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2015 Outlook

As it is the end of this year we are indulging in some speculation about issues which may be important in 2015.

Oil prices continue to tumble with most oil analysts now thinking about a stabilisation at maybe $60/bbl, but as the consensus forecast was around $110/bbl six months ago, and there are forecasters who are estimating a resurgence to $150, there is little reason for confidence about the price outlook. Nevertheless, IATA is becoming more optimistic largely because of fuel trends; global net profits for 2015 are now estimated at $25bn compared to $20bn this year.

Unfortunately, falling fuel prices aren't always beneficial for airlines; Ryanair, for example, lost out badly in 2008 because of their hedges locked in higher-than-market price.

This time round Ryanair is 90% hedged for FY2015 at $96/bbl while the European network carriers have hedges covering about 70% of the next two quarters need at around the same price. The US carriers have been reducing their hedging positions over the past year, with American having no hedges at all, and so stand to benefit most strongly from the price decline. Some of the Asian carriers — SIA and Cathay Pacific, for instance — which have a high proportion of their fuel hedged at over $100/bbl might be at risk again.

The graph below right is one way of looking at **European airlines** — how the stockmarkets rate the value of each passenger carried. IAG, with a very strong long-haul point-to-point traffic supporting its LHR/MAD hub system, is by far the most impressive performer, followed by the leading LCCs, which transport a different type of passenger, short-haul only, point to point. Lufthansa with a heavy reliance on short-to-long-haul connecting passengers, and recent union conflict, lags well behind. Air France/KLM is regarded with financial market distain.

The reason why **AF/KLM**, despite the financial signals, is not a takeover target for more efficient Eu-

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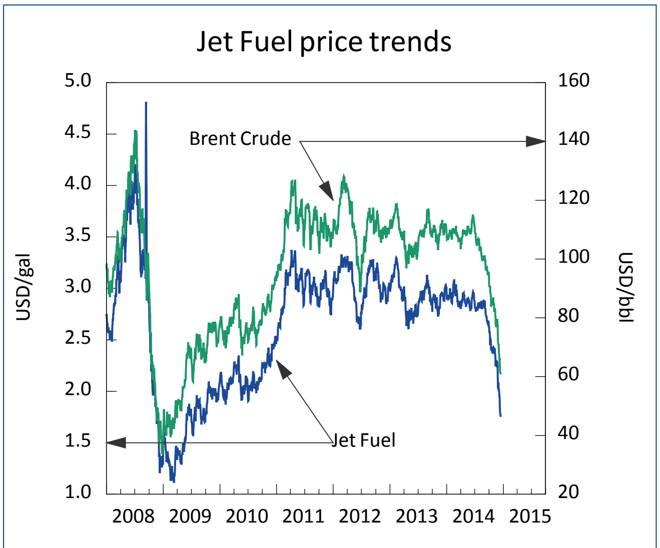

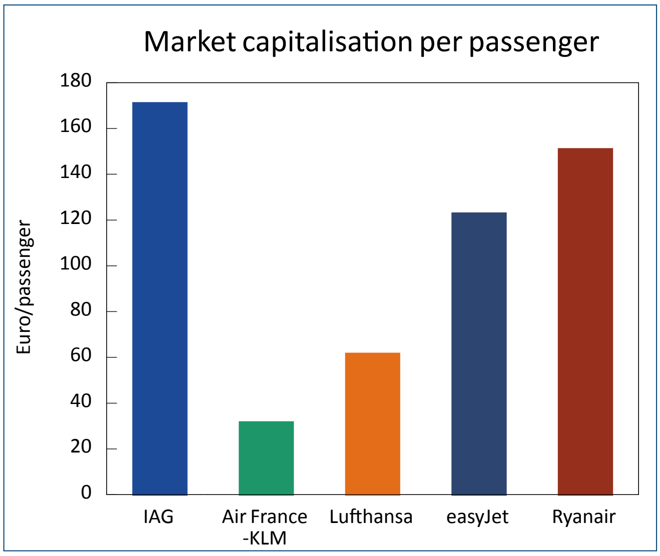

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ropean carriers seems all too clear — antitrust issues, union power and state control (still 16% owned by the French state, with employees having a further 7%). But what about a breakup of AF and KLM? Throughout the 1980s and 90s BA saw KLM as its natural ally; might it be tempted to try again? At a recent CAPA conference Willie Walsh draw a clear distinction between efficient KLM and undynamic AF. Perhaps reading too much into a throw-away comment, but share price weakness has caused stronger European airlines to consider what might be regarded as unusual investments — BA recently trying to buy into into Aer Lingus, AF itself studying easyJet back in 2009 (according to a recent report in *La Tribune*).

Cynics have compared **Etihad's investment spree** with Swissair's ill-fated Hunter strategy — buying minority stakes in loss-making, inefficient airlines, justifying the purchases in terms of mutual feed and economies of scale, and seeking elusive synergies from different airline models in unrelated markets. For the record, here is a comparison of Swissair's 2001 investments and Etihad's equity purchases up to the end of this year. Despite a 13 year gap the total expenditures were roughly the same — about $2.2bn, both accumulated over a 18 month timeframe (if Swissair's investments in catering and service companies are also included).

Etihad's Investments
(as at end 2014)

	$m
Air Berlin	688
Darwin (Etihad Express)	10
Air Serbia	100
Aer Lingus	30
Air Seychelles	45
Virgin Australia	300
Jet Airways	379
Alitalia	625
Total	**2,177**

Swissair's Investments
(as at mid 2001)

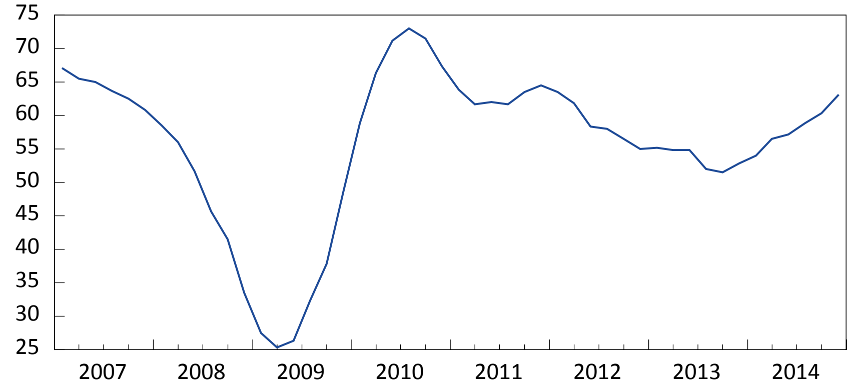
	$m
Sabena	300
SAA	230
Air Outre Mer	80
LTU	120
Air Europe Italia	85
Volare	45
Air Littoral	70
TAP	140
MAS	150
Sub-total	1,220
Aviation service companies	925
Total	**2,145**

Note: TAP and MAS were planned but not completed

There the similarity may end. Swissair had no financial reserves to help it survive the consequences of September 11, and its bankruptcy brought down the other airlines in its empire. Etihad is backed by the immense oil wealth of Abu Dhabi. But Mubadala — the investment arm of the Abu Dhabi sovereign wealth fund — is certainly not irrational, especially when investments are being appraised in the light of collapsing oil prices. And many (most?) of the Etihad airlines are going to need secondary equity infusions in the next few years, which may be problematic with the EC busying itself with foreign ownership rules.

Private jet usage has closely tracked the economic cycle and in particular the financial market collapse. Now there are clear signs of a sus-

Business Jet Confidence: UBS Index (MATs)



tained recovery. UBS's regular survey of "Business Jet Interest", derived from a questionnaire sent to brokers, financiers and manufacturers, measures whether interest in private/business jets is improving or deteriorating. Since 2010 it has been improving according to UBS, with most interest concentrated on large cabin jets. There are major regional differences, however: confidence is strong in Latin America, good in North America and Europe but markedly weakening in Asia.

One of the fall-outs of the global banking crisis has been a certain unease among shareholders about having business jets on corporate balance sheets — they can be, in many cases, justified as genuinely improving top management efficiency when business is good but look too much like an over-indulgence if things go wrong. This is one of the reasons why several PE-backed entities are now proposing vehicles for introducing pure operating leasing to this sector — less than 1% of private jets are on operating lease compared to about 40% in the commercial jet sector.

"**Customer-centric"** is the new marketing buzzword. And as with many marketing terms, it is difficult to pin down exactly what it means and whether it actually signifies anything new. However, it seems to relate to the use of big data to enable airlines to interact more with their passengers; for example, monitoring the passenger's travel patterns to remind him or her of important dates, to promote specific trips and to sell related products (not just hire cars and hotels).

The trouble is this trend seems to be driven at present by geeks obsessed with technology who don't realise how intrusive and patronising their sales suggestions can be. A future trend: clean websites with clear booking processes and no irrelevant pop-ups, advertising and questionnaires. But is that a premium service?

Where is the future demand for **freighter aircraft** going come from? The European network carriers are following the US majors in downsizing their pure freighter operations or withdrawing completely. The leading Asian cargo operator, EVA, is cutting its fleet by one third. The two giant integrators — FedEx and UPS — are planning on reducing their freighter capacity over the next five years.

The market has been convulsed by the impact of the internet and miniaturised IT. It has lost documents to email; 200 i-pads are equivalent to one old desktop.

Moreover, new technology and non-airline innovators could take the cargo industry in a new direction more rapidly than anticipated. Most noticeably, Amazon is currently accelerating its development of drones designed to fly goods to delivery collection points or directly to homes. Logically, the next step would be unmanned large cargo aircraft, and, although the FAA is finding it challenging coming to terms with the concept of unmanned aircraft, it has designated inspectors to work with Amazon in its research.

Depressed oil prices should imply low inflation and interest rates which is generally good for the **operating leasing business**, probably extending the upturn in this sector.

However, there is a new factor. Three LCCs — norwegian, AirAsia and Lion Air — between them have orders for over 1,000 narrowbodies (equivalent to approximately half the operating lessors' total orderbook) and have signalled their intention to lease out aircraft. One of the thoughts behind the move is that leasing companies have historically made a higher profit margin than airlines. Some of the intention may be for inter-group leasing; some may be for efficient use of ordered equipment that is surplus to requirement when delivery approaches.

However, none of them have publicly addressed the logic of the disparity between the airline model and aircraft leasing model. It could be commercial suicide for an airline to pursue a business of leasing aircraft that are surplus to its own requirements to another airline. And then there is the issue of the effect on lease rates and operating lessor profitability if this additional capacity goes in this sector.

Norwegian Air Shuttle: Brave Innovator

NORWEGIAN Air Shuttle's aggressive plan to become the first European LCC to build up a significant long-haul operation is starting to wobble, thanks to opposition to its Irish subsidiary and a plunge into the red over the past 12 months. Are these setbacks temporary, or are they indications that Norwegian's ambitions are just too grand to pull off?

Norwegian relaunched itself as a LCC in 2002 (see *Aviation Strategy*, November 2013), and has been posting profits at both the operating and net level since 2008. However, the strategy has become much more ambitious over the last couple of years — with the placing of an order for 222 737s and A320s in 2012 followed by the launch of long-haul routes in 2013 — and the airline lurched into the red in 2014.

The airline's growth has continued apace through the last 12 months: in the first three-quarters of 2014 passengers carried increased year-on-year by 19% to 18.3m, with RPKs in the January-September period rising by 45%, ahead of a 41% increase in ASKs, and with load factor increasing by three percentage points to reach 81.0%. This boosted revenue in 1Q-3Q 2014 by 27% year-on-year to NOK14.9bn (€1.8bn).

Revenue from international traffic accounted for 81% of all revenue in the third quarter (compared with 78% a year ago) and there was good news on the ancillary revenue front, where its share of total revenue rose to 13.4% in the third quarter of 2014 (equivalent to NOK124 — €15 — per scheduled passenger), compared with 10.9% in 3Q 2013 and not far short of the target proportion of 15%.

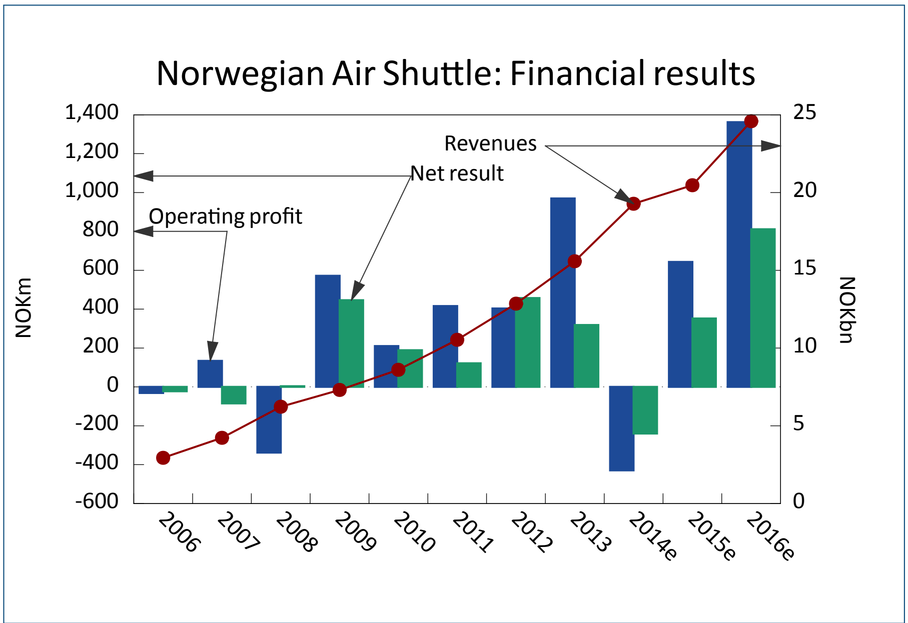
Into the red

However, whereas in the first nine months of 2013 the company achieved an operating profit of NOK1.2bn (€151m) and net income of NOK516m (€67m), in the same period of 2014 norwegian reported an EBIT loss of NOK328m (€40m) and a net loss of NOK91m (€11m).

The airline's balance sheet also weakened over the last 12 months. Cash and equivalents fell by 38% in a year to NOK1.4bn (€169m) as at the end of September 2014 (less than 10% of annual revenues), and long-term debt increased by a hefty 82% over the year to September 30 2014, to reach NOK8.2bn (€1bn). Most of that was due to greater financing for fleet expansion: total capital expenditure in the nine months reached NOK3.7bn against NOK1.2bn in the prior period. In November Norwegian successfully placed a NOK225m (€29m) bond issue, but the balance sheet leverage — with net debt standing at 275% of shareholders' funds — causes some concern.

Norwegian blames the recent results on a combination of "a weak Norwegian Krone, technical difficulties with our 787, the costs associated with the long overdue application before the US DoT for a foreign air carrier permit for Norwegian's Irish subsidiary, and costs associated with flight delays, such as wet-leasing replacement aircraft and accommodation, food and drink for delayed passengers".

Another fundamental reason for the weak results stems from the implicit aim of toppling SAS from its position as the *de facto* Scandinavian flag carrier. Both norwegian and SAS blame each other for putting too



much capacity into the Nordic markets, but the fact is that they do seem to be into an internecine fight. Norwegian is in direct competition with SAS on 35% of its routes (and 70% of volume-weighted city-pairs), and the intensity of the fight seems to have been driving down yields.

A key issue is the delay in getting US regulatory approval for an application made in December last year for a foreign air carrier permit for Irish subsidiary Norwegian Air International (NAI). This subsidiary is facing fierce opposition from the major US airlines, US and European unions, and some major European airlines (notably Air France-KLM and Lufthansa, but *not* BA). The motivation on the part of the airlines appears obvious — they do not really want any competition on the cosily-consolidated Atlantic, least of all from a low cost carrier. The opposition from the unions is less obvious (since norwegian would be hiring staff in the US and Europe) — but seem particularly aimed at closing down any possibility of the creation of aviation "flags of convenience˝.

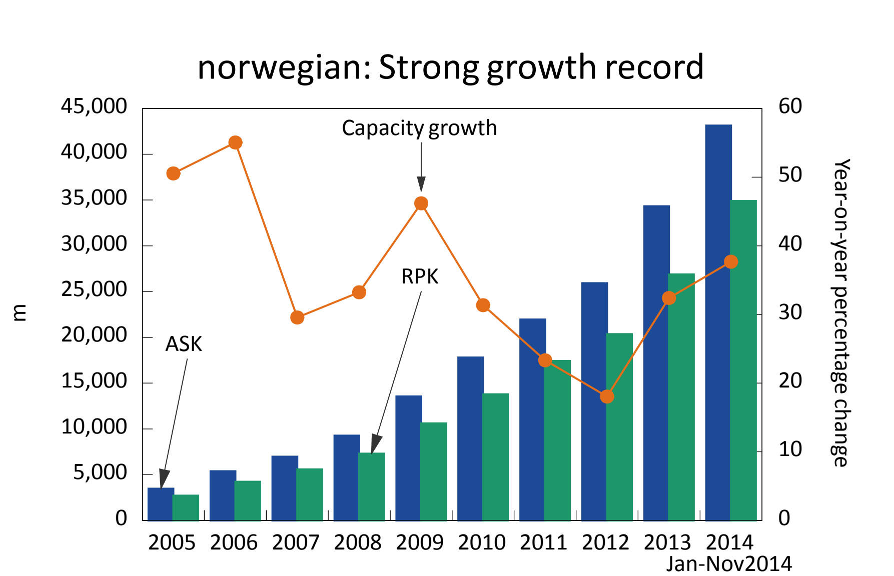
Flag of convenience: false analogy

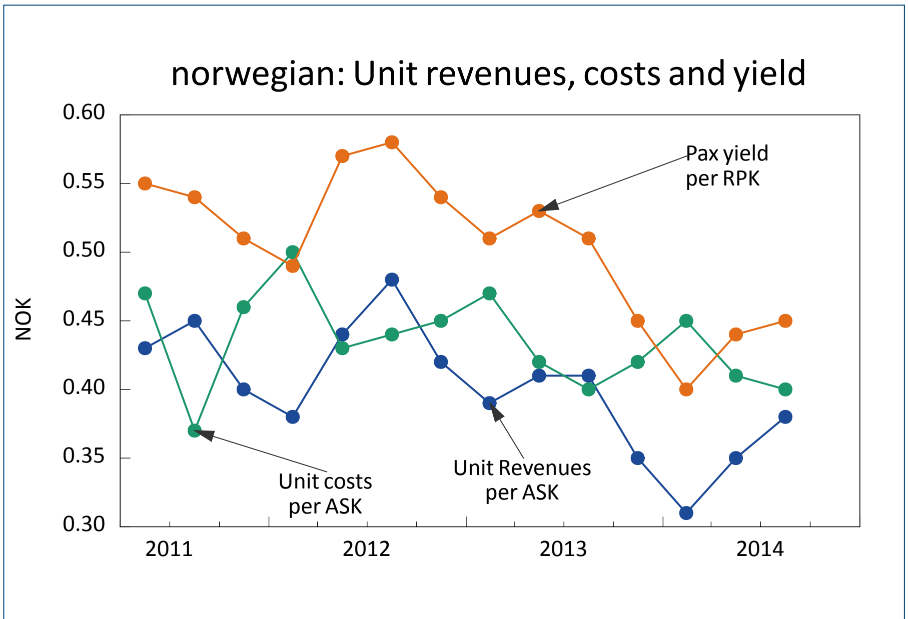
The arguments against the application are based on article 17*bis* of the 2010 protocol amendment to the 2007 US-EU Open Skies agreement. This states a recognition of the "importance of the social dimension ... and the benefits that arise when open markets are accompanied by high labour standards. The opportunities created by the Agreement are not intended to undermine labour standards or the labour-related rights and principles contained in the Parties' respective laws."

ALPA (Air Line Pilots Association) avers that NAI was established "in order to avoid Norway's employment laws and to be able to rent its pilots through a Singapore employment company. The pilots, who the company says are based in Thailand, work under individual employment contracts that contain compensation substantially below that of the Norway-based pilots who fly for NAI's parent company˝.

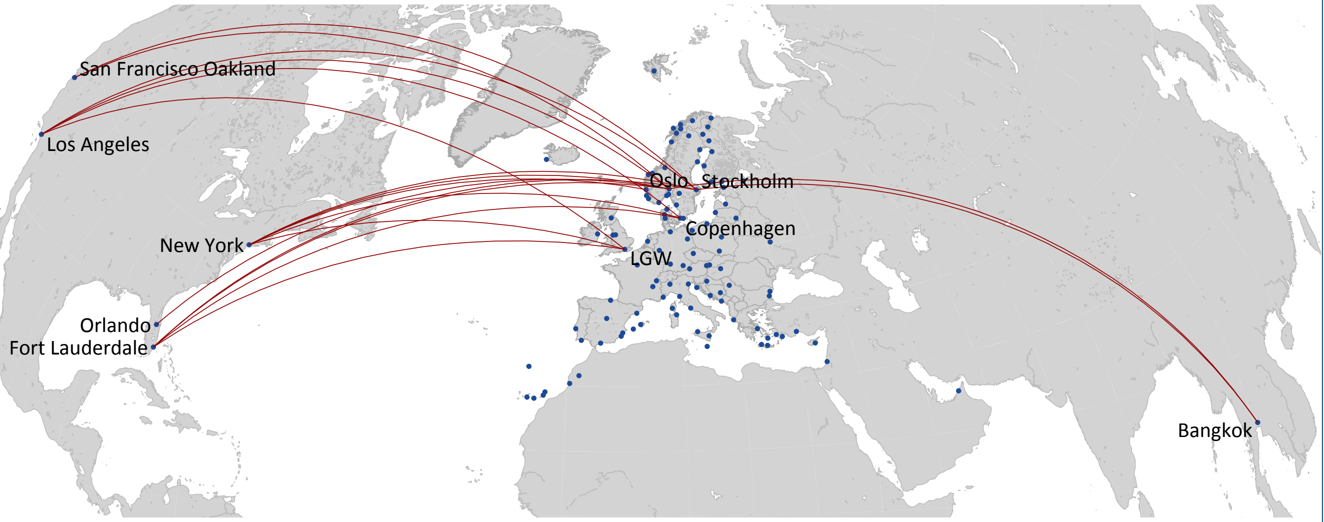
Norwegian argues that NAI would boost competition into the US and that it is just a means to obtain better traffic rights (as Norway is not an EU member) and more attractive aircraft financing rates — and not a means to get cheap labour. One of the reasons it chose Ireland, against the UK or Sweden, it states, was that Ireland has fully adopted the Cape Town agreement, and establishment in the country would not affect export guarantees.

It insists that, as NAI fulfils all necessary criteria and regulations, the refusal to grant a permit is in breach of the 2007 transatlantic Open Skies agreement, with Bjørn Kjos, the CEO





norwegian Route network - bases in USA and Asia



of Norwegian (and a former Norwegian air force pilot), saying that "the time is well-past due for the DoT to fulfil its legal responsibility and approve NAI's application".

Long-haul impact

The delay has slowed norwegian's long-haul growth timetable, halting US expansion and — in the airline's words — "reducing our ability to optimize our fleet of aircraft".

Norwegian now operates 417 routes to 126 destinations in 39 countries, with the long-haul network comprising Los Angeles (Oakland), New York, Orlando, Fort Lauderdale and Bangkok. The carrier is pursuing a three-phase plan for long-haul; the first is the establishment of Scandinavia to North America services (initiated in 2013, and subsequently to be expanded into a much larger network); the second is the launch of routes out of London Gatwick (in 2013), and the third is expansion of Europe to Asia routes (currently it operates only to Bangkok), most likely to India, China and Japan initially.

This is why it really needs to establish an EU AOC (whether in Ireland or elsewhere). Based in Norway it has access to long haul routes out of Scandinavia, and routes to the US from European points thanks to the EU-US Open Skies Agreement. However, Norway is not party to the European horizontal traffic agreements, and the company will need an EU certificate to access other long haul routes from the EU, in order to achieve the utilisation necessary on the 787s to make its low cost model work.

The US DoT approval delay is forcing adjustment of this overall plan, and the key knock-on effect is on anticipated improvements to unit cost and revenue. While Norwegian's average sector length continues to rise — in the first three-quarters of 2014 it rose 15% to 1,337km — the inability to optimize the long-haul fleet becomes more acute as further long-haul aircraft are delivered.

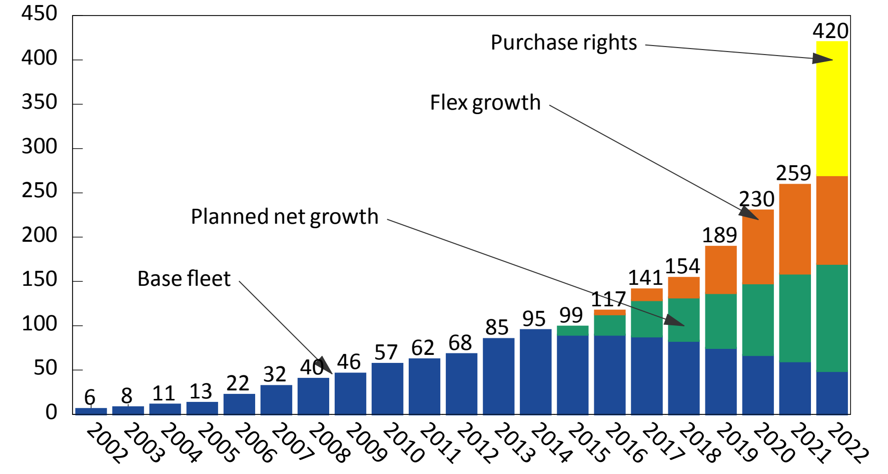
Norwegian began operating 787s (configured with 32 seats in Premium Economy and 259 in Economy) in May 2013, and there are currently seven 787s in operation, with another 10 coming by 2018, nine of which will be the 787-9 model, which has a longer range that the 787-8. The 787s were supposed to transform the economics of the long-haul network, where Norwegian previously wet-leased A340s. The A340s were a major factor in making the routes loss-making, with Kjos stating: "before the 787, we could not add up the figures to get a low enough cost and sufficient margin against legacy carriers".

The 787s improve fuel consumption per seat by approximately a third compared with the A340s, but this

norwegian fleet

	Fleet	Order	Options
A320neo		100	50
737-300	8		
737-800	83	50	6
737 MAX 8		100	100
787-8	7	1	
787-9		9	
Total	**98**	**260**	**156**

norwegian fleet plan



will have a reduced impact on the bottom line because of the sharp decline in oil prices. Combined with an inability to optimise schedules thanks to the US DoT issue, the introduction of the model has not been enough to turn the current long-haul routes into profitability.

The 189-seat 737 MAXs 8s start arriving from mid-2017, and this month norwegian revealed a plan to use these on long-haul routes between smaller European cities (such as Edinburgh, Aberdeen, and Bergen) and the US and Caribbean. The MAX extends the range of the 737 to more than 6,667 kilometres, and Kjos observes: “There are a lot of routes that are served via a hub-and-spoke system today that we will serve with direct flights in the future.” The carrier already employs 300 cabin crew in Fort Lauderdale and New York, and is starting to recruite American pilots, but clearly much depends on that US DoT approval.

As well as long-haul, norwegian is also counting on substantial short-haul expansion with another 50 737-800s are on order, plus 100 A320neos from 2016. Norwegian’s core strength is in its home base, at Oslo, where it had a 39% share of the market in the third quarter of 2014 (in terms of all passengers carried), backed up by significant market shares at Stockholm (24%), Copenhagen (17%) and Helsinki (12%).

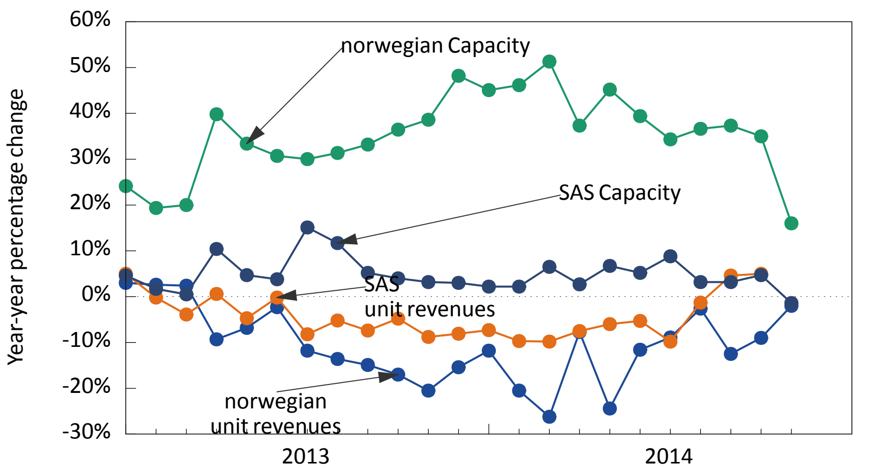
Growth has come elsewhere over the last year: from a 2% to 3% combined market share at all the Spanish airports it operates to (Malaga, Alicante, Las Palmas, Tenerife, Madrid Barajas and Barcelona), and — much more importantly — a leap from 5% to an 8% share at London Gatwick. Gatwick is much larger than any of Norwegian’s Scandinavian airports, and Norwegian only launched a base there as recently as the spring of 2013.

The 100 Airbus A320neos on order are likely to be based at norwegian’s six Spanish bases, although there is no clarity yet as to just where the significant route expansion necessary to take all these aircraft will occur.

Interestingly, the fleet plan has become less aggressive compared with the plan as of just 12 months ago, with the planned fleet at the end of 2015 being 99 aircraft, compared with a year-end 2015 target of 102 aircraft that was in plan a year ago. The fleet will then increase significantly in 2016 as new deliveries start arriving, to reach 117 by that year-end and comprising 101 737-800s (of which 68 will be owned, 13 sold and leased-back, and 20 leased); four A320neos and 12 787-8/9s (with three owned and nine leased).

Kjos has also indicated that some of the outstanding orders could be leased out to other carriers, depending on how the market looks in 2016 onwards as the deliveries start piling up. Norwegian has set up an Irish-based leasing subsidiary (Arctic Aviation Assets) that will give the airline fleet flexibility in the future. In this it

Battle for supremacy



is following a trend of other low cost carriers that have large numbers of aircraft on order — notably in Asia with airlines such as AirAsia, Lion Air and Spring.

The in-house leasing operation may provide a buffer to long term risk (but at the moment, as CFO Frode Fosse recently claimed, norwegian needs all the aircraft it can get its hands on for its own route network expansion). The downside may be that the carrier may well be left with a large overhang of aircraft that — without the experience or contacts of the established lessors — are difficult to place in the market (and could end up at competitors).

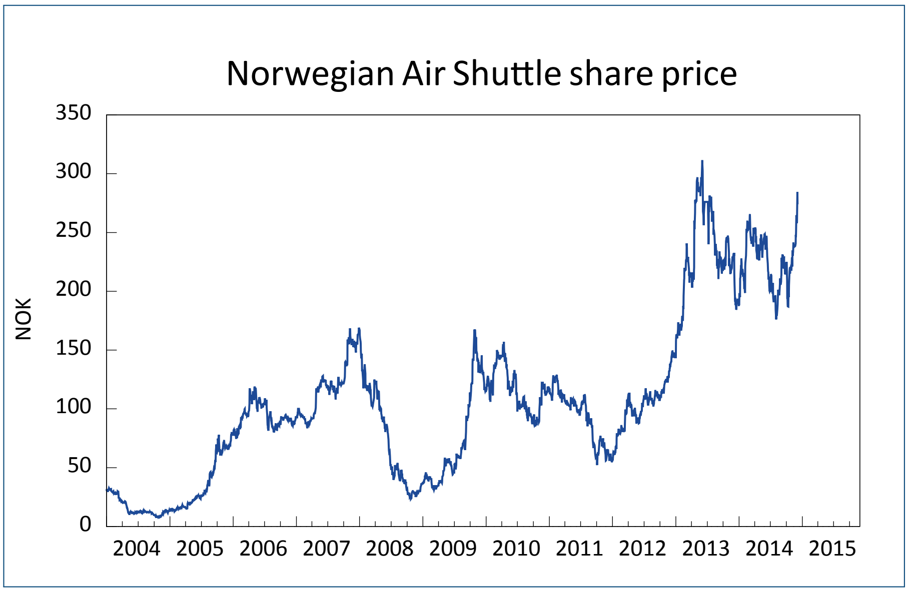
In addition, airlines rarely obtain the same low cost of funding as lessors, and have less clout than established lessors in being able to go back to manufacturers and switch models around in response to changing market demand. At the heart of the argument is whether norwegian (or indeed any airline) can operate successfully at the margins of the ultra-competitive leasing industry.

A cost battle

Unit costs have been gradually edging down, due to a combination of cost-cutting and the scale effects of increasing the long-haul network. In the third quarter of 2014, CASK excluding fuel fell 4% year-on-year to NOK 0.26, with overall CASK remaining at NOK 0.40, the same level at Q3 2013.

The problem is that this cost reduction has not been enough to close the gap with unit revenue, although the latter has risen substantially over the last two quarters, from NOK0.31 in Q1 2014 to NOK0.38 in July-September.

The question is whether the narrowing of the unit cost/revenue gap



will continue through the next few quarters, enabling the carrier to get back into the black? The airline is targeting full 2014 CASK excluding fuel of NOK 0.25 (and including fuel of NOK 0.41).

Norwegian does not hedge its jet fuel requirements, and it is possible that it could be the airline to benefit most from the decline in fuel prices in the short run: a 1% fall in the cost of jet fuel would have a NOK56m positive impact on operating income. However, the savings are being offset by the near 20% depreciation of the Norwegian Krone against the dollar (and for a 1% decline in the NOK-USD exchange rate the company estimates a negative effect on operating profits of some NOK 80m).

Norwegian's major cost reduction efforts are:

✈ Fleet adjustments. The current fleet comprises 83 737-800s, eight 737-300s and seven 787-8s, and the 300s will be replaced completely by 800s in 2015, which provide better economics, essentially giving 38 "free seats" according to Norwegian.

✈ Scale economies. As the long-haul network grows (which is why the US DoT approval issue is so important), overhead will be spread thinner, improving the underlying unit cost base. And frequency based costs will also be spread over greater ASKs as the average sector length increases.

✈ Continued off-shoring of costs. The Irish subsidiary is only the latest example of this; key parts of the back office infrastructure are already based in east European; the IT department, for example, is based in the Ukraine.

✈ Other costs measuresinclude increased automation (such as automated charter and group bookings), and more streamlined operational systems and processes.

Using norwegian's own figures, its unit costs are 75% higher than those of Ryanair, though much better than local rivals SAS and Finnair, which are 76% and 38% higher on a unit cost basis respectively. Remarkably, given its base in Norway and substantial operations in Scandinavia (with high costs, taxes and strong unions), its unit costs are not too dissimilar from those of easyJet or Vueling.

The future

Long-haul low-cost expansion is full of risk. The traditional wisdom is that there is not the same potential to create the cost advantages against incumbent legacy carriers as there has been in short haul. It is not just that long haul operations encounter the complexity of airport curfews and crew *hotac* expenses. It is also that incumbent carriers on long haul routes have a bucket of discount fares at the back of Economy that they can switch on to undermine incipient competition.

After receiving 14 737-800s and four 787-8s in 2014, 2015 will be a time for relative consolidation, with just a 5% growth in overall ASKs anticipated (with short-haul up by 2% and long-haul by 25%).

Investors appear uncertain as to whether the current dip into the red is a short-term blip. After a bumpy ride from the 2003 IPO until the end of 2011, the share price soared until the second quarter of 2013, after which it fell back (and coinciding with the launch of long-haul routes), becoming very volatile through 2014.

This industry needs innovators — and norwegian with Bjørn Kjos at its helm is an innovator. The real dilemma may be that, should norwegian be successful in creating a true low cost long haul operation, others with better balance sheets will follow.

Aero-engines: Join the team

WITH seemingly insatiable demand for jets, aero-engine manufacturers should be sitting pretty. In fact, three of the big four manufacturers are facing problems.

The engine market divides into two: narrowbodies and widebodies. The former has been dominated for decades by the unlikely pairing in CFM International of the US industrial giant, General Electric (GE), and the flower of French state capitalism—Snecma (now partly privatised in the Safran group). The joint-venture pools revenues and divides costs, according to which firm makes which parts of the engine and which completes final assembly; it has operated since 1974, with an exclusive franchise on 737s for decades and roughly half the A320 market. In the process, the Franco-American pairing virtually drove Pratt & Whitney out of the single-aisle market it had dominated since the birth of the jet age in the mid-1950s.

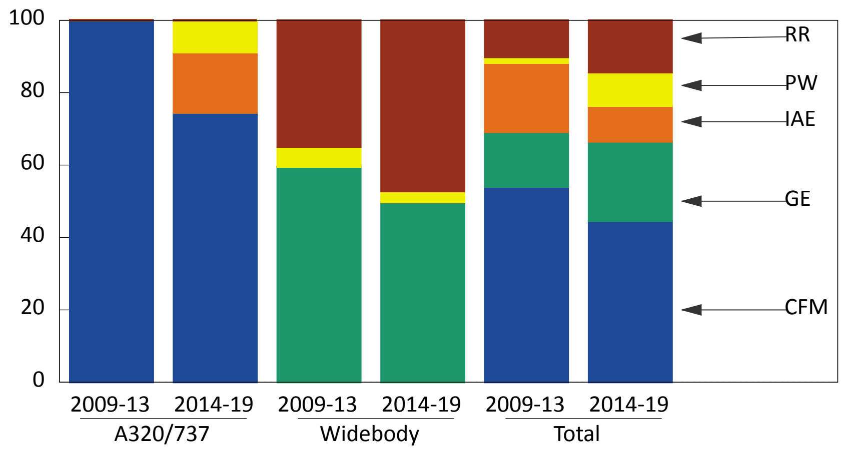
P&W was in effect forced to join a rival consortium with Rolls-Royce, Japanese and German manufacturers — International Aero Engines (IAE). After some squabbling over patents and strategy, Rolls-Royce sold out of IAE a few years ago, leaving P&W dominating IAE and well placed to plan its return to strength.

Meanwhile, Rolls-Royce bizarrely sits on the sidelines of a market that accounts for 80% of large aircraft sales. A joint venture with P&W was supposed to follow the exit from IAE, but that was abandoned in mysterious circumstances. The firm stood aside from the competition to re-engine A320s, reckoning that the game was not worth the candle: that was before the phenomenal success of the re-born Airbus.

CFMI's success gave it dominance in the total market, with 54% in 2009-2013 (see chart), but even this is now open to serious challenge. CFMI's share is forecast to fall to 45% over the next four years, because of the return of P&W with its Geared Turbofan (GTF) engine and its control of IAE. (The gearing apparently allows the fan and the turbine parts each to run at their optimum number of revolutions, producing a major gain in fuel efficiency.)

But CFMI for its part is bringing to market the LEAP-X engine which uses advanced lightweight materials to produce an equally impressive gain in fuel economy. So there is now real competition to get on the wings of new-engine versions of both the A320 and the 737.

Engine manufacturers' market share

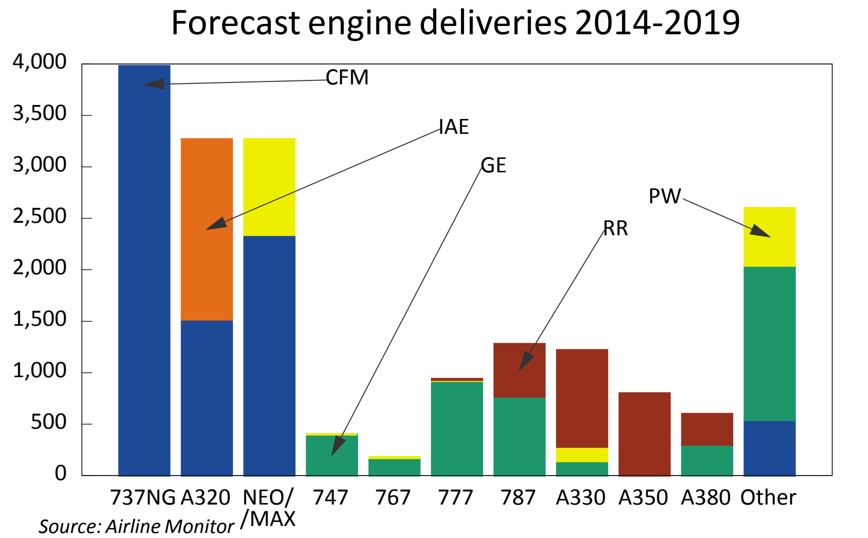


Source: Airline Monitor

Widebodies

For widebody aircraft the picture is simpler. P&W clings on here only through its partnership in the Engine Alliance with GE, waved through anti-trust concerns by the US Administration in the 1990s to allow the development of the biggest engines for the emerging 777s. GE secured its position as the 777s grew their load and range, by helping Boeing with the development of the 777-300ER, the most successful iteration of an already winning product.

This saw the development of the team concept whereby a new aircraft comes with an exclusive engine supplier: the 777 fleet came to be nearly 100% GE-powered in recent years, while the new A350 (built to rival both 787s and 777s) will be exclusively powered by Rolls-Royce. The re-engined A330 will also be a Rolls-



Source: Airline Monitor

Royce monopoly.

The only aircraft where competition remains open and heated is the 787 which looks like continuing a 60/40 split in favour of GE, and the A380 (50/50), though that could switch to a Rolls-Royce monopoly if Airbus responds to Emirates' call for new engines in a desperate move to keep the project alive into the next decade.

Wider issues

The leading position of GE is underscored by its profit margins which are around 20% in its aviation business compared to 13% at Rolls-Royce. Rolls-Royce had ten years of success and fast growth until early 2014, but during those boom times costs rose to an unsustainable level, as Chief Executive John Rishton acknowledged recently when he announced 2,700 redundancies including engineering teams.

GE is the only engine manufacturer with a strong position across the board; its share of the market (by volume) is poised to rise from 15% to 22%, even without counting in its half share of CFMI. But even GE is facing tough times emerging from the economic and financial crisis. It is hiving off its financial businesses (for long the source of much of its profit) in response to regulatory pressure and would have long shed its consumer business (washing machines and other white goods) had the crisis not wrecked that deal. Meanwhile, capital spending and dividend payouts are under pressure as it seeks to re-invent itself as a vibrant industrial conglomerate, but its recent purchase of the French Alstom group (power turbines and trains) will absorb much management time and money in the next couple of years.

Conglomeration is also a concern at P&W and Rolls-Royce. P&W took a mighty step by spending $16.5bn to buy aerospace equipment-maker BF Goodrich in 2012, turning itself from a broad conglomerate (Otis Lifts and air conditioning are two other big parts) into a group more focused on aerospace. But the CEO has just been replaced by the CFO, who at his first appearance before analysts in mid-December poured cold water on the prospect of spending heavily on aero-engine R&D to make the GTF technology suitable for larger engines. Analysts note that Gregory Hayes, the new CEO and ex-CFO, had worked for Harry Stonecipher who was famously focused on short-term financial gain when in power at McDonnell Douglas and Boeing.

Rolls-Royce, for its part, cannot seem to make up its mind whether it is an aero-engine group or a power systems conglomerate. It fumbled an attempt to buy the Finnish Wartsila marine engine group: the deal fell through after being leaked. But Rolls-Royce continues to develop revolutionary technology for specialised vessels, through marine subsidiaries in Nordic countries that it acquired with the Vickers group in the 1990s. It is getting out of gas turbine businesses supplying the energy sector (selling to Siemens) while buying the Tognum business of Daimler group, which makes giant diesel engines for ships.

Rolls-Royce has new engines under development for launch in 2020 and 2025, partly with the single-aisle market in mind. But investors fret about recent profit warnings, caused by defence cutbacks and problems selling to Russia during sanctions, and analysts frequently moan about the group's vague sense of direction: is it a jet engine business with some add-ons, or a full-blooded conglomerate built around gas turbine technology?

Aviation Strategy

Azul: Brazil's rapidly growing LCC reignites the IPO process

Azul started December with a bang: launching A330 services to the US and filing for an IPO in New York and São Paulo. These major moves came within days of the carrier announcing $6.5bn of orders and lease deals for the A320neo family aircraft.

The A320neo represents a yet another new aircraft type for Azul, which until this autumn operated only E190s/E195s and ATR72s in regional markets in Brazil. It signals Azul's ambition to expand into domestic long-haul and high-density markets and eventually become the largest airline in Brazil.

The November 28 A320neo transactions comprised of 35 firm orders from Airbus, valued at $3.6bn, and leasing deals for another 28 aircraft. Deliveries will take place in 2016-2023.

The launch of the US services (Fort Lauderdale on December 2 and Orlando on December 8, both from Azul's hub at Campinas near São Paulo) marked Azul's debut on the international arena and in widebody operations. Azul has announced plans to lease 12 widebody aircraft, including seven A330-200s (of which five were due by year-end) and five A350-900s (from March 2017).

The filing of the preliminary IPO prospectuses on December 1 represented the third time in 18 months that Azul initiated the IPO process. The delays have been entirely due to market conditions.

Azul originally filed in May 2013 to raise up to R$1.1bn ($405m) in offerings in the US and Brazil, but those plans had to be shelved due to weak economic and market conditions. Brazil was seeing faltering GDP growth, rising inflation, currency volatility and a wave of anti-government protests.

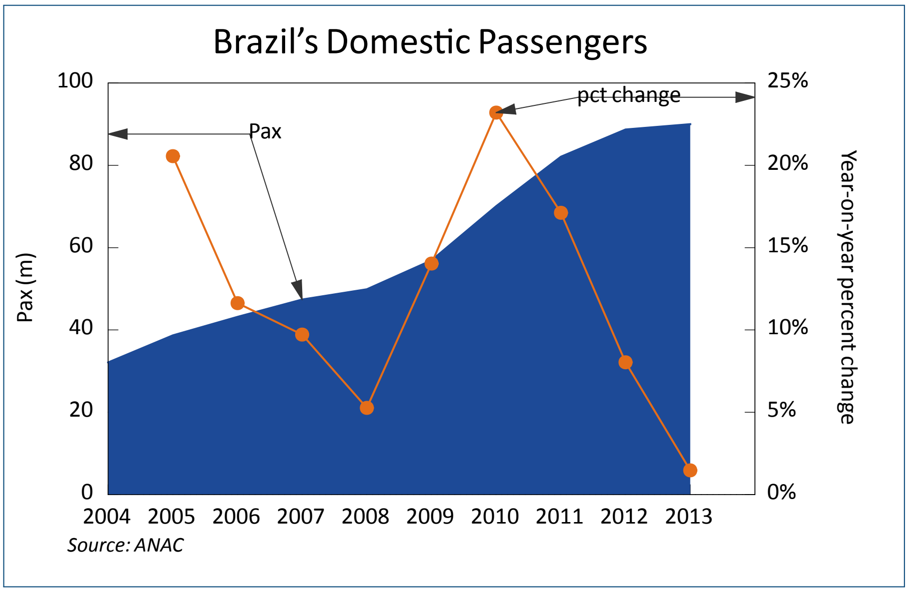
Azul briefly tried to revive the IPO plans in February, but it soon became apparent that 2014 would be another difficult year in Brazil. The airline formally withdrew its IPO registration in July.

World Cup hassles, anaemic GDP growth (0.19% projected for 2014), 6.4% inflation, depreciating currency and political uncertainty associated with October's presidential election made market conditions so dismal that only one company has managed to go public in Brazil so far in 2014 (Ouro Fino, a small veterinary products firm).

Brazil is stuck in economic doldrums. The government recently reduced its 2015 GDP growth forecast from 2% to 0.8%. But political uncertainty has dissipated; in particular, the appointment of a market-friendly finance minister in November helped improve market sentiment. Brazil has now a pipeline of IPOs and secondary offerings that some have estimated at $10-12bn.

The substantial fall in oil prices, which has lifted airline share prices worldwide, may make this an opportune time for airline IPOs. One potentially helpful trend for Azul is that Brazil's domestic air traffic has continued to grow this year, even as the economy was technically in recession. The first nine months of 2014 saw 5.4% domestic RPK growth, up from 1.4% in the same period in 2013. It was leisure traffic (as business travel has remained extremely weak), but not all of it was the lowest-yield World Cup traffic.

Azul is hoping that investors will focus on the long-term growth potential offered by the Brazilian market, and on how well it is positioned to



Brazilian Airlines' Domestic Market Shares

	% of total domestic RPKs	
	June 2014	June 2013
TAM	37.5%	39.7%
Gol	35.1%	36.0%
Azul		12.8%
TRIP		3.9%
Azul+TRIP	17.7%	16.7%
Avianca Brazil	9.0%	6.9%
Others	0.7%	0.7%
Total	**100%**	**100%**

Source: ANAC

take advantage of that growth.

Domestic passengers in Brazil have grown from 29m in 2000 to 90m in 2013, thanks to the rapid rise of Brazil's new middle class and the stimulation of low fares offered by LCCs (mainly Gol, but also Azul since its launch in December 2008). Air travel per capita still remains relatively low. Long-distance travel alternatives are limited, and there is much further potential to get people to switch from bus to air. According to Azul's filings, Brazil's domestic passenger numbers are expected to reach 122.4m in 2017, an increase of 32.4m on the 90m in 2013.

Third time lucky?

Azul has registered to sell a yet-to-be-specified number of preferred shares in simultaneous international and Brazilian offerings. The preferred shares receive dividends (0.1% of annual net income). The company plans to list the ADSs on the NYSE and the regular preferred shares on the São Paolo Stock Exchange.

Because of the aircraft leasing deals, Azul's leadership has stated that the airline has no urgent need to raise funds. Rather, the main purpose of the IPO is to provide an exit to investors, some of whom have already waited for six years.

Then again, Azul's cash reserves are low (R$348m in September 2014 or 6.6% of 2013 revenues), profitability is spotty, and the carrier has a lot of growth planned. Without the IPO, it would probably have to be urgently looking for new debt or private equity funding. As a public company, raising funds would be easier. Azul would then be able to tap the large US capital markets (debt and equity) for all of its funding needs. The IPO prospectus lists a large number of underwriters — relationship-building for future financing deals.

The IPO proceeds collected by Azul will be used to finance E-Jet and ATR deliveries, fund capital expenditures associated with adding new destinations, repay US62.3m and R$103.2m of short-term debt, and for general corporate purposes.

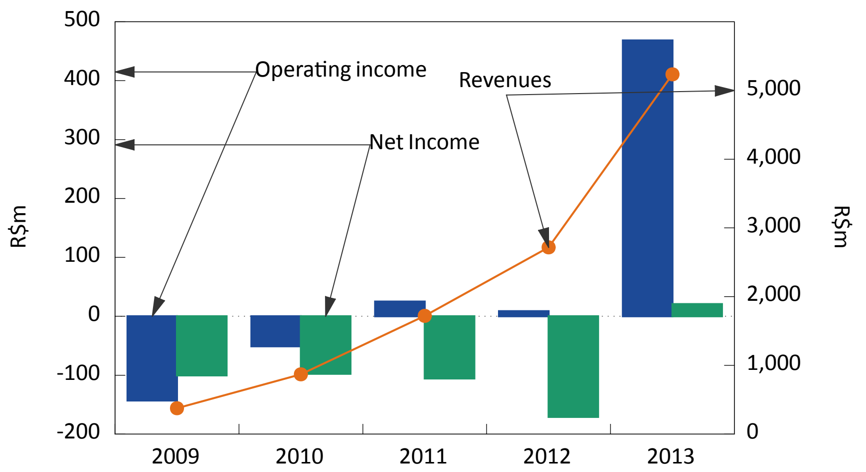
A large part of the proceeds will be collected by the selling shareholders. Azul currently has 464m common shares and 93m preferred shares. Founder, chairman and CEO David Neeleman holds 67% of the common stock; the remainder is held by the Chieppe and Caprioli families (founders and owners of TRIP, which Azul acquired in 2012).

In addition to Neeleman and the ex-TRIP executives, holders of Azul's preferred stock include private equity firms Weston Presidio, TPG Growth and JP Morgan's Gavea Investimentos — all early investors that contributed to Azul's R$400m start-up capital.

In December 2013 Azul raised R$240m in a private placement from Fidelity (US institutional investor), private equity firm Grupo Bozano and Peterson Partners. Azul issued warrants to those investors that entitle them to receive some of the preferred shares in the IPO. The Class B preferred shares originally issued to those investors will then be abolished, leaving just one class of preferred shares. Some of the IPO shares will be reserved to Azul's directors, officers, employees and FFP members.

After the IPO, Neeleman will continue to hold the majority of Azul's stock and voting rights. He will continue to control all shareholder decisions, including the ability to appoint the majority of the board of directors. Neeleman, who was also JetBlue's visionary founder, has indicated in several interviews over the years that he

Azul: Financial Results



did not like the way he was ousted from the New York-based carrier by its board of directors after one fateful snowstorm in early 2007.

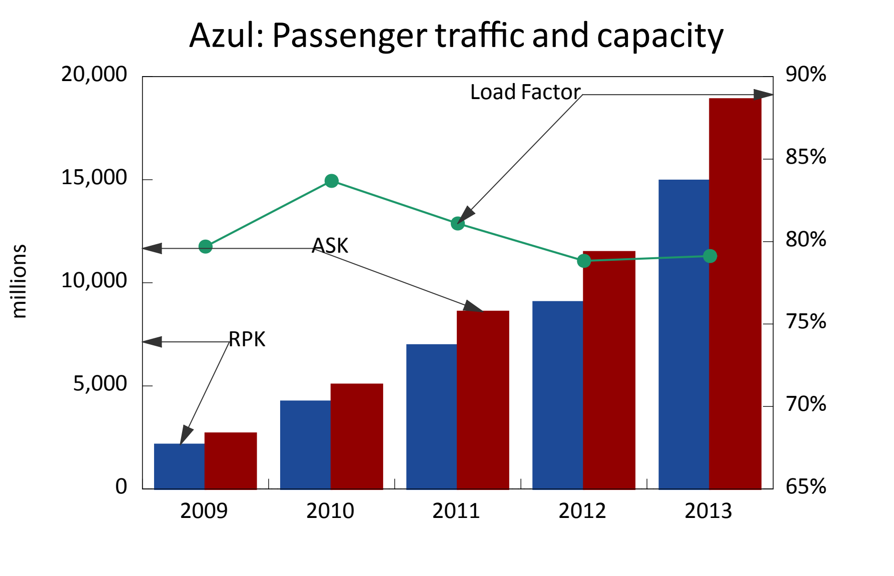
Key selling points

Azul's main selling points are its formidable route network in Brazil and its great growth prospects. However, the one thing that may ultimately sway investors is David Neeleman's track record of founding and running four successful LCCs.

He co-founded Morris Air in the 1980s (and sold it to Southwest in 1993), helped launch WestJet in 1996 and created JetBlue in 1998. At Morris he implemented the industry's first electronic ticketing system and pioneered a home reservation system that is now the foundation of JetBlue's call centre. He took the electronic ticketing to Open Skies, which he sold to Hewlett Packard in 1999.

Neeleman is an American born in Brazil, with dual citizenship. In addition to raising an impressive amount of capital for Azul from investment funds in the US and Brazil, he has built a management team that "combines local knowledge with diversified experience in and knowledge of best practices from the United States".

Azul already has the largest airline network in Brazil in terms of cities served (103) and daily departures (31.6% of the total). The airline covers all of Brazil and offers high frequencies in many markets. But the smaller aircraft have meant that its current market share (RPKs) is only 16.8% (September 2014). Azul operates a hub-and-spoke network, which allows it to consolidate traffic and serve many smaller cities.



Azul's home base and main hub is at Viracopos Airport in the city of Campinas (1m population), just 50 minutes from downtown São Paulo. The airline operates a secondary hub at Belo Horizonte's Confins.

The main hub's strategic location, its brand new \$1.5bn terminal and the feed generated by Azul's huge domestic network make the carrier well positioned to operate the US services, which its customers had been asking for years.

The business model domestically is to stimulate demand by providing frequent and affordable air service to underserved markets. The result is that Azul is the sole carrier in 65% of its existing routes and the frequency leader on another 11% of routes.

Azul has also built a strong brand. Its low fares, nonstop flights, superior offerings (leather seats, more legroom, free LiveTV) and its customer focus and fresh approach have gone down well in the domestic marketplace. Azul has been voted "best low-cost carrier in Latin America" four years in a row by Skytrax.

All of that, combined with a leading network position and a good yield management system, have enabled Azul to achieve significantly higher unit revenues than the other carriers. The PRASK premium, consistently high load factors, high efficiency and a competitive cost structure offset the poorer economics of smaller aircraft.

Azul will obviously achieve significant CASK improvements from the deployment of the widebody aircraft and the A320neos. The latter will be operated on domestic high-demand long-haul routes, including those to the Northeast of Brazil, from 2016.

Also, Azul can be expected to

Azul Fleet Plan

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
E175/190/195	26	38	69	78	81	88	86	86	86	86
ATR 42/72	1	11	49	55	52	55	55	54	54	54
A320neo							6	14	21	28
A330/A350					5	7	7	11	12	12
Total	**27**	**49**	**118**	**133**	**138**	**150**	**154**	**165**	**173**	**180**

benefit from economies of scale as it rolls out its growth strategy. This is because it created a "robust and scalable operating platform" before launching its operations, featuring advanced technology such as ticketless reservations, an Oracle financial system and electronic check-in kiosks at its main destination airports.

Azul is expected to be the main beneficiary of the Brazilian government's planned regional aviation stimulus programme, under which hefty ticket price subsidies will be paid to encourage airlines to develop regional services. The programme got delayed in November, but there is still hope that Congress could approve it early in 2015.

Azul was the main beneficiary of another government programme — the redistribution of slots at Congonhas — that took place in October. The carrier received 26 slots at São Paulo's centrally-located airport, which enabled it to start 13 daily flights to some of its most profitable destinations.

Azul's plan is to continue expanding its domestic network while "simultaneously leveraging the strong connectivity we have created in Brazil to benefit from the addition of select international destinations in the US". The next destination will be New York (JFK) by mid-2015. Two-thirds of the 24% capacity growth Azul is projecting for 2015 will come from the US services.

Growth opportunities are important, because Azul has not yet attained sustained profitability and because there is evidence of potential economies of scale. After losses or marginal operating profits in in 2009-2012, Azul's operating margin jumped to 8.9% in 2013. Also, that year Azul earned its first annual net profit of R$96m. The reason was the TRIP acquisition, which almost doubled the carrier's revenues in 2013. But Azul's earnings have again declined this year, and there was a net loss in January-September. Perhaps the international services will get Azul back on track to profitability.

By Heini Nuutinen
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WestJet: Canadian LCC diversifies into long-haul international markets

WESTJET, Canada's JetBlue-style LCC, has diversified its strategy significantly in the past 18 months. It has moved aggressively to capture business traffic, launched a regional airline subsidiary and begun seasonal transatlantic operations with 737-700s. The Calgary-based carrier is now preparing to launch widebody operations, beginning with four used 767-300ERWs in the West Coast-Hawaii markets in late 2015, with Europe/Asia following in 2016.

WestJet is probably a good candidate for growth and network diversification. It has an impeccable profit record, a strong balance sheet and ample cash reserves. It has exceeded its 12% ROIC target for nine consecutive quarters. It enjoys a relatively low cost of capital, having in early 2014 become only the second airline in North America to be rated investment-grade (after Southwest; Alaska became the third in June).

WestJet has a unique people-focused culture, an award-winning product and a strong brand. It has high productivity and efficiency levels and great cost controls.

And WestJet needs new growth areas. It does not have the opportunities that US LCCs enjoy in being able to tap the huge US market for domestic and near-international expansion. It has already captured 40% of the Canadian domestic market. It is already a major player in the Canadian winter sun market to Florida/Mexico/the Caribbean. It has tested the Hawaii routes with wetlease operations and entered the key transborder business markets. Widebody operations and Europe/Asia are the next logical steps for the carrier.

But the new strategies pose many risks. First, they represent new areas of overlap with Air Canada. Competitive clashes between the two have escalated significantly in the past two years. As WestJet set up a regional subsidiary, Air Canada added regional turboprop operations. As Air Canada launched its low-cost unit Rouge for international leisure markets (July 2013), WestJet began seasonal transatlantic forays. As WestJet began tapping the business segment, Air Canada implemented successful cost cutting; the result of that has been a narrowing of the cost gap between the two airlines. According to Air Canada, Rouge has achieved 23% and 30% lower operating costs on A319s and 767s, respectively, than Air Canada.

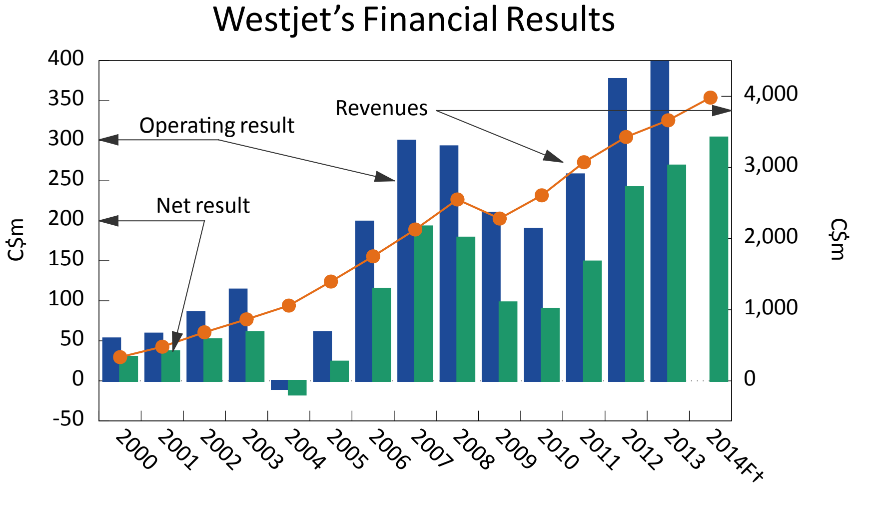
Second, WestJet's new strategies will help keep industry capacity growth in Canada well above the US market's levels. Although WestJet plans to slightly moderate its ASM growth from 6.5% this year to 4-5% in 2015, analysts believe that its growth will accelerate in 2016.

Third, the cost of adding a new widebody aircraft type and destinations in new regions are likely to keep WestJet's profit margins below those of US carriers.

Fourth, investors have questioned whether WestJet has got its capital deployment priorities right. Instead of expansion, should it not be raising its ROIC target and catching up with the US carriers' levels?

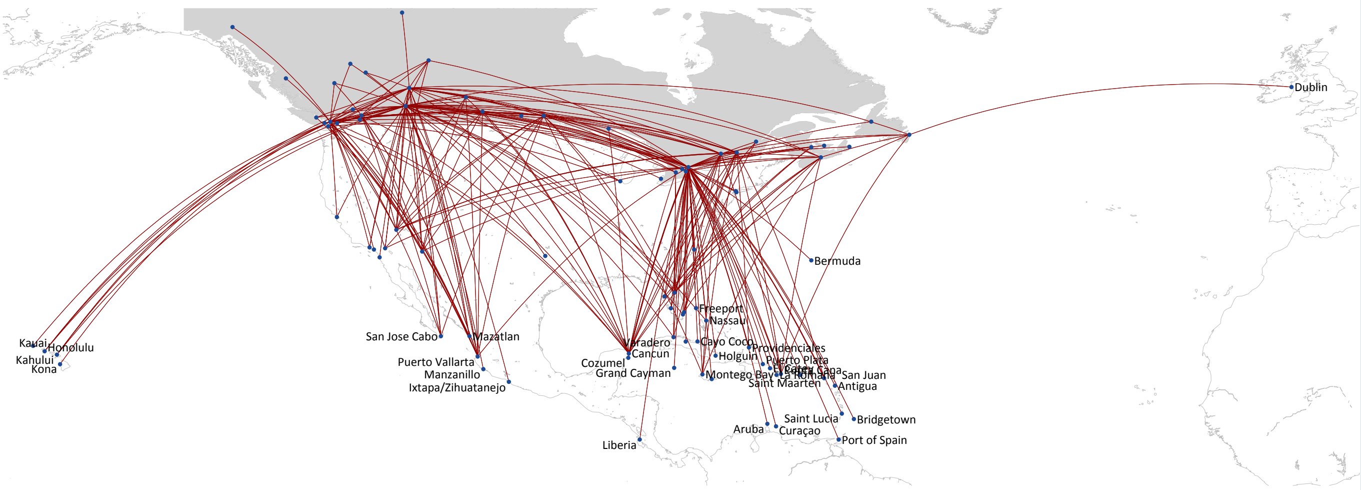
Financial strength, some concerns

WestJet has been profitable throughout its 18-year history, except for a small operating loss in 2004. Between 2004 and 2008, WestJet's ASMs almost doubled and its



†Note: Analysts' consensus estimates (December 5, 2014)

Westjet: International route expansion



revenues surged from C$1.1bn to C$2.6bn. When recession hit in 2009, WestJet quickly reduced ASM growth to 2.6%, which helped it achieve a 9.2% operating margin that year. The past three years have seen the annual operating margin steady at around 11%.

The consistent earnings have enabled WestJet to maintain a healthy balance sheet. Cash amounted to C$1.4bn in September, 36.5% of trailing 12-month revenues. Adjusted debt-to-equity ratio was 1.49. ROIC in the 12 months ended September 30 was 13.8%.

But continued fleet spending has meant negative free cash flow, which is not likely to change anytime soon. Capex is projected to be C$820-840m in 2015.

Obtaining the BBB- credit rating with S&P has opened up attractive new debt financing options for WestJet. The first of those materialised in July: a private offering of C$400m of unsecured five-year notes that have an interest rate of only 3.3%. Being able to tap the unsecured market like that adds much flexibility to WestJet's fleet financing plan.

But WestJet no longer stands out from the crowd in terms of financial performance. In the third quarter, six of the top nine US carriers had higher operating margins than WestJet's 12.5%. Analysts believe that WestJet's earnings growth will lag that of its North American peers in the next couple of years.

Capacity growth appears to be the main culprit. Industry capacity in Canada has increased at a faster rate, leading to a less favourable pricing environment (even as air travel demand has remained strong). While WestJet's ASM growth has moderated, it still amounted to 11.1% in 2010, 8.5% in 2011, 4.1% in 2012, 8.6% in 2013 and around 6.5% in 2014.

Another negative this year has been the decline of the Canadian dollar against the US dollar (over 7% so far this year), which has increased WestJet's aircraft leasing, maintenance and interest expenses. About one third of WestJet's total costs are denominated in US dollars or linked to US$ indices. WestJet lacks the diverse foreign currency revenues enjoyed by Air Canada that would help compensate. And it could see demand weaken in the Canadian southbound leisure market because of the C$/US$ exchange rate.

There are also concerns about price wars in the Canadian southbound market this winter because of intensified competition. On those routes WestJet faces not just Air Canada's Rouge but a revitalised CanJet, which has launched its own tour operator business and charter flights from Toronto to southern destinations.

However, WestJet's earnings should soar in the near term because of the fall in oil prices. WestJet will benefit fully because it does not have fuel hedges in place.

That said, the effects of the oil price decline are more complicated for Canadian carriers, because the country is a net exporter of oil. The currency effects are a major negative for WestJet, but at this point the GDP impact seems minimal. A December 12 report from Royal Bank argued that an increase in non-energy related exports would offset the effects of lower oil prices. The report predicted that the net impact from lower oil prices in 2015 will be negligible in terms of real GDP and that GDP growth would amount to 2.5% this year and 2.7% in 2015. The report assumed WTI oil price averaging $70 in 2015.

WestJet has indicated that it will be revisiting the 12% ROIC target. It is committed to continued stock buybacks and dividends, but the bulk of the cash will go to funding aircraft deliveries. WestJet has US$6.9bn of aircraft commitments, including 65 737 MAX deliveries in 2017-2027. But the fleet plan has much flexibility built in (see table).

Cost and revenue measures

The combination of significant new cost pressures and a desire to tap the business and corporate travel segments has kept WestJet's management busy implementing new cost and revenue initiatives.

The cost challenges arise from inflation across the board, the expense of adding new cities and aircraft types, the weaker Canadian dollar and the shorter stage lengths associated with Encore. The narrowing cost differential and increasing competitive overlap with Air Canada also call for special measures.

In 2013 WestJet initiated a new cost-cutting programme aimed at reducing annual operating expenses by C$100m by year-end 2015. It has already achieved a run rate of C$125m annual cost cuts, a year ahead of schedule. But ex-fuel CASM has still risen by 1-1.5% this year and is projected to rise by 2-3% in 2015.

Longer-term strategies to help keep unit costs in check include the substantial 737 MAX orders, a move into widebody operations and potentially increasing seating density following the installation of new slimline seats on the 737s. The seats are part of a major investment in new in-flight entertainment systems, including satellite-based Wi-Fi. Half of WestJet's 737s will have the seats by the end of 2015, with the rest following in 2016.

The slimline seats will give WestJet a choice: either improving passenger comfort or getting a material unit cost reduction by adding six seats to each aircraft. This is because even though the seat pitch will stay physically the same, the new slimline seats "will give effectively an extra inch of knee room".

Unfortunately WestJet is not ready to make that decision at the time of the slimline seat installation (which might be the most cost-effective time to add more seats). Instead, the carrier will wait and see how passengers respond to the new seats.

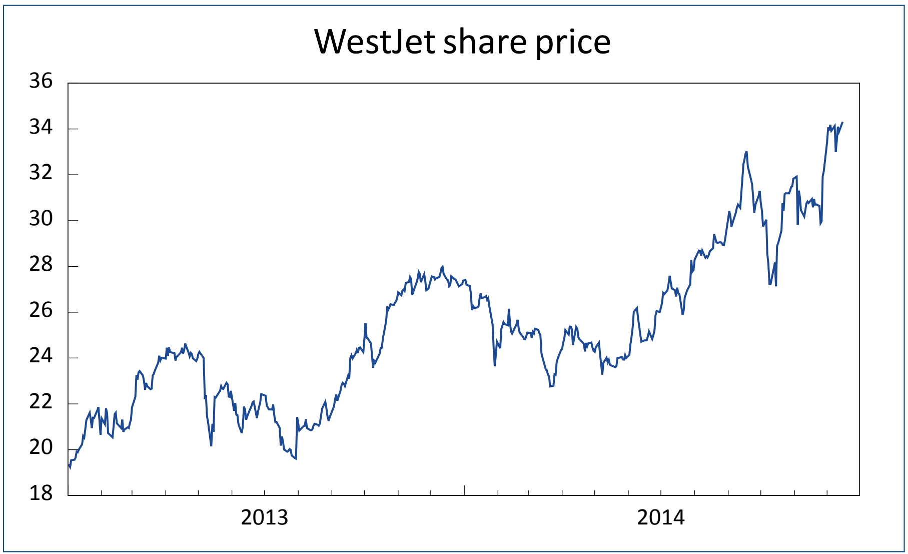
In recent years, WestJet has gone after the business and corporate segments quite methodically. First, in 2011 it made its schedules more attractive to business customers, especially in the Eastern Triangle linking Toronto, Ottawa and Montreal. Then came a multitude of product initiatives aimed at attracting business traffic or creating new ancillary revenue streams.

WestJet added premium economy seating with extra-legroom in the first three rows of aircraft in late 2012. The JetBlue-style product is sold for a fee at the gate or at a "Plus" fare in advance. "Plus" is the highest and most flexible of three fare bundles that were introduced in 2013.

Westjet's Flexible narrowbody fleet plan

	Fleet	Aircraft deliveries/disposals								Fleet
	Sep 2014	Q4 2014	2015	2016	2017	2018-20	2021-23	2024-27	Total	2027
737-600	**13**									**13**
737-700	**69**									**69**
737-800	**27**	3	10	7	1				21	**48**
737 MAX7						6	4	15	25	**25**
737 MAX8					4	19	11	6	40	**40**
Disposals		-5	-5						-10	**-10**
Maximum 737 fleet	**109**	-2	5	7	5	25	15	21	76	**185**
Lease expiries			-11	-7	-6	-13	-7		-44	**-44**
Minimum 737 fleet	**109**	-2	-6		-1	12	8	21	32	**141**
WestJet Encore Q400	**14**	2	9	5					16	**30**

Notes: (1) Table excludes the option to lease or purchase four 767-300ERWs from Boeing secured in July 2014. (2) 13 of the 737-800 deliveries in 2015-2017 can be converted to the 737-700. (3) WestJet has options for ten 737 MAXs that would deliver in 2020-2021. (4) The MAX 7 and MAX 8 orders can be substituted for one another or for the MAX 9. (5) There are options for 15 Q800s in 2015-2018.



Like other LCCs, WestJet is finding premium seating to be a good revenue generator. Demand has been strong, and the upgrade fee on long-haul routes was recently increased from C$45 to C$50. Revenues are running at the upper end of the C$50-80m target range.

Thanks to Plus, a co-branded credit card and other initiatives, ancillary revenues were up by 17% to C$51.4m or C$9.80 per passenger in the third quarter.

Recent months have seen important new revenue initiatives: a C$25 fee for a first checked bag and major improvements to the FFP. The latter included the introduction of rewards tiers and features such as "status match" to encourage Air Canada's FFP members to try out WestJet's programme.

In September WestJet fell in line with the US airline industry in charging a fee for a first checked bag. One complicating factor had been that Air Canada was not charging that fee domestically, but after WestJet's announcement Air Canada quickly matched it. (In the US, JetBlue also added that fee in November, leaving Southwest as the lone holdout.)

WestJet's bag fee applies to those traveling on the lowest fare bundle (Econo) within North America. There are plenty of exceptions. Only one in five passengers is affected, which could bring in up to C$100m annually. On top of that there will be the benefit of some people upgrading to the "Flex" fare category.

WestJet is committed to passing some of the benefits of the unbundling to passengers in the form of lower "Econo" fare sales, which also aim to stimulate demand. One such sale was launched immediately after the first bag fee announcement.

WestJet has many more revenue initiatives in varying stages of development that will boost ancillary revenues in the future. The most obvious ones are potential fees on Wi-Fi and inflight entertainment systems.

Growth plans

WestJet has a simple purpose: to be Canada's low-fare leader, and to go where Canadians want to go (at least those are the aims that its executives frequently refer to).

Canadians definitely want to go the sun destinations to escape their harsh winter. The southbound leisure business will always be important to WestJet; after all, it is critical to the carrier's seasonal aircraft deployment strategy (under which large chunks of capacity are shifted twice annually between the domestic market and the winter sun routes).

Those routes now have much competition and overcapacity, but WestJet is to some degree insulated from price wars in the package holiday segment as it gets more feed from its domestic network and carries more VFR, timeshare and second-home traffic.

The new wholly-owned regional subsidiary Encore, which WestJet launched in July 2013, is helping provide that feed, though a more noble purpose is to "liberate smaller communities from the high cost of regional air travel". The Calgary-based unit has its own president, workforce and headquarters. WestJet chose the 78-seat Q800 turboprop over the ATR 72 for its unit and placed orders with Bombardier for up to 45 Q800s. Encore began operations in western Canada but now also serves points in the east. In October it operated 14 Q800s and over 100 daily departures to 19 destinations. Fleet is projected to grow to 25 aircraft by year-end 2015, and the 20 currently held options would deliver in 2016-2018.

WestJet considers the regional routes a "natural evolution". Encore has stimulated demand with its low fares. About half of the 4-5% systemwide ASM growth that WestJet projects for 2015 will be at the regional unit.

While the business-oriented US markets are also important for WestJet, the carrier opted not to join its US LCC peers in bidding for the American-US Airways DCA slot divestitures. WestJet's entry into LGA in 2012 was its first major foray into the Canada-US business market, and since then it has also added DFW to its network.

At DCA, and certainly in long-haul international markets, WestJet has long relied on airline partners. It has an "open architecture" type alliance strategy similar to those of JetBlue and Gol. It has codeshare agreements in place with 12 carriers, including Delta and American.

As an interesting twist to its network strategy, in June WestJet launched its own daily scheduled seasonal Toronto-Dublin services, operated via St. John's (Newfoundland), a stop mandated by ETOPS rules. Those flights have been successful and will be resumed in May 2015, when WestJet will also launch its second transatlantic route, Toronto-Halifax-Glasgow. The latter offers passengers daily connections via Halifax or Toronto to/from 22 other WestJet cities in Canada.

Those services tap into the strong historical and ethnic connections between Canada and both Ireland and the UK. The markets have significant VFR traffic. And the drastically lower fares (up to 50% off existing fares) have stimulated much new demand.

WestJet has said that it sees potential to fly to four or five cities in Europe out of Atlantic Canada (probably mainly in the UK). But, mainly, it views these services as a useful learning experience in the European market as it prepares to receive its first widebody aircraft in mid-2015.

Under a July 2014 agreement, WestJet is either leasing or buying four used 767-300ERWs from Boeing. The aircraft are expected to seat 262 (including a version of Plus seating). After an initial run in North America for ETOPS approvals, the 767s will enter WestJet service in late 2015 for the winter season in the Alberta-Hawaii market, where they will replace two 757-200s currently operated by Thomas Cook. In the spring of 2016 the four aircraft will be launched in yet-to-be-specified international markets.

WestJet has said that it is considering various routes to Europe and Asia and that it will announce the 2016 destinations in mid-2015. It could be more UK cities, or Mediterranean or Asian sun destinations, avoiding the routes on which Air Canada has already deployed Rouge.

WestJet's management has reportedly indicated that there could be more used 767-300ERs available from Boeing for further growth. But because of the riskier nature of long-haul international expansion and the tougher economics for LCCs, WestJet can be expected to grow in those markets at a measured pace.

Freighter values and lease rates

THE following tables reflect the current values (not "fair market") and lease rates for cargo aircraft. Figures are provided by The Aircraft Value Analysis Company (see below for contact details).

The values and rates reflect AVAC's opinion of the worth of the aircraft in the present market. 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.

Freighter values
(US$m)

	New	5 years old	10 years old	20 years old
A300B-600SF				13.2
A330-200F	91.5	77.3	39.0	
737-300QC				6.0
747-400M				19.8
747-400F		68.3	55.7	30.6
747-400ERF		70.2	57.9	
747-800F	186.5	147.2		
757-200PF				13.4
767-300F	55	45.1	35.2	
777-200F	164.2	131.4		
MD-11C				10.6
MD-11F				14.2

Freighter lease rates
(US$000s per month)

	New	5 years old	10 years old	20 years old
A300B-600SF				160
A330-200F	755	643		
737-300QC				94
747-400M				246
747-400F		737	623	412
747-400ERF		750	655	
747-800F	1776	1444		
757-200PF				144
767-300F	357	338.0	300	
777-200F	1642	1371		
MD-11C				163
MD-11F				217

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