

IAG Group: The contrast between BA and Iberia.

The annual capital markets day from International Consolidated Airline Group (IAG) at the beginning of November portrayed the usual mixture of positives, negatives, aspirations, plans, acquisitions and inevitable restructuring details. The most notable element was that performance at British Airways was relatively good - albeit offset in the current year by the increase in fuel prices - but that the problems in Spain and at Iberia were severely undermining the group's outlook.

The event took place on the same day as the announcement of the group's third quarter results. In the three months to end September 2012, the group saw revenues up by 13% on the back of a 5% increase in capacity and traffic, and a 9% increase in unit revenues. The increase in unit revenues appears high but was specifically affected by the weakness of the Euro against Sterling and the US Dollar in the period. In fact the quarter suffered severely from the London Summer Olympics, which had the expected impact of diluting traffic mix, reducing yield and demand. For the group, operating profits came in at €270m before exceptional items against €363m in the prior year period - diluted by some €30m losses on the British Midland operations acquired earlier in the year. Unit costs grew by over 10%, while non-fuel unit costs were up by 8% year on year. On a "like-for-like" basis, unit revenues fell by 0.3% year-on-year, unit costs grew by 0.8% (and ex-fuel unit costs were up by 0.2%). British Airways apparently registered all the profits; Iberia in contrast merely broke even in the main summer season.

For the nine months to end September, group revenue grew by 11% to €13.6bn with bmi accounting for 3% of the increase and exchange rate movements for 5.5%. Capacity was up by 3% (impacted by the strikes at Iberia in the early part of the year) and unit revenues grew by 9% (or 3% at constant exchange rates). Operating costs grew by 15% (with a 24% hike in fuel costs) and operating profits came in at a mere €17m, down from €451m in the previous year.

For the remainder of the year, there appears to be some optimism that the dilution that arose around the Olympics on BA's operations has disappeared and that yield and unit revenue growth is resuming. However alongside the continued weakness in Iberia's core operations and the impact of hurricane Sandy, the group expects to make a significant fourth quarter loss and gave guidance for a full year operating loss of €120m (after bmi trading losses and exceptional items, but not allowing for labour disruption in Madrid).

Vueling integration

At the same time the group announced a bid for the 54% free float in Vueling it does not already own. The management were eager to

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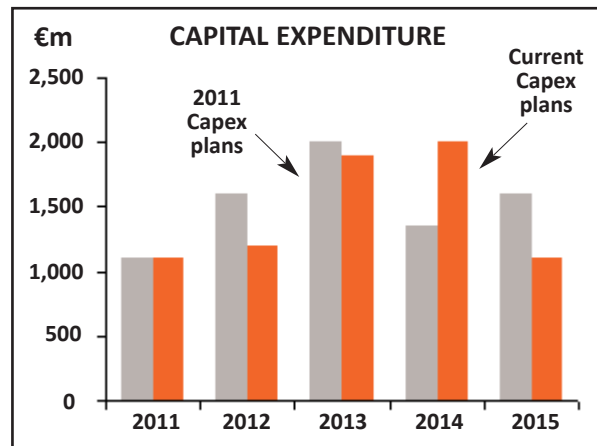
point out that Vueling will be managed as a separate operating company within the IAG umbrella reporting to the IAG CEO Willie Walsh - and that there would be no attempt to integrate with IB Express. It will only cost €113m in cash, will be funded from internal resources, and is expected to be completed in the second quarter of 2013, subject to regulatory and stock market approval. There should be no competition issues: following the merger between Iberia's Clickair and Vueling the local authorities have treated Vueling as part of the Iberia group.

Vueling will bring a profitable operation (even in the current year with the extreme Spanish economic slowdown), a fleet of 55 A320s, a strong position as Catalonia's effective flag carrier with 30% of operations at Barcelona's El Prat airport (which it operates as a hub, Barcelona being the fourth largest real O&D airport in Europe), and strong growth potential. It also operates bases at Amsterdam and Rome Fiumicino. As a hybrid LCC, there may even be some further potential group synergies e.g. through intensified code shares; it has had a reasonable track record of cooperation with other network carriers.

Synergies and financial targets

At IAG's inaugural capital markets day last year the management presented its strategic target of achieving €0.52 earnings per share and a 12% return on capital employed in 2015. This effectively equated to a level of operating profits in that year of €1.5bn and a near 10% margin: a strategic plan redolent of a combination of BA's pre-merger plans and Iberia's love of five-year targets. The target, it was then explained, was based on expected 2011 operating profits of around €500m. The additional €1bn was made up of €150m organic growth, the creation of €450m in group-wide synergies (roughly half from revenues and half from costs) combined with €400m in underlying profit improvements at the two carriers.

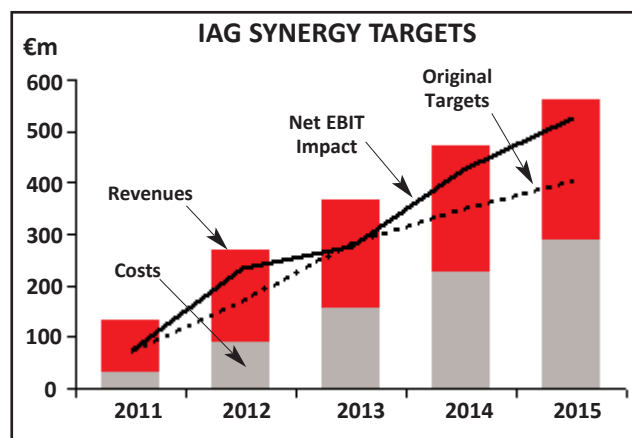
The targets presented this year were little different: the same €0.52 earnings per share and 12% return on capital by 2015. The operating profit target had been raised slightly to €1.6bn, mainly from the additional accretive benefits flowing from the acquisition of bmi. However, the baseline of profitability has



slipped significantly from the sizable problems and challenges in 2012: most notably the significant increase in fuel costs, the exceedingly weak Spanish economic environment and the additional trading losses from bmi in the first year of acquisition. Combined these have created an additional gap to fill of €625m.

One of the first responses is that the group has raised its estimate of total group synergies to €560m by 2015 and a net profit and loss impact of €525m in that year. Monitoring the performance of planned synergies defies analysis through published accounts; we have to take the company's word for the statement that it had already achieved a net annual benefit of €74m in 2011 and €235m in 2012. This gives them remaining synergies of some €280m.

Secondly the group has reduced its expectation of organic growth by half a percentage point - pointing to a 2% annual growth in capacity, which it is assumed will add €100m to operating profits rather than the original idea of €150m.



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Consequently to achieve the targets IAG will now need to find profit improvements of some €1.2bn (up from the €400m postulated last year). It has outlined three main elements:

Transform London: generate improvements of around €600m from

- bmi transformation (i.e. using the bmi slot portfolio efficiently to recover lost short-haul connections and introduce new (and reintroduce old) long-haul routes)
- create returns and synergies from the joint businesses on the Atlantic with AA (and on Asian routes with JL)
- improve asset turn
- short-haul strategy
- cost discipline

New fleet savings: to create benefits of around €250m

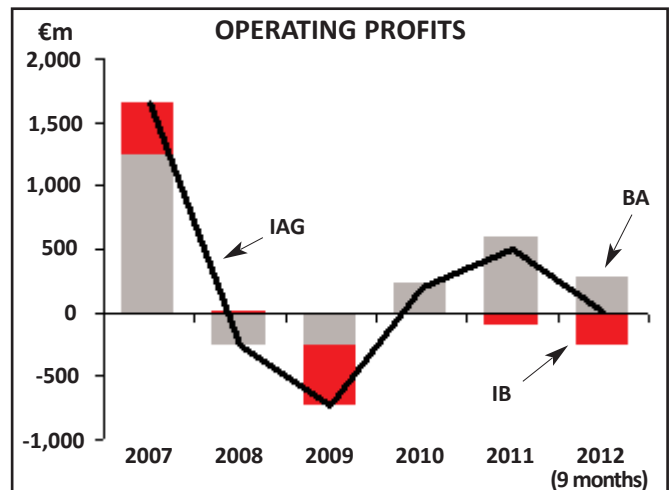
- The new BA long-haul fleet with A380s and the long awaited 787s will allow accelerated disposal of the 747 and 767 fleet, with new 777s for delayed 787s
- new leased twin engine A330s to replace the expensive four engine A340s, with an accelerated disposal of A340s

Transform Spain: to create benefits of around €450m

- Need to attend to labour cost competitiveness and realign to the “new normal”. The introduction of IB Express is a first step but does not go far enough. Significant restructuring is deemed required.
- New low cost platform. Although other LCCs have been exiting the Spanish market, there is little protection should the local economy recover.
- Potential acquisition of Vueling

Fleet plans

Last year the group had planned to increase its fleet from 344 units to 372 by 2015. With the problems in Spain and in a first stab at restructuring Iberia operations, the group now looks to reduce its fleet from 380 units (including 25 A320s from bmi) down to 358 by 2015 (see table, page 4). There are some tweaks in the BA long-haul fleet - with delays in the 787 deliveries they now only expect to take delivery of 12 of that aircraft type in the next three years (down from 16) but have upped the interim deliveries of 777s



to nine in the period, and at the same time look to accelerate disposals of older 747s. The major difference however is in the Iberia fleet plans. The current idea is to reduce the long-haul fleet to 29 A330/A340s from the current 33 (still taking delivery of 8 A330s from next year) rather than growing the fleet to 40 units. In addition, the company will be disposing of some 34 short-haul A320s - or a third of the fleet. The result of the changes has been to reduce total group capex between 2012 and 2015 to €6.2bn from €6.6bn (and heavily weighted to 2013 and 2014).

Transform Spain

Iberia probably had been hiding a little under the success of the Spanish economy in the run up to the 2008 financial crisis; but the disastrous impact of the recession there has highlighted the need for a complete restructuring - the company has been burning cash in the last three years, with cash balances down to €1.5bn at the end of September. The company's CEO Rafael Sánchez-Lozano presented the transformation plan the group is initiating - sadly unable to give too many details as the negotiations with the powerful unions had only just started.

Sánchez-Lozano stated the key objectives of the restructuring as:

- To stop Iberia haemorrhaging cash by mid 2013. This will involve negotiations with employee groups being concluded as quickly as possible - if they have not reached agreement by the end of January next year, they will accelerate the downsizing of Iberia, to safe-

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Analysis

	Aircraft	2012	2015	(last year's 2015 plans)	Deliveries 2012-15	Outstanding orders post 2015	Further options/ purchase rights
IB	A330/340	33	29	40	8		8
BA	747	52	43	45			
	767	14	7	1			
	777	52	58	54	9		
	787		12	16	12	12	28
	A380		9	9	9	3	7
	A318	2	2	2			
Total long-haul		153	160	167	38	15	43
IB	A320 family	77	52	76	9	8	
BA	A320 family	110	120	95	10		
	Other	40	26	34			
Total short-haul		227	198	205	19	8	
Total fleet		380	358	372	57	23	43

Source: IAG

guard the company's viability

- To give Iberia a competitive cost base for long-term growth: the IAG Group return on capital of 12% would imply a turnaround in profitability of at least €600m from 2012 levels at the proposed scale of Iberia – this is the minimum required to allow them to grow the business profitably in the long term.
- The transformation will be funded entirely through Iberia's own resources.

Last year they recognised that they had challenges that needed addressing.

- In the high fuel cost environment the A340s were uncompetitive on costs and the Iberia long-haul brand was "tired", not having been updated for thirty years. The first new (leased) A330 is due to enter service in January next year; and plans are still in place for a rebranding.
- The Madrid hub suffered from inefficiencies that affected punctuality, service levels and quality. Improvements in the last year have improved punctuality significantly.
- The short-haul operation was not competitive against low cost carriers: the introduction of Iberia Express (despite union opposition and even with only 14 aircraft) has possibly improved the position.

However, the company has lost over €850m at the operating level since the beginning of 2008. Cash balances have fallen from €2.27bn to €1.05bn at the end of September. Cash outflow from operations accounted for only €155m of the €1.2bn decline in cash balances; but early retirement payments totalled €455m, fleet investments €394m and debt repayments €335m. And the Spanish econo-

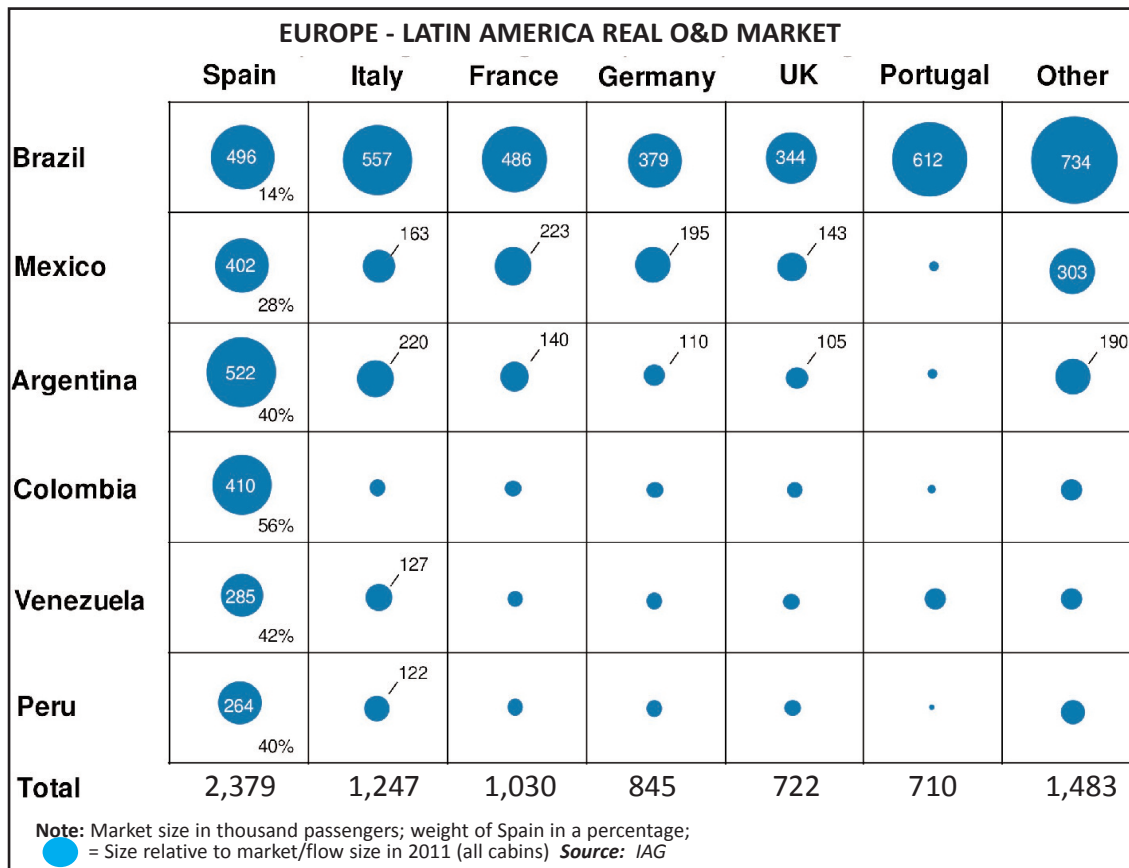
my is now expected to enter a severe double dip recession.

One of the major strengths of Iberia has always been seen as its position as a major gateway to South America. It is the third largest metropolitan area in the EU (behind London and Paris) with a population of just over 7 million; Madrid Barajas is the fourth largest airport in Europe; Madrid is present on six of the top ten O&D routes on the South Atlantic – to Caracas, Buenos Aires, Lima, Mexico, Quito and Sao Paulo. In the table (see page 5) we reproduce IAG's numbers showing the real O&D traffic between Europe and Latin America. This shows that local demand between Spain and South America accounts for 28% of the total demand and in some markets Spain accounts for over 40% of total demand (and 56% to Colombia). In contrast, Brazil alone accounts for 43% of the market between Europe and South America (for which Spanish demand accounts for only 14%) - and Iberia consequently has a relatively poor access into the strongest LatAm market.

The presence of high real O&D demand should make the basis for a strong connecting hub operation: and this indeed has been the focus since the expansion of Barajas with its third and fourth runways and the erection of Terminal 4. However it appears that the group management have only just discovered that the operation, in withdrawing from non-hub flying and concentrating on short-haul into Madrid, had been pursuing short/medium-haul connecting traffic, leading to significant short-haul losses.

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Analysis



The key components of the restructuring plan are:

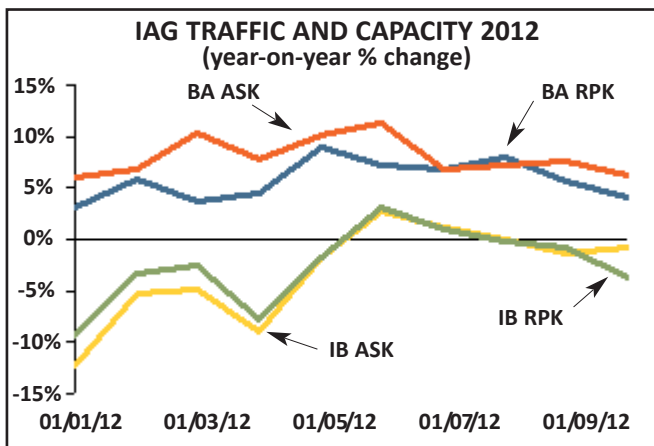
- Focus on the core network
- Network redesign.
- Suspend non-strategic, loss-making, routes and frequencies.
- Close the gap in cost, fleet and product.
- Keep effective feed for the long-haul network.

Taking a leaf out of BA's own restructuring a decade ago, Iberia will focus on long-haul premium markets and exit low margin flying that is based more on lower yielding leisure demand. It plans to realign its long-haul schedule to concentrate on routes that can support daily or double-daily rotations - among other things to optimise crew and other operating costs. It will concentrate on the short- and medium-haul routes that can provide relevant volumes and yields to its long-haul operations and/or those with reasonable margins. It will also selectively reduce frequencies on individual routes to drive profitability - always a little difficult to do without reducing the attractiveness of the product in the market place.

In 2013 it therefore plans a significant cut in operations. It is disposing of five of the long-haul A340s and 20 of the short-haul A320s. Total capacity in available seat kilometre terms is expected to decline by 15% year on year. It will be cutting the bottom 13 routes that are apparently currently losing €100m annually.

- Renewal of commercial plan.
- Narrow the unit revenue gap to competition with a commercial action plan providing a customer proposition that will ensure competitiveness.

The company was less clear on the proposals to fulfil this element of the plan. However, it is also likely to be taking benefit from BA's own experience in this area in introducing new sources of ancillary revenues - such as changes to the baggage policies, encouraging upgrades and up-selling, trying to encourage continuing channel shift in distribution. In the medium term it still recognises that it needs a re-branding at some point; this may in the short run be helped by new seating and cabin configurations on the introduction of the A330s next year.



- Short/medium-haul restructuring.
- Transform the short- and medium-haul operation, reducing the unit cost gap to low cost competition, delivering an efficient short- and medium-haul operation.

In a patent broadside to the unions the company stated that it “will reduce salaries” and improve productivity in the short/medium-haul mainline operations by getting similar salary and productivity levels for pilots and cabin crew as low cost carrier benchmarks. Iberia Express (which started in March amidst considerable union dissatisfaction and currently has 14 aircraft in operation) has apparently shown an excellent track record in unit costs, operational performance and customer satisfaction and, says Iberia, will continue to be central to its plans. It is aiming to extend the IB Express product to the rest of the mainline short-haul operations.

- Comprehensive Labour restructuring.
- Negotiate salary adjustments and productivity improvements to close the gap in labour cost and achieve a competitive and flexible cost structure.

The aim is to reduce salaries and increase productivity throughout the company. This will involve significant negotiations with the main unions in order to remove barriers in collective labour agreements, which in their words “prevent us from achieving a competitive cost base”. Along with the steep reduction in capacity the company will be looking to make some 4,500 positions redundant - over a fifth of the workforce. For those that remain, the company is targeting salary reductions of 25%-30% and removal of automatic annual increments.

- Restructure non-core businesses

- Secure competitive maintenance and handling costs for the airline
- End non-profitable third party activities

It is interesting that the Iberia MRO business is now being referred to as non-core. It had been one of the areas that the company had pursued for some time in order to reduce its own maintenance costs by increasing third party sales; which have grown from 30% of total divisional revenue to over 50%. It had also been touted as an area that could provide good group-wide synergies (since BA had itself disposed of its airframe and engine maintenance there had been the opportunity to “insource”). It currently runs four divisions covering line maintenance, heavy maintenance, components and engines (where it had some significant core competences, including RB211-535 and CF34 overhaul and repair licenses, and CFM56 parts repair license). The company was not being specific about its plans.

More clearly the company stated that it would discontinue all handling services outside Madrid - unless they can deliver acceptable profit margins (of between 10% and 20%). It currently has 21 licences to run third party handling at 36 airports in Spain - due to expire at the end of next year. For IAG, airport handling brought in revenues of €290m in 2011; and it is likely that only a handful of the Spanish licenses could be profitable.

Implementation

Implementing the restructuring plan is unlikely to be easy. There will be significant redundancy costs; and the difficult negotiations with the unions will include an attempt to discuss a satisfactory lay-off scheme (in IAG's view) - bringing maximum payouts down to the legal maximum of one year's salary. There will also be some costs inherent in the early retirement of some of the fleet and delays in future deliveries.

The company has started the negotiations and has bluntly stated that this is a “fight for survival”. It has given an ultimatum to the unions to complete negotiations (presumably satisfactorily) by the end of January in order to be able to put the adjustments in place for the 2013 Summer season; failing this, the company will implement further capacity reductions

in order “to preserve the viability of Iberia”.

The first reactions from the unions has, unsurprisingly, been negative. Three main unions (CCOO, UGT and SEPLA) issued a joint press release insisting that the management should take some of the blame, rejecting the plan for capacity reductions or the separation and disposal of MRO and ground handling, demanding that Vueling (if acquired) be integrated within Iberia rather than at the IAG level. It also included interesting demands that “[Iberia] maintains a proportionate level of growth in line with our partner airline in the merger and in the JBA” and that “no worker in Iberia, either ground staff, cabin crew or a pilot will lose their job whilst Iberia and its associate airlines maintain or increase their own capacity and operations”. Obviously this is a long way from the company's position.

While the plan is being pushed forward by CEO Rafael Sánchez-Lozano, and the company states that it will be accomplished using Iberia's own resources, the hand and experience of Willie Walsh is apparent. He after all successfully pushed through swingeing bits of union bashing at Aer Lingus and BA; and is not one to give in.

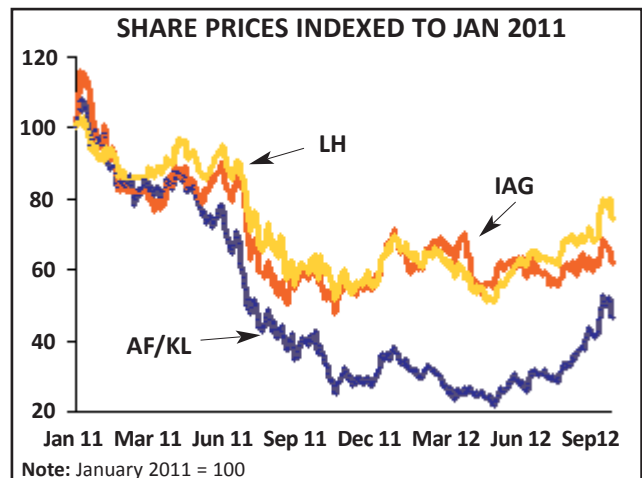
Transform London

The story at British Airways in contrast is encouraging. This year the strong increase in fuel costs is having a serious effect - but the airline should still end the year with a reasonable level of operating profits of around £250m.

The British Airways' management highlighted the strategic aims as transforming the profitability of BA through:

- partnerships
- new fleet
- revenue innovation
- cost discipline
- short-haul standalone profitability
- once-in-a-lifetime opportunity from bmi
- balancing customer and commercial focus with cost discipline
- determination to provide a return on capital that the brand franchise deserves.

The acquisition of bmi from Lufthansa may be described as transformational. In one go it has allowed BA to recover a significant slug of slots at the constrained Heathrow, to put it



above 50% share of operations, allow it to reinstate some of the short-haul feed it has had to abandon in favour of long-haul, and allow it room to introduce new (and sometimes reintroduce old) long-haul services.

The company states that integration is virtually complete while trading losses at the bmi operations have been halved from the prior year proforma £200m (it expects breakeven mid-2013). In the current winter season it has allowed BA to add 20 routes to the Heathrow network, extra capacity on eight existing routes and timing improvements across the network; although it is unfortunately back into the position of operating from three terminals at the base airport and is unlikely to be able to consolidate all operations into Terminals 3 and 5 until 2014. BA appears comfortable that the bmi slots will add an effective £100m to operating profits by 2015.

Partnerships

BA also gave a few comments on the development of the ATI joint venture on the Atlantic with American and Iberia - what it terms the North Atlantic Joint Business. After two years of operation it has seen an 11% growth in capacity, basically as a catch up for the pre-ATI constraints, with a revenue increase of 23% (and unit revenues up by 10%), share of premium traffic up by 1.6 percentage points, share of non-premium up by 1 point and premium load factors increased by 4 points to 77%. The number of corporate deals with transatlantic code share has been ramped up significantly from 150 at the

beginning of 2011 to over 700 now; while the proportion of JB passengers on BA's own metal has risen from 5% to over 20% in the period. Of course because of the wonders of joint venture accounting the results are not easily discernible in the published figures, but the company is seeing this as a major focus in its aims to reach the group financial targets for 2015.

Little meanwhile was said on the development of the joint venture with JAL (which was only launched in October) save that within a month 10% of passengers on its services were booked on the JL code of which 95% had been booked in Japan - a notoriously difficult distribution market for non-Japanese companies. In contrast Walsh appeared unconcerned that long term partner Qantas had withdrawn from the Kangaroo route joint venture and switched allegiance to Emirates.

The management emphasised that its short-haul operations were a clear priority, even stating (perhaps vainly hoping) that short-haul needs to be profitable in its own right, as well as feed long-haul. They stated that they now have a good competitive cost base at Gatwick "at LCC levels" and that the bmi acquisition will bring further synergies at Heathrow.

One major benefit coming through to BA will be the long awaited long-haul fleet replacement programme. Next year the company will take the first of its A380s and 787s - and plans to take on 27 new long-haul aircraft in the next three years. This will allow the retirement of older 747s and 767s (with some interim 777s helping for the additional delays in the 787). The new aircraft, it states, will create fuel savings of £150m a year in 2015 (at \$110/bbl). The company still has a lot of flexibility (especially regarding retirements) but at the moment is assuming annual capacity growth of 2-3% per annum to 2015. This will be biased towards North America, Asia and partner hubs.

On the cost side the management stated a clear aim to hold non-fuel unit costs at 2012 levels, i.e. impose a cost discipline to offset inflation. This would equate to annual cost cuts of £200m at current inflation levels. Part of this is already in place with the establishment of the mixed fleet crew complement - which by 2015 should provide £80m incre-

mental benefits - but obviously this will need further structural change internally.

Conclusions?

The merger between British Airways and Iberia was long in the making (the first moves being more than a decade ago); and during the intense negotiations in 2008 and 2009 there would have been few who would have thought that the economic environment would change so disastrously over the following few years. At the time of the merger agreement, the relative value of BA was reduced by the 20% decline in the value of Sterling and the overhang of their pension liabilities. It is entirely possible at this year end that IAG will have to write down the implicit goodwill on the investment in Iberia as an impairment loss, which former British Airways' shareholders may consider an additional insult.

IAG established itself as a vehicle for airline consolidation that could easily absorb new acquisitions. The first of these is relatively small - Vueling - but gives access to an interesting sector of the market. The group meanwhile has walked away from TAP after showing initial interest and at the moment it is difficult to see where there may be realistic further targets.

It must be difficult indeed in merger discussions, when both sides agree to the strategic necessity, to stand away and consider the negative scenarios; but here we now have a significantly negative scenario. British Airways itself seems very much on normal track, but the restructuring of Iberia looks as if it is going to be a tough fight; and a view that the Spanish unions' stance might be softened by the similarly significant restructuring planned at SAS (where it appears most of the unions have agreed to the plans) may be optimistic. If union negotiations fail, is it a far flung thought that Iberia may be allowed to go bust?

Going on Willie Walsh's past performance in similar circumstances there is the possibility that the idea will work. It may nevertheless be a painful uphill struggle to achieve the needed €600m turnaround at Iberia to reach the group's stated targets for 2015.

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London's capacity conundrum

The debate on the need for and location of additional capacity for London's air transport demand has been running for a long time. Those with long memories will recall the Maplin airport debate from the early 1970s, which was killed off by the oil crisis of the period. Fortunately, that oil crisis led to reduced growth in demand. Reduced demand coupled with more intense use of London's other airports meant that London (still the world's largest origin and destination market) has continued to cope with its existing airport infrastructure of six major airports. But most accept that the existing system is approaching saturation so the debate on where to provide additional capacity has come alive again with the Davies report due to make its initial findings public at the end of 2013.

Interested parties such as Heathrow Airport are making their views known with a report by Frontier Economics (see note below) claiming that a lack of capacity is 'costing' the UK £14 billion a year in lost trade, a figure that will rise to £26 billion by 2030.

To all intents and purposes, Heathrow is completely full in terms of aircraft movements and Gatwick is close to capacity. However, with the expected growth in passengers per ATM and some infilling of off-peak periods current capacity for London's airports is estimated to be as illustrated in the table on the right.

To meet increased demand, five possible airport development scenarios exist:

A new airport in the Thames Estuary

This is the option preferred by the Mayor of London as it keeps additional capacity away from built up areas with lots of voters. This scheme is also supported by the construction sector due to the scale of the construction projects that would result. The airport would open in the 2030s probably with at least four parallel runways and capacity for at least 120 million passengers.

Demand comes from flights transferred from Heathrow and other London airports. Heathrow is either shut or reduced in operations to a small 'city' airport handling no more than 20 million passengers a year. Access to Central London and to the West would be provided by high-speed rail.

A third runway at Heathrow

A third runway built at Heathrow is the option preferred by the airlines, it preserves and enhances the role of Heathrow as a global hub, it minimises costs to airlines and passengers. In economic terms, this option produces the highest returns. There has also been talk of a four-runway airport being the ideal requirement. Whilst this is true, this requirement is a long way in the future at a point at which there is much uncertainty about the nature of this demand and how it should be met.

A second runway at Gatwick

A second runway is built at Gatwick opening in 2025. This option satisfies the demand for additional capacity in the region but is less popular with airlines as the number of connecting flights is limited and most Heathrow airlines do not use Gatwick.

An expansion of Stansted or Luton

An expansion of Stansted is seen by some as an alternate to building a new airport in the Thames Estuary. It is not seen as

LONDON'S AIRPORTS EXISTING CAPACITY

Airport	Annual Passenger Capacity	2011 Annual Traffic vs historic peak
Heathrow	86 m	69 m / 69 m
Gatwick	42 m	34 m / 35 m
Stansted	35 m	18 m / 24 m
Luton	18 m	10 m / 10 m
City	8 m	3 m / 3 m
Southend	3 m	0 m / 0 m
Total	192 m	134 m / 139 m

Note: 'One Hub or None'
<http://www.frontiereconomics.com/europe/en/news/1163/>

a viable answer by network airlines due to the airport's recent experience of falling demand. The other issue for most airlines is the lack of feed from a short-haul market due to the entrenched presence of Ryanair and easyJet, which means that the short-haul market out of Stansted cannot be served profitably by conventional network carriers. The same situation also exists at Luton.

No new runways in the South East

This is preferred option of those concerned about the environmental effects of adding airport capacity. Supporters of this option suggest that regional airports and high-speed rail can pick up some of the demand. 'Excess' demand in the London region can be controlled by increased Air Passenger Duty (taxes paid by the passenger) offset by lower APD rates in the regions.

Questions demanding answers

The UK Department for Transport (DfT) does not publish unconstrained forecasts for London, but if one takes the long-term drivers of demand defined by the DfT for the UK as a whole and apply to London traffic (assuming a gradual shift of regional demand from London's airports to the regions), then a trend demand forecast could be shown as the graph below. The graph assumes fuel and taxation levels increase with an impact equivalent to 1.0% per annum, long-term trend GDP growth of 2.25% and the DfT's suggested multiplier of

1.3 (declining 0.05 each decade). We also assume that the transfer traffic grows at an equivalent rate to UK origin and destination demand.

The Mid forecast is derived from DfT demand forecasts for the UK as a whole whilst the illustrative Low forecast uses lower GDP and lower multiplier plus a price effect equivalent to a 1% per annum to produce a substantially lower forecast.

In the Mid case, demand forecasts suggest that the current London system will run out of capacity during the 2020s. Even the illustrative Low case leads to a need for a single new runway during the 2030s. In reality, a perfect allocation of demand to capacity is unlikely due to airline and passenger preferences for particular airports so the above timescales understate the lack of demand at the airports of first preference.

• Can growth be controlled using taxation?

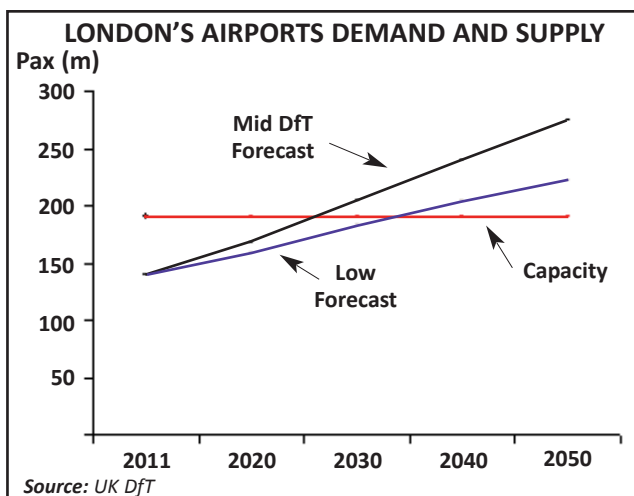
One potential solution is to increase taxation on aviation (a lightly taxed industry according to many) such that demand is contained within the existing infrastructure. But the question has to be what type of demand to tax? Short-haul demand and transfer traffic are the two obvious candidates as these sectors can use alternate airports or modes.

Short-haul routes

Apart from Eurostar and a handful of ferry routes there is little alternative to flying to most international destinations. Even Amsterdam (230 miles from London) is a trip made mainly by air as travel by rail takes five hours. In reality, short-haul air travel only exists to feed the long-haul network or due to Britain's status as an island. Short-haul domestic routes have reduced considerably, partly because of investment in the rail system but 40% of the domestic traffic into London's two main airports are actually transferring on to other longer-haul flights and make up a comparatively small proportion of slots at both the main airports so there is not much to be gained.

Transfer traffic

34% or 23 million passengers flying through Heathrow are transfer passengers of whom an estimated 28% (18 million) are international to international transfers.



Surely an obvious target for diminishing by taxation? An airport the size of Heathrow will always have connecting passengers, their presence enables airlines to fly routes that would not otherwise be sustainable. The airlines will argue that reducing connecting traffic over Heathrow will merely lead to fewer direct routes and smaller aircraft. On average 47% of British Airways passengers are connecting, as are 44% of Air Canada, 33% of South African Airways and even 19% of Lufthansa and 12% of Air France passengers. On particular routes more than half the passengers can be connecting onto other flights, the economics of a daily service might not be viable without connecting passengers on routes such as Seattle, Phoenix, Chennai and Bangalore to name a few. A tax on transfers could lead to a significant reduction in London's long-haul air network and potentially damage London's role as a business city. For UK regions, the impact of losing access to the global aviation network is also a concern. However the counter to that particular argument is the existence of air services from the regions to other hubs (Amsterdam, Paris, Frankfurt and Dubai all have extensive connections to UK regional airports).

Increased Use of Surface Modes

High-speed rail has done a good job of replacing short-haul air travel in markets such as Germany and France but so far not in the UK where the planned route of the proposed North-South High Speed 2 rail line does not serve Heathrow (a proposed station at Acton is 15 minutes by train from Heathrow).

Where rail does form an effective replacement to air travel, rail will take significant traffic from competing air services. The success of the high-speed Eurostar services serving Paris and Brussels from London and the success of improved conventional rail services between London and Manchester both illustrates this. However, neither rail services have eliminated air services between London and these three cities. There are three main reasons why short distance air services have not been eliminated:

- The remaining passengers are often transfer passengers using London as a transfer point to transfer to a more distant ultimate destination;
- The train services only serve London's central area and are not as convenient as the airports for many passengers; and
- Airlines can compete on price.

The table below illustrates how little Heathrow traffic could be diverted to a high-speed network. Even assuming destinations as far distant as Frankfurt and Dusseldorf could be diverted (needing a direct rail link to Heathrow taking no more than three hours) only some 10 million passengers or 15% of traffic could be diverted to rail.

RAIL DIVERSIONS?			
	Core	Rail replaceable	Total
Domestic	1.37	4.70	6.07
EU	17.36	5.88	23.23
Other Europe	5.38	0.00	5.38
Long-Haul	36.07	0.00	36.07
Total	60.18	10.58	70.76

Diverting Demand to Regional Airports

A common cry of regional politicians and UK regional airports is that the UK regions have the capacity to soak up much of the excess demand from the London airports. Their case is supported to a certain extent by CAA ultimate origin and destination statistics that show many millions of passengers travelling to and from London to catch flights from London's airports. Only 74 million (72%) passengers out of 103 million origin destination passengers at London's four largest airports had their ultimate O&D in the South East. The other 28% (or 29 million) had ultimate O&Ds in the Regions. Simplistically, these 29 million passengers would have possibly preferred to use their local airports.

The reason why this is not possible is down to the airlines, they have not found a profitable way to serve those 29 million passengers. There are very few barriers to airlines to fly from say Manchester to Los

Angeles and Manchester airport would be delighted to offer incentives to do so. The harsh reality is British Airways did fly the route briefly but withdrew despite high load factors presumably because they could not make viable financial returns. However, airlines such as Emirates have found a way to serve regional airports profitably so in the future it is likely that more routes will become viable in the longer term, especially with the advent of lower cost long-haul capacity such as the 787. Like high-speed rail, attracting (not diverting) air services to the regions helps capacity in the South East but is very unlikely to provide more than a marginal contribution to meeting the London capacity demand. Regional air services should be encouraged where financially feasible.

What is the Business Case?

An additional runway at Heathrow is what the aviation industry wants. Most airlines wanting access to Heathrow are willing to pay for it and the economic benefits are stated to be in the billions.

A three runway Heathrow would probably have capacity in the order of 120 million passengers a year. Using a similar approach to the previous illustrative forecasts, 120 million capacity could last up to 2050 depending on economic growth and the selective use of the APD to control demand.

Why is expansion at Heathrow so unpopular?

However, the whole idea of expanding Heathrow is deeply unpopular in the area around Heathrow on noise, congestion and pollution grounds even though the proposal is that the third runway be restricted to narrow body flights only. Partly environmental problems can be addressed by compensation, noise insulation and a switch to rail rather than road access. However the issue remains; Heathrow and its flight paths are situated in densely populated and wealthy areas. Many of the local inhabitants place a very high price on living where they do, probably a much higher price than any compensation scheme on offer, this does suggest that higher levels of compensation may be part of the answer. As was the case with the Olympics, removing car parks alleviated much of the traffic conges-

tion issues and drove Olympics spectators onto the public transport network. Harder to achieve with passengers carrying baggage but compared to other airports such as Amsterdam and Frankfurt, Heathrow access to anywhere but Central and West London remains poor hence public transport only achieves 41% market share, there is much more that could be done to improve rail access to London, starting with changes to the proposed HS2 route and access to the Great Western and Southwest rail lines.

Is Gatwick an alternative solution?

Gatwick's new owners are examining the idea of a second parallel runway. No actual physical construction work can start prior to 2019 (due to an agreement with local authorities), but given the planning issues any such scheme will raise, that date should not be a hindrance.

The key question is will demand be sufficient to finance a second runway? A third runway at Heathrow would likely lead to a mass exodus of some Gatwick flights to Heathrow in the short term (up to 5 million passengers depending on what scenario one uses) but in the long-term Gatwick is the favoured point of departure for about 20% of the London market given its excellent rail access and wealthy hinterland. It is likely that much of the increased demand unleashed by a second runway would in fact come from Stansted and Luton due to the higher yields historically earned at Gatwick.

In the long-term a second runway at Gatwick is probably justifiable economically but investors will require considerably certainty before financing it. That means that everyone will need to have confidence in the outcome at Heathrow before committing to financing a new runway at Gatwick.

If no third runway was built at Heathrow and a second runway built at Gatwick it is likely that network carriers would incrementally build up services connecting Gatwick to other hubs. Apart from a minor role as a hub already (13% of passengers are connecting) Gatwick's main role is likely to be as a feed 'spoke' to other hubs for network carriers such as Emirates and Korean. But the experience post the liberal-

isation of the USA bilateral where virtually all the USA bound flights (except to Florida) transferred to Heathrow illustrates the problems Gatwick has attracting airlines if not passengers.

Expansion of Stansted or Luton Airports

The only votes in favour of these proposals are probably from those opposed to expansion at Heathrow and Gatwick. The main obstacle to these proposals is a lack of demand from airlines, who like it or not control the market. In particular, the main problem for most airlines are the existing incumbents: easyJet and Ryanair. These two low-cost Goliaths would make it very diffi-

cult for any new short-haul airline to enter these two markets.

At present, it is very hard to see how expansion at either Stansted or Luton could be financed given the opposition of the existing airlines using these airports to increased fees. The likes of Ryanair will point to the decline in traffic at Stansted in recent years as evidence that the existing fees are too high never mind the fees for a new runway. In reality, the existing airlines would probably prefer to keep both airports as they are, content to collect increasing fare revenues as capacity gets tighter in the London market rather than pay more to

HUB FAILURES

London-Stansted

As originally planned, Stansted was developed in 1991 as a reliever hub airport for London with a modern terminal, transfer systems and a rail link to central London. It never succeeded in this original aim. Airlines such as KLM and American Airlines came and went. In the end they were replaced by Ryanair, which pioneered low-cost travel in Europe using Stansted as its main base. Since then, Stansted has been almost exclusively used by the low-cost sector, unable to attract other airlines to serve the airport.

Tokyo-Narita and Osaka-Kansai

Intended to be a new hub for Tokyo, Narita opened in 1978. The concept failed as the existing Haneda airport remained open so almost no domestic feed traffic was available. This coupled with only a single runway meant that Narita was effectively bypassed and its status in the global aviation network diminished. Capacity issues meant that some international flights were allowed back into Haneda at off peak periods. Narita is now trying to attract low-cost traffic despite some of the highest airport fees in the World. An identical situation also occurred at Osaka-Kansai.

Montreal-Mirabel

Built to replace Dorval in 1975, the airport was never popular due to its lack of domestic flights and connections and poor surface access. In the end, the airport's original role was abandoned and international flights were allowed back into Dorval where they have remained ever since.

Milan-Malpensa

Malpensa was opened as a 'new' airport for Milan in 1999. The existing airport at Linate remained open for Intra-EU flights. Alitalia transferred its hub from Rome to the new airport but continued to serve Linate as well. The costs of maintaining two networks into both Milan airports were partially responsible for the airline nearly collapsing. In the end Alitalia returned its hub to Rome and apart from a few Extra-EU services abandoned Malpensa. Malpensa has since been successful in attracting LCCs by offering lower charges.

let competition in.

A New London Airport in the Thames Estuary

One proposal is to build a new hub airport for London with at least four runways on a site in or adjacent to the Thames Estuary, possibly in association with a new Thames barrier with high-speed rail links to Central London. What are the issues:

- No demand (which airlines would serve the airport?);
- Heathrow and Gatwick compensation;
- High cost (who is going to pay?); and
- Poor access to rest of UK (how would passengers coming from the West of London or the regions access the airport?)

Dealing with these issues, how would one go about financing an Estuary airport?

Demand

The first issue to address is that of demand. To be a successful hub requires a successful hub airline. Schemes to launch a

new hub airport occur ever so often but as the five examples below suggest, success is not guaranteed, especially if the existing hub airport remains open.

Enforced transfer of air services to a new airport

To succeed, the Estuary Airport would require the transfer of many air services to the new airport. This approach has been used in the USA, where Dallas Fort Worth was made a success by forcing all but Intra-State and bordering States air services to transfer to the new a airport. A similar approach was adopted in the Washington and New York areas. In Europe, the rules have to comply with European competition rules covering competition between airlines. The proposal to make Linate an airport only serving flights to Rome failed. Instead flights had to be allowed to all the major hub airports in Europe. This competition crippled Malpensa's network and con-

POSSIBLE TRAFFIC DISTRIBUTION RULES FOR HEATHROW AND OTHER LONDON AIRPORTS

Ban Extra-EU Flights

Administratively simple, largely destroys Heathrow's role as a hub by removing 41 m passengers but would require BA to provide a large Intra-EU network at the Estuary Airport, probably at a loss. Likely impact? See Malpensa or Narita. Heathrow would probably reduce to about 20 m passengers initially but without further restrictions it is very likely that there would be large-scale market entry into Heathrow by other airlines including LCCs.

Even under this rule, some Extra-EU flights would serve Gatwick or other London airports. It is possible to see a scenario whereby demand at the Estuary airport is as low as 30 m passengers, way below the 120 m capacity proposed. In reality, Extra-EU flights would probably have to be banned from other London airports.

Perimeter Rule

All flights beyond a certain distance would be banned from Heathrow. This approach is used in the US in markets such as Dallas, New York and Washington. A similar outcome to the Extra-EU ban with fewer passengers at Heathrow (under 15 m) and more passengers at the Estuary airport (around 40 m).

Again, there is a real risk of leakage of passengers to Gatwick and other London airports without further traffic restrictions.

Rationing

This is similar to the Malpensa Traffic Distribution Rules whereby only thick routes have access to Heathrow in return for operating flights into the new airport. All other routes are diverted to the new airport. Deeply unpopular with airlines resulting in capacity not being expanded. Similar risks as above.

Aviation Strategy

Analysis

tributed to the near collapse of Alitalia.

Since almost all agree that the stated point of a new estuary airport is to provide London with a new hub, it has to gain a hub airline, the most obvious candidate being British Airways. What would make BA transfer to the new airport, located as it is on the wrong side of London? There are a number of prerequisites that ideally need to be met:

- Adequate airport infrastructure, runways, terminal and baggage systems capable of handling waves of probably at least 100 flights per hour, a four parallel runway system is therefore the minimum requirement;
- Adequate access infrastructure, not just to central London but beyond to the West of London and beyond to the West and North, HS2 and the proposed revamped Great Western Network will need to be linked directly to the airport as well as HS1 to Paris and Brussels;
- Adequate housing for the 75,000-100,000 employees within reach of the airport;
- Protection from competition from other London airports. The other airports will probably need to be closed or limited in what air services they can operate. Who compensates who and for what? Private companies such as the owners of Heathrow, Gatwick, Stansted etc will require compensation for loss of business if their access to air services is suddenly restricted.

The shaded box (on page 14) illustrates just how complex it will be to transfer traf-

fic to the new airport and the requirement not just to manage demand at Heathrow but also at the other London airports. The key conclusion is that overall traffic will fall as routes become unprofitable either due to higher fees or lower levels of transfer traffic. Main losers are passengers (higher fares and access costs) and airlines, especially British Airways and Virgin Atlantic due to loss of transfer traffic.

Conclusions

In the absence of a new runway at Heathrow or a new airport, London's role as a global hub will be diminished and possibly with it, the role of London as global city.

As the discussion above illustrates, there are numerous issues to be resolved before there can be a coherent and workable strategy for London's airports. The matter is pressing. Will the politicians have the courage to come out with a workable solution? A strategy that meets the demands for air travel but also recognises and tackles the environmental costs that any such an expansion might cause? What has been recognised by the current generation of politicians is the need for a policy supported by all sides in Westminster and no sudden changes down the road for political expediency. With the Davies Commission due to report at the end of 2013, the need for some convincing answers is pressing.

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Jet values and lease rates

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

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

NARROWBODY VALUES (US\$m)									
	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A318 (CFM)	25.8	17.5			717-200			6.9	
A319 (IGW)		25.9	18.9		737-300 (LGW A)				2.8
A320-200 (IGW)		29.0	22.5	9.6	737-400 (LGW A)				2.7
A321-200 (LGW)		33.4	24.7		737-500 (LGW A)				2.4
					737-600 (LGW)			11.3	
					737-700 (LGW)	24.9		19.3	
					737-800 (LGW)	31.6		23.8	
					737-900			16.9	
					757-200 (RB 211)			13.5	8.3
					757-200ER (PW)			13.5	8.2
					757-300 (LGW)			15.8	
					MD-82				1.1
					MD-83				1.4
					MD-87				1.1
					MD-88				1.5
WIDEBODY VALUES (US\$m)									
	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A300B4-600				3.4	747-400 (PW)			35.0	16.2
A300B4-600R				6.6	767-200 (CF6)				3.1
A310-300 (IGW)				4.5	767-300 (CF6)				6.9
A330-200			48.3		767-300ER (LGW)			22.2	12.2
A330-300 (IGW)			38.1		777-200 (PW)			31.8	
A340-300 (LGW)			26.5		777-200ER	105.2	83.9	62.5	
A340-300 (HGW)			31.4		777-300			49.2	
A340-300ER			33.1		787-8	108.3			
A340-500 (IGW)			38.3						
A340-600 (IGW)			45.8*		MD-11P				11.6
A380-8 (IGW)	211.8	169.6							

Source: AVAC
Note: As assessed at end-October 2012; mid-range values for all types; * = 2003 manufacture

Aviation Strategy

Jet lease rates

NARROWBODY LEASE RATES (US\$000s per month)									
	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A318 (CFM)	213	159			717-200			101	
A319 (IGW)		218	175		737-300 (LGW A)				63
A320-200 (IGW)		246	210	111	737-400 (LGW A)				51
A321-200 (LGW)		288	228		737-500 (LGW A)				47
					737-600 (LGW)			108	
					737-700 (LGW)	222		178	
					737-800 (LGW)	260		209	
					737-900			144	
					757-200 (RB 211)			140	121
					757-200ER (PW)			142	123
					757-300 (LGW)			151	
					MD-82				45
					MD-83				48
					MD-87				39
					MD-88				51
WIDEBODY LEASE RATES (US\$000s per month)									
	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A300B4-600				111	747-400 (PW)			357	221
A300B4-600R				92	767-200 (CF6)				84
A310-300 (IGW)				96	767-300 (CF6)				105
A330-200			496		767-300ER (LGW)			272	197
A330-300 (IGW)			417		777-200 (PW)			342	
A340-300 (LGW)			359		777-200ER	909	772	625	
A340-300 (HGW)			399		777-300			511	
A340-300ER			405		787-8	834			
A340-500 (IGW)			456						
A340-600 (IGW)			547*		MD-11P				146
A380-8 (IGW)	1,870	1,572							

Source: AVAC
*Note: As assessed at end-October 2012; mid-range values for all types; * = 2003 manufacture*

AIRCRAFT AND ASSET VALUATIONS

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Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
Air France/ KLM Group YE 31/03	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	
	Apr - Sep 11	18,600	18,240	360	-257	1.9%	-1.4%	137,282	114,846	83.7%	40,605	102,516
	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	
Jul - Sep 12	8,989	8,356	633	383	7.0%	4.3%	72,246	62,098	86.0%	21,279		
British Airways YE 31/03	Year 2009/10	12,761	13,130	-369	-678	-2.9%	-5.3%	141,178	110,851	78.5%	31,825	37,595
IAG Group YE 31/12	Oct-Dec 10	5,124	5,116	8	121	0.2%	2.4%	50,417	39,305	78.0%		56,243
	Jan-Mar 11	4,969	5,109	-139	45	-2.8%	0.9%	51,118	37,768	73.9%	11,527	56,159
	Apr-Jun 11	5,951	5,678	273	135	4.6%	2.3%	53,425	42,635	79.8%	13,288	56,649
	Jul - Sep 11	6,356	5,842	514	401	8.1%	6.3%	55,661	47,022	84.5%	14,553	57,575
	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 YE 31/12	Year 2009	6,149	6,796	-647	-381	-10.5%	-6.2%	62,158	49,612	79.8%		20,671
Lufthansa YE 31/12	Year 2009	31,077	30,699	378	-139	1.2%	-0.4%	206,269	160,647	77.9%	76,543	112,320
	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
	Jul - Sep 12	10,400	9,538	862	803	8.3%	7.7%	71,197	59,410	83.4%	29,433	114,022
SAS YE 31/12	Year 2009	5,914	6,320	-406	-388	-6.9%	-6.6%	35,571	25,228	70.9%	24,898	18,786
	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	1,642	1,551	91	46	5.5%	2.8%	10,300	7,936	77.0%	7,625	14,985	
Ryanair YE 31/03	Year 2009/10	4,244	3,656	568	431	13.5%	10.2%			82.0%	66,500	
	Apr-Jun 10	1,145	992	152	120	13.3%	10.5%			83.0%	18,000	7,828
	Jul-Sep 10	1,658	1,150	508	426	30.7%	25.7%			85.0%	22,000	8,100
	Oct-Dec 10	1,015	1,016	-1	-14	-0.1%	-1.3%			85.0%	17,060	8,045
	Year 2010/11	4,797	4,114	682	530	14.2%	11.0%			83.0%	72,100	
	Apr-Jun 11	1,661	1,418	245	201	14.7%	12.1%			83.0%	21,300	
	Jul-Sep 11	2,204	1,523	681	572	30.9%	25.9%			87.0%	23,000	
	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 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	
	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.

Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.	
Alaska	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	
	Jul - Sep 12	1,272	1,003	269	163	21.1%	12.8%	13,315	11,654	87.5%	6,950	12,035	
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%		
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	
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	
Continental	Year 2009	12,586	12,732	-146	-282	-1.2%	-2.2%	176,305	143,447	81.4%	62,809	41,000	
	Year 2010	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	
United	Year 2010	12,586	12,732	-146	-282	-1.2%	-2.2%	176,305	143,447	81.4%	62,809	41,000	
	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	
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	
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	
JetBlue	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.

Aviation Strategy

Databases

		Group revenue US\$m	Group costs US\$m	Group op. profit US\$m	Group net profit US\$m	Operating margin	Net margin	Total ASK m	Total RPK m	Load factor	Total pax. 000s	Group emp.
ANA YE 31/03	Year 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
	Year 2011/12	16,008	14,887	1,121	347	7.0%	2.2%	91,162	59,940	65.8%	44,903	
Cathay Pacific 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	
	Year 2012											
JAL YE 31/03	Year 2005/06	19,346	19,582	-236	-416	-1.2%	-2.2%	148,591	100,345	67.5%	58,040	53,010
	Year 2006/07	19,723	19,527	196	-139	1.0%	-0.7%	139,851	95,786	68.5%	57,510	
	Year 2007/08	19,583	18,793	790	148	4.0%	0.8%	134,214	92,173	68.7%	55,273	
	Year 2008/09	19,512	20,020	-508	-632	-2.6%	-3.2%	128,744	83,487	64.8%	52,858	
	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 YE 31/12	Year 2006	8,498	7,975	523	363	6.2%	4.3%	71,895	52,178	72.6%	22,140	16,623
	Year 2007	9,496	8,809	687	12	7.2%	0.1%	76,181	55,354	72.7%	22,830	16,825
	Year 2008	9,498	9,590	-92	-1,806	-1.0%	-19.0%	77,139	55,054	71.4%	21,960	18,600
	Year 2009	7,421	7,316	105	-49	1.4%	-0.7%	80,139	55,138	68.8%	20,750	19,178
	Year 2010	10,313	8,116	120	421	1.2%	4.1%	79,457	60,553	76.2%	22,930	
	Year 2011	11,094	10,678	416	-89	3.7%	-0.8%	84,285	64,483	76.9%	22,934	
Malaysian YE 31/12	Year 2006	3,696	3,751	-55	-37	-1.5%	-1.0%	58,924	41,129	69.8%	15,466	19,596
	Year 2007	4,464	4,208	256	248	5.7%	5.6%	56,104	40,096	71.5%	13,962	19,423
	Year 2008	4,671	4,579	92	74	2.0%	1.6%	52,868	35,868	67.8%	12,630	19,094
	Year 2009	3,296	3,475	-179	140	-5.4%	4.3%	42,790	32,894	76.9%	11,950	19,147
	Year 2010	4,237	4,155	82	73	1.9%	1.7%	49,624	37,838	76.2%	13,110	
	Year 2011	4,549	5,300	-751	-825	-16.5%	-18.1%	52,998	39,731	75.0%	13,301	
Qantas YE 30/6	Year 2007/08	14,515	13,283	1,232	869	8.5%	6.0%	127,019	102,466	80.7%	38,621	33,670
	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 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	
	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 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	
	Year 2011	15,260	14,289	971	1,095	6.4%	7.2%	113,987	93,185	81.8%	48,671	
China Southern 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	
	Year 2011	14,017	13,342	675	944	4.8%	6.7%	151,074	122,342	81.0%	80,674	
China Eastern 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	
	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) YE 31/12	Year 2008	796	592	203	-142	25.5%	-17.9%	14,353	10,515	73.3%	9,183	4,593
	Year 2009	905	539	366	156	40.4%	17.3%	21,977	15,432	70.2%	14,253	
	Year 2010	1,245	887	358	333	28.8%	26.7%	24,362	18,499	75.9%	16,050	
	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..

Aviation Strategy

Databases

	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
Sep '12	32.0	24.7	77.3	23.0	20.2	87.9	17.9	15.1	84.6	59.1	50.8	85.9	89.7	74.7	83.2
Ann. change	1.8%	4.0%	1.6	2.6%	4.5%	1.6	1.5%	3.6%	1.7	2.4%	4.1%	1.4	2.4%	4.4%	1.5
Jan - Sep '12	267.1	196.3	73.5	191.5	162.9	85.1	158.9	130.0	81.8	519.0	432.2	83.3	777.0	623.1	80.2
Ann. change	1.4%	3.8%	1.7	1.7%	4.4%	2.2	4.0%	6.1%	1.7	3.4%	5.5%	1.6	2.9%	5.3%	1.8

JET ORDERS

	Date	Buyer	Order	Delivery/other information
Boeing	15 Nov	Avianca	3 x 787	
	14 Nov	SilkAir	23 x 737-800, 31 x 737 MAX 8	
	06 Nov	Aeromexico	60 x 737 MAX 8/9	plus 30 purchase rights
	04 Nov	ALAFCO	20 x 737 MAX 8	
Airbus	15 Nov	AJW Capital	2 x A340-500	
	12 Nov	Afriqiyah A/W	4 x A350-900	
	08 Nov	TransAsia A/W	6 x A321neo	

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

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