, both in terms of adjusting fleet size thanks to the staggered expiration of leases and ability to reassign aircraft to different markets.

As to the fleet strategy, LAN is adding mainly A320s and 767-300s and disposing of A318s and A340s. It will receive two new 777Fs this year and will take delivery of the first two of 32 ordered 787s in late 2012. It has also ordered 20 A320neos for delivery in 2017-2018.

LAN will be the first airline to operate the 787 in Latin America. The aircraft will initially fly between Santiago and Buenos Aires, Lima, Los Angeles, Madrid and Frankfurt, replacing A340s and 767s in those markets. It will free up A340s for expansion in the Australia/New Zealand markets.

TAM, too, is growing its Airbus narrow-body fleet and continuing to take more 777-300ER deliveries. The airline is committed to deploying the 777s on its European routes and will also take that aircraft to Miami in October.

The LAN and TAM fleets are already fairly streamlined and broadly compatible and there is not much scope to rationalise them, but Latam's leadership has mentioned that it may seek to reduce the number of aircraft types.

The global alliance decision

One of the toughest decisions still facing Latam is the choice of a global alliance. LAN is a longtime member of oneworld, while TAM has been a member of Star since 2010. One of the conditions imposed by the Chilean and Brazilian antitrust regulators is that LAN and TAM may not belong to more than one global alliance after the end of a 24-month period following the closing of the merger.

It is a pity that the regulators ruled out the potentially interesting solution of LAN and TAM belonging to different alliances, because none of the alternatives seem that good. If the choice is oneworld, there could be serious negative effects for TAM and the Brazilian market - a key growth area and a top priority for Latam.

Choosing Star could be impossible, or at least extremely problematic, because of the Chilean antitrust authority's ruling that Latam could not belong to the same alliance as AviancaTaca (which has just joined Star).

When the merger closed, Latam's leadership stressed that joining oneworld was not a foregone conclusion and that there were "several options". Industry observers have suggested that the options may include TAM becoming independent, LAN and TAM going for the third alliance (SkyTeam) or AviancaTaca leaving Star. In the second-quarter call, Latam executives merely stated that all the different options had been evaluated, that no definite decision had yet been reached, and that there was a need to "clarify" the matter by the end of the year.

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		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Air France/	**Year 2009/10**	**29,096**	**31,357**	**-2,261**	**-2,162**	**-7.8%**	**-7.4%**	**251,012**	**202,453**	**80.7%**	**71,394**	**104,721**
KLM Group	Apr-Jun 10	7,301	7,469	-168	939	-2.3%	12.9%	60,345	49,283	81.7%	17,623	102,918
YE 31/03	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**
	Jan - Mar 12	7,400	8,058	-658	-482	-8.9%	-6.5%	63,391	51,733	81.6%	17,463	101,222
	Apr - Jun 12	8,351	8,920	-569	-1,150	-6.8%	-13.8%	67,456	55,820	82.8%	19,980	
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												
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**
	Jan - Mar 12	5,136	5,463	-326	-240	-6.4%	-4.7%	51,425	39,140	76.1%	11,384	56,532
	Apr - Jun 12	5,926	5,931	-5	-72	-0.1%	-1.2%	55,851	45,421	81.3%	14,347	60,418
Iberia	**Year 2009**	**6,149**	**6,796**	**-647**	**-381**	**-10.5%**	**-6.2%**	**62,158**	**49,612**	**79.8%**		**20,671**
YE 31/12												
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	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**
	Jan - Mar 12	8,675	9,174	-499	-520	-5.8%	-6.0%	59,648	44,242	74.2%	21,867	120,898
	Apr - Jun 12	10,136	9,673	464	294	4.6%	2.9%	69,228	53,384	77.1%	27,483	117,416
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	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**
	Jan - Mar 12	1,419	1,548	-128	-108	-9.0%	-7.6%	8,701	5,943	68.3%	6,416	14,836
	Apr - Jun 12											
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%		
	Year 2011/12	**6,053**	**5,112**	**942**	**772**	**15.6%**	**12.8%**			**82.0%**	**75,800**	
	Apr - Jun 12	1,648	1,480	170	127	10.3%	7.7%			82.0%	22,500	
easyJet	**Year 2007/08**	**4,662**	**4,483**	**180**	**164**	**3.9%**	**3.5%**	**55,687**	**47,690**	**85.6%**	**43,700**	**6,107**
YE 30/09	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**	
	Oct 11 - Mar 12	2,302	2,458	-156	-141	-6.8%	-6.1%	30,785	27,329	88.8%	25,200	

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

		Group revenue US$m	Group costs US$m	Group op. profit US$m	Group net profit US$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Alaska	**Year 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**
	Jan - Mar 12	1,039	967	72	41	6.9%	3.9%	11,819	10,029	84.9%	5,995	11,832
	Apr- Jun 12	1,213	1,087	116	68	9.6%	5.6%	12,776	11,054	86.5%	6,565	11,965
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
Chapt. 11 from Nov 29	**Year 2011**	**23,957**	**25,127**	**-1,170**	**-1,965**	**-4.9%**	**-8.2%**	**248,349**	**203,562**	**83.9%**		
	Jan - Mar 12	6,037	6,126	-89	-1,660	-1.5%	-27.5%	61,021	50,722	83.1%		
	Apr - Jun 12	6,452	6,310	142	-241	2.2%	-3.7%	61,618	52,441	85.1%		78,100
Delta	**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**
	Jan - Mar 12	8,413	8,031	382	124	4.5%	1.5%	87,559	69,765	79.7%	37,557	78,761
	Apr - Jun 12	9,732	9,598	134	-164	1.4%	-1.7%	95,563	80,497	84.2%		80,646
Southwest	**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**
	Jan - Mar 12	3,991	3,969	22	98	0.6%	2.5%	49,298	38,116	77.3%	25,561	46,227
	Apr - Jun 12	4,616	4,156	460	228	10.0%	4.9%	53,623	43,783	81.6%	28,859	46,128
Continental	**Year 2009**	**12,586**	**12,732**	**-146**	**-282**	**-1.2%**	**-2.2%**	**176,305**	**143,447**	**81.4%**	**62,809**	**41,000**
United	**Year 2009**	**16,335**	**16,496**	**-161**	**-651**	**-1.0%**	**-4.0%**	**226,454**	**183,854**	**81.2%**	**81,246**	**43,600**
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
	Apr - Jun 12	9,939	9,364	575	339	5.8%	3.4%	103,986	87,692	84.3%	37,071	84,500
US Airways Group	**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
	Apr - Jun 12	3,754	3,350	404	306	10.8%	8.2%	37,072	30,908	83.4%	21,206	31,467
JetBlue	**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
	Apr - Jun 12	1,277	1,147	130	52	10.2%	4.1%	16,030	13,674	85.3%	7,338	12,308

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 2007/08	13,063	12,322	740	563	5.7%	4.3%	90,936	61,219	67.3%	50,384	
YE 31/03	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
	Year 2011/12	16,008	14,887	1,121	347	7.0%	2.2%	91,162	59,940	65.8%	44,903	
Cathay Pacific	Year 2008	11,119	12,138	-1,018	-1,070	-9.2%	-9.6%	115,478	90,975	78.8%	24,959	18,718
YE 31/12	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	
	Year 2012											
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	
	Year 2010/11	16,018	13,802	2,216		13.8%		86,690	59,740	68.9%	34,795	
	Year 2011/12	14,166	12,117	2,049	2,194	14.5%	15.5%	71,202	48,217	67.7%	25,441	32,000
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 2006/07	9,555	8,688	866	1,403	9.1%	14.7%	112,544	89,149	79.2%	18,346	13,847
YE 31/03	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	
	Year 2011/12	9,664	9,519	145	270	1.5%	2.8%	113,410	87,824	77.4%	17,155	13,893
Air China	Year 2007	6,770	6,264	506	558	7.5%	8.2%	85,257	66,986	78.6%	34,830	19,334
YE 31/12	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	
	Year 2011	15,260	14,289	971	1,095	6.4%	7.2%	113,987	93,185	81.8%	48,671	
China Southern	Year 2007	7,188	6,974	214	272	3.0%	3.8%	109,733	81,172	74.0%	56,910	45,474
YE 31/12	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	
	Year 2011	14,017	13,342	675	944	4.8%	6.7%	151,074	122,342	81.0%	80,674	
China Eastern	Year 2007	5,608	5,603	5	32	0.1%	0.6%	77,713	57,180	73.6%	39,160	40,477
YE 31/12	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	
	Year 2011	12,943	12,296	647	689	5.0%	5.3%	127,700	100,744	78.9%	68,681	57,096
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..

	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
June '12	31.5	23.8	75.6	23.3	20.9	89.8	17.9	14.9	83.5	59.1	50.5	85.4	89.4	73.6	82.3
Ann. change	3.3%	4.3%	0.7	2.5%	5.3%	2.3	4.6%	10.1%	4.2	3.8%	7.2%	2.7	3.9%	6.9%	2.4
Jan - Jun '12	169.7	120.1	70.8	119.2	98.7	82.8	103.5	82.6	79.8	333.8	271.4	81.3	497.7	388.2	78.0
Ann. change	1.3%	4.4%	2.1	0.8%	4.3%	2.8	4.8%	7.4%	1.9	3.7%	6.4%	2.1	3.1%	6.2%	2.3

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	02 Aug	EL AL	2 x 737-900ER	
	20 July	Korean Air	2 x 777-300ER	
	19 July	Ethiopian Airlines	1 x 777-200LR	
	12 July	United Continental	100 x 737MAX9, 50 x 737-900ER	
	09 July	Air Lease Corp.	60 x 737MAX8, 15 x 737MAX9	
	06 July	Virgin Australia	23 x 737MAX	plus 4 options
Airbus	12 July	Synergy Aerospace	6 x A330-200, 3 x A330-200F	
	12 July	UTair	20 x A321	
	11 July	CIT Group Inc.	10 x A330	
	10 July	Cathay Pacific	10 x A350-1000	
	10 July	Drukair	1 x A319	

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