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EasyJet's expansion plans: aberration or innovation

EasyJet's expansion plans have been met with a mixture of surprise and apprehension in the investment community. This is understandable as easyJet seems to be veering away from the classic model of low-cost airline growth by contemplating a fleet split between 737NGs and A320s and by moving to acquire its low-cost rival Go and the intra-German carrier Deutsche BA.

Southwest, the low cost paragon, itself diverged from a strategy of pure organic growth when it bought Morris Air in 1991, and it now operates four types of 737 (-200, -300, -500, -700) which do not have a great deal of communality among them. Nevertheless, easyJet's announcements indicate that it has made the decision that at this point in the European aviation cycle, things will be done differently than in the US.

The timing issue is important. At present, European low-cost carriers have a major opportunity to rapidly expand their market share, partly because their AEA competitors are in disarray. Post September 11, the flag-carriers have been forced into serious capacity reductions, aircraft parking and widespread job-cutting. This has resulted in routes and slots becoming available (at Gatwick and Paris for easyJet) at the same time as aircraft prices have slumped and the supply of pilots and other airline personnel has increased. The travelling public is clearly attracted by the low-cost product, not only by the prices but also by the simplicity of being able to compare fares and book online.

In short, a possibly unique opportunity exists for easyJet to grow rapidly by buying market share rather than by growing the market as it has done in the past. And already there are signs that market conditions are changing - for example lease rates are edging up and some of the Euro-Majors, notably BA, are putting together coherent strategies for the intra-European market.

To state the obvious: the European internal market has many differences from the US. It is not homogenous, and national flag-carriers are still able to exercise control by various mechanisms. It is difficult for a UK-based carrier to move smoothly into continental European bases and build frequencies rapidly. Taking over Go and DBA may allow easyJet to shortcut these barriers.

The risks are equally obvious: easyJet may end up buying an incompatible partner. However, easyJet appears to have no illusions about the merger process: the Go and DBA brands and cultures will be completely subsumed if the offers are successful. Also, easyJet's management does have experience of the practical difficulties of absorbing an acquired company. The purchase of TEA Switzerland in 1998 was a relatively small transaction, but it has revealed the full spectrum of integration problems.

CONTENTS

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Just Go

Easyjet's official line on the Go deal is that " Exclusive negotiations are at an advanced stage…further announcement to be made in due course …acquisition must be in the interests of shareholders, customers and staff".

At the highest level, the easyJet/Go combination does appear to make sense. Their business models are similar, based on point-to-point, high utilisation, no frills, low-cost, building frequency, internet distribution and serving primary airports. Go's fleet is compatible - 737-300s configured to 148 seats. Go, although it has achieved success since its escape from BA, does not have as clearly defined a role as Ryanair, the cheapest carrier in the business, nor easyJet, the web's favourite airline and lately the budget businessman's airline.

There are a number of complementary issues regarding the two carriers' networks.

First, there would appear to be a major potential for rationalising the UK trunk routes from London Stansted (in Go's case) and London Luton (in easyJet's case) to Belfast, Glasgow and Edinburgh. Here one option would be to combine the routes at one of the two airports (and in the process play the two airport owners off against each other) while at the same time expanding service from Gatwick to these points. This would give easyJet dominance north and south of London.

It will be interesting to see if the deal is investigated for anticompetitive implications. Presumably not, as bmi and BA (for the moment) provide competing services from Heathrow.

Second, Go would provide easyJet with its first link into Germany. Go flies to Munich which is the DBA's base (see below).

Third, easyJet would take over Go's Italian service, bringing it into a new country. (easyJet's previous reluctance to serve Italy is believed to be connected to a legal case following a fatal accident at Genoa in which a tanker, owned by Stelios Haji-Iannou's Stelmar company, exploded; this case has now been resolved in Stelmar's favour.)

The UK-Italy market has proved very profitable for Ryanair which has gained a 30% market share flying to secondary airports (Treviso, Bergamo, Ancona, etc but also now Rome Ciampino). Go has the network to five primary points (Milan, Venice, Bologna, Rome and Naples) but has not yet developed frequencies, and is estimated to have a market share of about 6%. Alitalia, having just announced net losses of €1bn for 2001, should be getting even more worried.

Fourth, there should be potential for synergies in the Spanish market where the two carriers serve some of the same destinations (Barcelona, Palma, Malaga) albeit from different UK regions. Ryanair remains excluded from the Iberian market because the airport authorities refuse as yet to sign the type of airport deals that are central to its operations.

Fifth, the acquisition of Go will remove potential competition between the two carriers on routes to Nice, allowing easyJet to concentrate on building its base at Paris Orly from where it will launch four routes in the second half of this year.

DBA

The agreement easyJet has signed with BA regarding DBA is very different from the Go proposal. easyJet has an option to buy 100% of DBA at any point over the next 12 months for a price between €30m and €40m. The cost of the option is €5m plus €600,000 per month.

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NEW DATABASE PAGES

Financial and traffic statistics at the back of the newsletter have been revamped - comments welcome

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	EasyJet	Go	DBA
Bases	London Luton	London Stansted	**Munich**
	London Gatwick	East Midlands	
	Liverpool	Bristol	
	Geneva		
	Amsterdam		
Points served	**Belfast**	**Belfast**	Berlin
	Glasgow	**Glasgow**	Hamburg
	Edinburgh	**Edinburgh**	Dusseldorf
	Aberdeen	Newcastle	Bonn/Colgne
	Inverness	**Nice**	Stuttgart
	Paris Orly*	**Barcelona**	**Malaga**
	ParisCDG	Bilbao	
	Nice	**Palma**	
	Zurich	Ibiza	
	Athens	Alicante	
	Barcelona	**Malaga**	
	Palma	Faro	
	Madrid	Milan	
	Malaga	Bologna	
		Venice	
		Rome	
		Naples	
		Munich	
		Prague	
		Copenhagen	

*Notes: * Will become a base in the second half of this year*
Overlapping destinations are shown in bold

easyJet will second three managers to DBA with the purpose of converting the carrier to the low cost model. Some of the conversion issues are relatively clear-cut: DBA's 16 737-300s will be reconfigured from 136 seats to 149, and web-based sales will be accelerated.

The unknown factor is whether union agreements can be sufficiently adapted to replicate a low-cost operation (BA decided that the union agreements would prevent it from radically changing DBA's cost base). Changing the corporate culture from its current form, a mini-version of BA/Lufthansa, reinforced by German labour regulations, is the main challenge.

Nevertheless, this may be a low risk way for easyJet to assess and enter the German market. The domestic market alone is about 22m passengers a year, and is dominated by Lufthansa and its affiliates (Eurowings, for example). DBA currently operates from its Munich base to five key cities, as well as charter flights and a holiday route to Malaga starting in June. The intra-Europe international market is at least equally important - this is a still largely traditional bilateral regime, only recently disturbed by the high-profile arrival of Ryanair at Frankfurt Hahn.

There does appear to be unexploited potential for Internet sales in Germany - there are apparently 29m Internet users - but there is also a certain reluctance to make credit card transactions over the phone.

Lufthansa's reaction to easyJet/DBA will of course be critical. There does seem to be a certain reluctance to countenance the possibility that Lufthansa will be faced with the same degree of competition in a few years as BA experienced a couple of years ago. The chairman-designate of Lufthansa, Wolfgang Mayrhuber, has been quoted, perhaps too cryptically, as completely dismissing the threat from the low-cost carriers.

Low-cost subsidiaries: compromise carriers

Air Canada is the latest of the major carriers to experiment with a new low-cost subsidiary. Air Canada ZIP will be based at Calgary initially operating six 737-200s, with plans to grow to 22. The new carrier will take on the successful and expansionist WestJet. This is despite the miserable performance of such ventures in the US where there has been a long list of failures from Continental Lite in the mid 90s to US Airways' MetroJet last December.

In Europe many of the Euro-majors, including Lufthansa, are considering whether they should set up a lower cost subsidiary. KLM is currently the leading exponent of low-cost subsidiaries, and has announced plans to expand Buzz by merging it with Basiq Air, the low-cost scheduled arm of KLM's charter carrier Transavia.

One of the fundamental problems with low-cost subsidiaries is that they are compromises. The parent airline's aim is usually to counteract low-cost competition but it has to do this without either disturbing its own unions or undermining its core network business. Consequently a series of conflicts arise.

Airport base

To leverage the benefits of a low-cost subsidiary, the optimal place to locate it might be at the main hub where yields are strongest (despite the fact that airport charges are likely to be high there). This is rarely if ever possible because of fears of brand pollution and union agreements. Locating at a secondary airport at the incumbent airline's main city base then seemed to be a good idea: establishing Go at Stansted, it was thought, would not only inhibit the growth of Ryanair but would also tie up slots at London's third airport.

That didn't work for BA - Go helped stimulate the overall low-cost market and cannibalised BA's Heathrow traffic. BA has in effect been forced to retreat further into Fortress Heathrow, while its control of the London market has been eroded. Heathrow is the most convenient airport for west London, but the low-cost carriers are in a stronger position in of north and east London (easyJet at Luton; Ryanair, Go and Buzz at Stansted) and now south London (easyJet at Gatwick).

Conflict between BA and Go was further intensified because the UK competition authorities insisted that the two operations be conducted completely separately. The result was Go planned its network growth independently from BA and gave its parent some nasty surprises when it announced the launch of competing services.

Rod Eddington's assessment of Go when he arrived at BA was that it was not, as his managers claimed, a response to the low-cost threat but a way for the mainline carrier to avoid really confronting the low-cost threat. He was probably right even if the price he sold Go at, £100m, now looks distinctly cheap.

Union considerations

Frequently low-cost subsidiaries are seen as a way of tackling labour costs without confronting unions - a variation on the A/B wage scales introduced by American in the 80s. The unions themselves tend to be deeply suspicious of such ventures, regarding them, quite correctly, as a potential threat. Their response is to attempt to ring-fence the subsidiaries' activities - to impose a scope agreement like those the US Majors' pilots have negotiated with regard to the regional affiliates and the low-cost subsidiaries.

Post September 11, the US Majors largely abandoned their low-cost experiments. US Airways closed down MetroJet, United ended California-based Shuttle by United and Delta reduced Delta Express's operation by half. In all cases the airline managements cited union undermining of their cost structures - not so much in terms of pilot salaries as in terms of productivity.

In Europe low-cost subsidiaries have been neutralised by becoming just like their parent. Alitalia Team was a brave attempt to tackle cost problems by shifting operations to a more efficient structure. But now Alitalia is now almost 100% Alitalia Team, and most of the efficiency gains have evaporated leaving Alitalia again in a distressed financial situation. Macedonian Airlines in Greece was an attempt to at least challenge Olympic's all-powerful labour force by outsourcing some services to a more cost-effective subsidiary, with crews flying on more flexible working practices. Inevitably, they have managed to make so many modifications to the rule book that Macedonian is now just as costly as its parent.

Mainline legacy

One of the great hopes for low-cost subsidiaries is that they will be able to combine some of the best elements of the mainline carriers with the operational efficiencies of a dedicated low-cost operator.

Unfortunately, rather than a halo effect, low-cost subsidiaries tend to cause brand confusion. For example, customers became confused and frustrated by differentiation between CAL Lite and Continental Airlines - it just seemed that service was even worse on some flights than on other. Air Canada risks further undermining its brand if ZIP is perceived as a lower quality, same fare carrier in western Canada (this is how WestJet's management expects ZIP to impact their business).

In terms of technology transfer from the mainline to the subsidiary, there does appear to be much scope because yield management systems, internet booking engines, etc have to be specifically designed for the low-cost model.

Fleet planning in a low-cost subsidiary has frequently proved to be an exercise in expediency. MetroJet inherited unwanted and fuel-inefficient 737-200s from US Airways; ZIP is getting a similar deal from Air Canada. Buzz's fleet reflects its history - a mix of 100-seat BAe 146s from KLM uk plus some 737-300s. KLM is only now addressing Buzz's fleet problems, and will probably opt for an all 737 operation.

It is a little ironic that one of the major concerns when Go was set up was that it would benefit unfairly from BA's superior credit rating when leasing aircraft. Now the leading low-cost carriers have credit rating and stock market valuations well in excess of the mainline carriers. Airbus and Boeing are desperate for their business, and they can negotiate the best unit prices.

Rationale?

So, is there a rationale for low-cost subsidiaries in the European market?

There is the hope that it is possible to improve the low-cost subsidiary model so that it does work effectively. Most of the early attempts at low-cost carriers in the deregulated European market failed, and lessons were leant from those failures.

For some of the beleaguered mainline carriers, creating a low-cost subsidiary may be an emergency fall-back strategy. They will have set up a legal entity and an embryonic airline to retreat into if competition gets really tough, and bankruptcy looms.

Market balance: gradual resolution

The jet aircraft global imbalance is gradually being resolved, mostly through the supply rather than the demand side.

Traffic figures remain depressed. In the first quarter of this year the US majors showed a traffic decline of 10% domestically and 12% internationally while AEA RPKs were down 10% intra-Europe and 9% intercontinentally. (The European figures do not reflect the impact of Europe's low-cost carriers - intra-Europe traffic would have been marginally positive if their RPKs had been included.)

The positive indicator is load factor, which is consistently strong in all markets, indeed at record levels for March on transatlantic and transpacific routes. At these levels it should be possible to push up yields again, and that is of course what most airlines are trying to do. The counter-effect for business travel orientated carriers is that the yield mix is continuing to deteriorate as passengers downgrade from business class.

There are reports that some airlines have now decided to accept deliveries postponed from last year - Iberia is taking its A320s for example - but aircraft orders are limited to those from the low-costs and Asian carriers, which are showing signs of renewed confidence.

Boeing has now confirmed that deliveries this year will be about 380 units, down almost a third from 2001; 2003 deliveries are estimated at less than 300. Airbus is on target for about 280 units this year, down 14% from 2001.

Even more important for market balance is the number of aircraft now parked which are never likely to return to passenger service. Our calculations show the theoretical surplus (see Aviation Strategy, February 2002) at just over 2,300 units. Lo and behold there are at present 2,300 aircraft parked according to ACAS. The age/type profile is detailed below: it suggests that about half the parked aircraft are permanently out of commercial service. The peak of the storage trend has now been reached and aircraft are starting to be deparked (as Lufthansa describes it).

Finally, we present opposite a summary of some of the key values of new and second-hand jets as assessed by the Aircraft Value Analysis Company (AVAC). The significance of AVAC's values is that they actually represent market values, estimates of the prices that aircraft might be traded at. Other appraisers tend to rely on concepts like base or fair market value that depends on assumptions of theoretical market balance.

PARKED AIRCRAFT BY AGE AND TYPE

Age in years	< 1	1 to 4	5 to 9	10 to 14	15 to 19	20 to 24	25 to 29	30 to 34	35+	Total
707	0	0	1	0	0	0	6	36	21	**64**
717	7	13	0	0	0	0	0	0	0	**20**
727	0	0	0	0	10	173	121	65	59	**424**
737	13	30	22	89	111	102	61	57	0	**485**
757	0	1	6	10	15	1	0	0	0	**33**
A318	1	0	0	0	0	0	0	0	0	**1**
A319	4	14	0	0	0	0	0	0	0	**18**
A320	2	9	12	16	1	0	0	0	0	**40**
A321	0	12	2	0	0	0	0	0	0	**14**
DC9	0	0	0	0	0	38	46	82	19	**185**
MD80	0	1	6	24	26	24	0	0	0	**83**
MD90	0	7	4	0	0	0	0	0	0	**11**
Caravelle	0	0	0	0	0	3	0	5	8	**13**
747	3	2	6	7	21	54	26	39	0	**158**
767	0	3	6	15	19	0	0	0	0	**43**
A300	0	0	0	0	14	24	3	0	0	**41**
A300-600	0	2	7	9	3	0	0	0	0	**21**
A310	0	0	2	16	10	0	0	0	0	**28**
A330	2	10	5	0	0	0	0	0	0	**17**
A340	4	2	7	1	0	0	0	0	0	**14**
DC10	0	0	0	1	0	34	72	12	0	**119**
DC8	0	0	0	0	0	0	1	67	18	**86**
L1011	0	0	0	0	6	47	39	0	0	**92**
MD11	0	2	11	2	0	0	0	0	0	**15**
1-11	0	0	1	1	2	5	1	34	17	**61**
146	1	0	3	26	12	0	0	0	0	**42**
F100	0	0	16	36	1	0	0	0	0	**53**
F28	0	0	0	2	26	11	15	10	0	**64**
145	3	1	0	0	0	0	0	0	0	**4**
328JET	2	3	1	0	0	0	0	0	0	**6**
CRJ	1	32	1	0	0	0	0	0	0	**34**
Concorde	0	0	0	0	0	1	3	0	0	**4**
Total	**43**	**144**	**119**	**255**	**277**	**517**	**394**	**407**	**142**	**2,300**
Age profile	**1.9%**	**6.3%**	**5.2%**	**11.1%**	**12.0%**	**22.5%**	**17.1%**	**17.7%**	**6.2%**	**100%**

Source: *ACAS, as at March 2002.*

NARROWBODY CURRENT VALUES (US$ millions)

	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A318	30.8				717-200	22.4			
A319 (IGW)	33.6	26.6			727-200Adv				1.8
A320-200 (IGW)	40.2	31.8	23.4		737-200Adv				3.0
A321-200 (LGW)	46.5	37.0			737-300 (LGW)		17.1	21.1	
					737-400 (LGW)		21.8	17.4	
					737-500		18.2	13.2	
					737-600	30.4			
					737-700	34.1			
					737-800	42.3			
					737-900	43.6			
					757-200	45.4	36.5	27.6	
					757-200ER	47.9	38.7	29.5	
					757-300	54.2			
					MD-82			13.1	8.1
					MD-83		17.9	14.8	
					MD-88		18.24	15.0	
					MD-90		20.1		

WIDEBODY CURRENT VALUES (US$ millions)

	NEW	5 years old	10 years old	20 years old		NEW	5 years old	10 years old	20 years old
A300B4-200				6.8	747-200B				12.4
A300B4-600			20.8		747-400	135.4	105.1	74.9	
A300B4-600R (HGW)		47.0	34.0		767-200			22.6	10.0
A310-300 (IGW)		40.5	29.0		767-300		51.4	36.3	
A330-200	89.6				767-300ER (LGW)	75.9	59.6	43.3	
A330-300 (IGW)	89.6				767-400	81.8			
A340-200		65.0			777-200	100.9	79.3		
A340-300 (LGW)	97.3	77.8			777-200ER	116.7	94.7		
A340-300ER	105.0	84.9			777-300	121.8			
A340-500	117.4								
A340-600	137.6								
					DC-10-30				10.0
					DC-10-40				3.3
					MD-11P		55.2	41.7	

Source: AVAC
Notes: As assessed at end-April 2002, mid-range values for all types

Regional spin-offs: a unique investment opportunity

Following on from JetBlue's extremely successful IPO (*Aviation Strategy*, April 2002), two US Majors are tapping the equity markets for new funds - not directly, but through the spin-offs of their regional carrier subsidiaries.

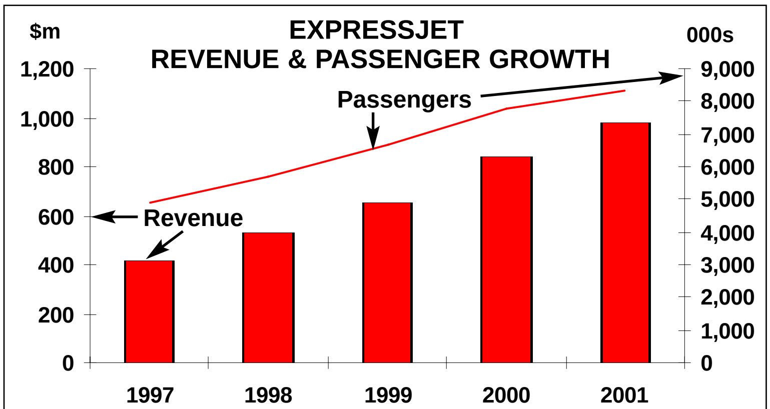
In a marketing splurge both regional carriers were re-christened, Continental Express became ExpressJet and Pinnacle Airways emerged out of Express 1, a Northwest Airlink commuter. ExpressJet has hubs at Houston, Cleveland and Newark, while Pinnacle feeds its parent at Detroit, Minneapolis and Memphis.

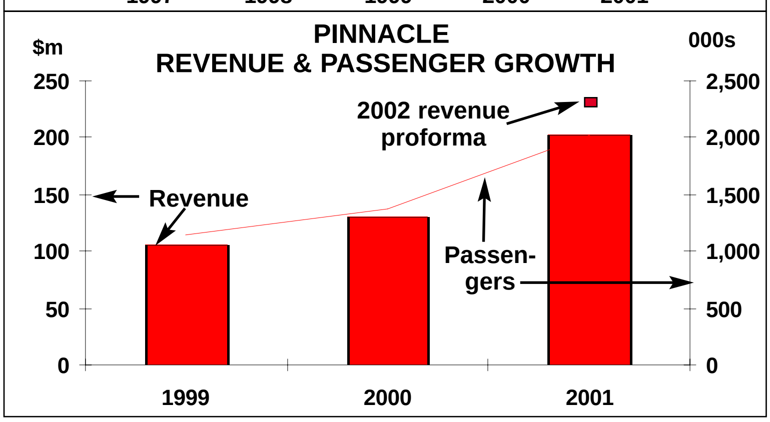
In mid-April the ExpressJet IPO was launched by Salomon Smith Barney, the price having being pushed up from $14 to $16 a share and the number of shares on offer increased. The IPO capitalised ExpressJet at just under $1.1bn, which, remarkably, is above the equity market valuation of UAL and compares to $1.6bn for its parent, Continental Airlines. Continental in effect received all of the funds, about $480m from the flotation, and its stake in ExpressJet was reduced from 100% to 53%.

The schedule and pricing of the Pinnacle IPO, led by Morgan Stanley, has not yet been finalised, but it could capitalise the carrier at $800m compared to a current stockmarket valuation of $1.7bn for NWA Corp.

Investor confidence

It is clear that investors are showing much more confidence in the fast-growing regional sector: Pinnacle more than doubled its traffic and capacity during 1999-2001 while ExpressJet grew by about 60% over the same period. The impact of September was significant but nowhere near as severe as that on the US Majors: for example, ExpressJet noted that its revenue declined by 6% in the second half of 2001 compared to the first half, the equivalent decline for the Majors was 19%.





Yet the regionals are almost totally dependent on their parent for traffic and cashflow. Both ExpressJet and Pinnacle operate using capacity purchase agreements (having changed from revenue-sharing agreements which simply prorated revenue for passengers connecting between the regional and mainline carriers).

In ExpressJet's case Continental pays its regional carrier a rate per block hour, which is designed to provide ExpressJet with an average operating margin of 10%. If uncontrollable costs such as fuel, insurance, ground handling fees, etc. vary so that the operating margin drops below 8.5% in any quarter, Continental makes a compensation payment to ExpressJet to bring the margin back up to 8.5%. If the margin rises above 11.5% ExpressJet compensates Continental so that the margin is reduced to 11.5%. In calculating the operating margin ExpressJet cannot take into account unanticipated changes in labour costs nor the costs associated with any "controllable" cancellations - ie, it has to take full responsibility for its union negotiations and labour relations. The current agreement with Continental runs through to the end of 2004.

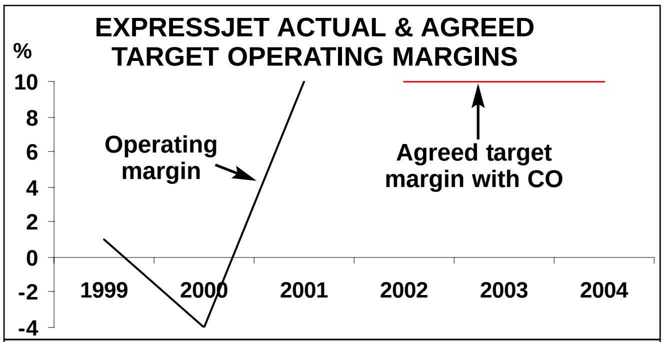
ExpressJet's net profit in 2001 was $28m, equivalent to 4.9% of revenues, after $25m of government subsidy but also a one-off reduction of $33m in Continental's payments.

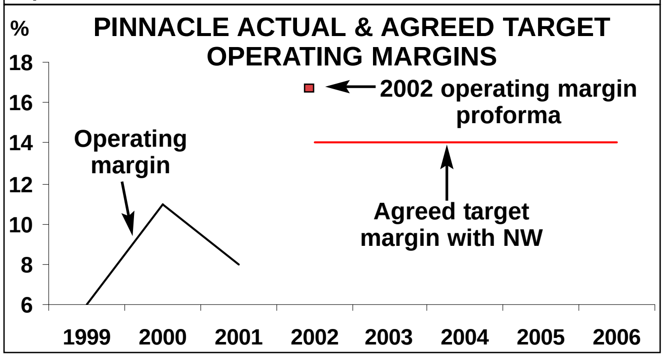
Moreover, Continental is the lessor of almost all of ExpressJet's fleet, the terms of the leasing agreements reflecting "the context of a parent-subsidiary relationship". ExpressJet has opted for an all-jet strategy with its remaining turboprops scheduled for replacement by the beginning of next year. The airline has currently 145 Emb 145s in service and has placed firm orders for a further 129 Emb 145s for delivery during 2002-05.

In Pinnacle's case the operating margin target on their capacity purchase agreement is 14%, with a minimum of 12%. The agreement runs through to 2007 when the new target will be set at somewhere between 10% and 14%. Pinnacle didn't enter into the capacity sharing agreement with Northwest until March this year, having previously revenue shared with its parent.

Its net profit was $14.2m or 6.9% of revenue in 2001, but in order to illustrate the effect of the new capacity purchase agreement and of course to boost the sales message, the 2001 P&L accounts have been restated under the assumption that the new agreement was in place a year previously. The result is to increase operating profit from $17m to $35m and net profit from $14m to $21m.

These pro-forma accounts for 2001 could have an impact on the valuation of the airline. If, for instance, potential investors are persuaded that the pro-forma rather than the actual results are more relevant to the valuation of the airline, then the price would be pushed up from around $550m to over $800m, assuming that Pinnacle achieved roughly the same historic price/earning ratio as ExpressJet. Northwest intends to sell up to 87% of its stake in the carrier, and will take all the proceeds from the sale.





Pinnacle's fleet is supplied by Northwest. It has committed to increasing Pinnacle's current jet fleet from 30 CRJs to 83 by 2004, while the turboprops will be phased out by the end of this year. Northwest has an additional 221 CRJs as firm orders or as options, which it has not yet allocated to any regional carrier. Pinnacle, naturally, expects to receive a significant proportion of these regional jets.

Logical ratings?

The ratings associated with the regional carrier IPOs do seem to be very high (as is JetBlue's), and it is difficult to get fully comfortable with the relative capitalisations of parent and subsidiary. There is a recent precedent for subsidiaries of airlines being considered far more valuable than their parents - during the dotcom boom, the theoretical valuation of priceline.com dwarfed that of its owner Delta while travelocity.com was worth much more on paper than AMR Corp.

On the other hand, the regional carriers do offer a unique investment proposition. Their operating profits are guaranteed at a reasonable level as long as the capacity purchase agreements with their parents remain in place, and their rate of revenue growth is confidently expected to remain strong - at least 25% a year.

US loan guarantees - not widely needed after all

To the relief of many in the US government and industry circles, the controversial $10bn federal loan guarantee programme has less than two months left to run. The deadline for submitting applications is June 28, and some Washington lawmakers have been calling for the programme to be wound down even earlier.

Loan guarantees were a key element of the $15bn airline industry bailout package passed by Congress in the wake of September 11. The programme has turned out to be exactly what many had hoped for - a safety net that few airlines would actually need or choose to use. However, without such a safety net, no US airline would have been able to raise cash through normal commercial channels in the aftermath of the terrorist attacks, and there would probably have been several Chapter 11 bankruptcy filings.

Of the major carriers, only America West needed immediate assistance - a modest $380m government guaranteed loan that enabled it to avert bankruptcy in January. Since then no other loan guarantees have been issued. In early May, the Air Transportation Stabilization Board (ATSB) was considering applications from just four small airlines - Vanguard and Spirit (early 1990s low-fare entrants), Alaska-based commuter carrier Frontier Flying Service and cargo operator Evergreen International.

By imposing unexpectedly onerous terms and conditions for the America West "test case" transaction, which included the government obtaining warrants for up to 33% of the carrier's stock, the ATSB effectively ensured that no airline would apply for federal loan guarantees unless and until it was truly desperate.

Nevertheless, the lack of interest has evidently caught the ATSB by surprise. Its executive director, Joseph Adams Jr, resigned unexpectedly in late April, saying that he had little to do. This was less than four months after his arrival on a 12-month leave from Brera Capital Partners, a New York City-based investment firm.

Despite their continued financial losses, US major airlines have not needed government guaranteed loans simply because most have continued to be able to raise funds by conventional methods (albeit, in many cases, at higher rates).

The financially strongest airlines - Southwest, American and Delta - were already able to access the capital markets in the fourth quarter of 2001, while carriers like Continental successfully deployed more creative tactics such as secondary share or convertible note offerings.

Even US Airways managed to raise $404m in November through a private financing involving unencumbered aircraft and engines. United raised $775m in a private, long-term debt financing in late January - the same week that it reported a horrendous $2.1bn net loss for 2001.

The US capital markets are reopening for more airlines, with both Northwest and Continental completing EETC offerings in the public markets in March.

Of course, US airlines have received an aggregate total of $3.9bn in government cash grants since September 11. As an unexpected bonus, in recent months many of them have also been able to collect substantial federal income tax refunds resulting from the government's March economic stimulus package.

Under the new tax rules, the "net operating loss (NOL)" carryback period is extended from two to five years, enabling many airlines to use their large 2001 and 2002 losses to recover income taxes paid from 1996 to 2000. One early estimate put the total industry gain from that source at $2bn.

As a result, industry liquidity remains satisfactory. According to UBS Warburg analyst Sam Buttrick, the major airlines had an aggregate $14.2bn in cash at the end of

March, down only slightly from $15.7bn at year-end. Given that the industry is now entering its seasonally strongest period, no major airline is currently viewed as a potential Chapter 11 candidate this year.

Little surprise, therefore, that pressure has been building in Washington to cut short the airline aid programmes, particularly in light of the need to fund critical homeland security improvements. In early May the House appropriations committee considered proposals to double the current $2.50 passenger security fee charged on airline tickets and to terminate early both the loan guarantee and cash grant programmes.

Following a massive outcry and lobbying effort by the airline industry, the ticket tax proposal was subsequently rejected. As many airline CEOs pointed out, the industry could ill afford to price passengers out of a market at a time when economic conditions were weak, yields remained depressed and financial recovery prospects looked uncertain.

As regards the possible reduction in the original $5bn cash grant budget, many airlines appear to have already stopped counting on receiving their final cash grant installments. For most passenger carriers, the final cash grant payments (for which applications were due by mid-May) represent just 15% of the total that they originally expected to receive, and many may have difficulty proving that their September 11-related financial losses exceeded the cash amounts already received.

It is hard to see how the loan guarantee programme could be terminated early, because such a move could have serious implications for the few remaining potential applicants that are currently working to meet the June 28 deadline. Such candidates include Las Vegas-based National Airlines, US Airways and potentially also United.

US Airways has been working on a restructuring plan that calls for the participation of all key stakeholders. The airline disclosed in mid-April that it was likely to apply for a government-guaranteed loan "to provide liquidity to execute the restructuring plan and fund the business as the industry recovers". The plan was expected to be ready by early May, after which US Airways would spend perhaps a month negotiating with its key partners.

Like America West, US Airways is expected to seek the support of banks, creditors, manufacturers, lessors, vendors and state and local governments. However, unlike America West, US Airways has high labour costs and would probably also have to secure pay and work rule concessions to meet the ATSB's loan guarantee criteria.

United is just getting started with the hardest part of its financial recovery plan - asking its workforce to agree to substantial wage cuts and concessions. The airline indicated in April that it had not yet decided whether to apply for federal loan guarantees, that it would prefer not to but that an application "may be helpful in putting a plan together with the unions and others".

Even under the most optimistic of scenarios, United's company-wide concessions negotiations are likely to take months. The airline could in theory submit a loan guarantee application (to meet the June 28 deadline) before securing any labour concessions and then use the ATSB's subsequent demands to put pressure on its workers.

One potential problem that both US Airways and United face when negotiating concessions from third parties is that they have used mainly public capital markets instruments to finance their fleets. Such financings are much harder to renegotiate than operating leases (which constituted the bulk of America West's aircraft financing commitments).

Of those two candidates, only US Airways has potential liquidity issues arising later this year, because its cash reserves dwindled to just $561m at the end of March. By comparison, United has an ample $2.9bn in cash reserves, which gives it much staying power to withstand prolonged concessions talks.

The loan guarantee guidelines require applicants to be carriers for whom "credit is not otherwise reasonably available". While US Airways is likely to qualify in that respect, United might find it hard to convince the ATSB because of its strong cash position and success in tapping the commercial debt markets in January.

By Heini Nuutinen

Air France: exploiting its asset base

Ten years ago Air France was one of the apparent basket-cases in Europe: it was close to bankruptcy, was rescued by the State in a manner that raised the hackles of all the other (non-State owned) European carriers, rescinded the US bilateral to avoid competition, and managed to survive. Now it is taking its rightful place among the top three European carriers, is increasingly focussing on the customer, has formed one of the top three global alliances, and is profitable.

Given that the main asset of any airline is its portfolio of hubs and routes, Air France has an incredibly strong asset base. The top four airports in Europe are London, Paris, Amsterdam and Frankfurt.

Like British Airways at Heathrow and unlike either KLM and Amsterdam or Lufthansa at Frankfurt, it has a strong natural catchment area (the second best in Europe) with 11m people living in the greater Paris area and strong levels of point-to-point O&D demand. Totally unlike BA and similar to KLM and Lufthansa, it has a home base airport at Roissy CDG that has space for expansion, (and importantly the political will to force through that expansion) and the capacity to provide a real hub operation.

The airport's third runway opened in March 1999 and the fourth in March 2001, with a speed of completion from initial plans that would leave the likes of BAA (the operator of Heathrow) or Fraport (the operator of Frankfurt-am-Main airport) with mouths agape. The interconnection potentials that Air France can provide through its own and its partners' networks now far exceed any other hub in Europe.

In addition, it has at CDG a unique multi-mode hub for passengers and cargo. The airport has its own TGV station and is connected to the TGV network. Air France is able to schedule and ticket efficient transfers between the high-speed train network, for example to and from Brussels or Lille, onto its intercontinental and international air routes. This incidentally provides it with a high level of protection from the incursion of the low-cost carrier.

France has the largest domestic market in Europe (even greater than normal when taking into account the overseas dominions and territories (DOMTOM) in the Caribbean, Indian Ocean and Pacific). France by its very nature and political leanings is highly centralised - and unlike any other European nation maintains the idea that all roads lead to Paris. Air France's second hub at Paris Orly airport is devoted to the very strong provinces to capital market.

In the mid-1990s, the company took on as advisors Stephen Wolf and Rakesh Gangwal, who have created stockholder value everywhere they have been, except lately at US Airways, to help turn the company around. There are two basic ways to return a company to profitability: cut costs (shrink) or increase revenues (grow). In a heavily unionised government owned airline, cutting staff and shrinking was not an option.

In very short shrift they identified that Air France needed to reorient itself. Up to that time, the company was very much an operations-led carrier - it would operate the route structure and schedules to suit the aircraft and the engineers and not the passenger. Now the concept was inverted and operations and schedules were only to suit what the customer wanted.

As a result the company started turning CDG in to a real hub; established a six-wave pattern to maximise interconnections between long- and short-haul; rescheduled the timetable to maximise user-friendliness (daily flights at the same time each day using the same aircraft). The result was substantial: aircraft utilisation rocketed, staff utilisation dramatically improved, unit revenues increased and profitability arrived.

To get the hub working properly, Air France signed code share deals with both

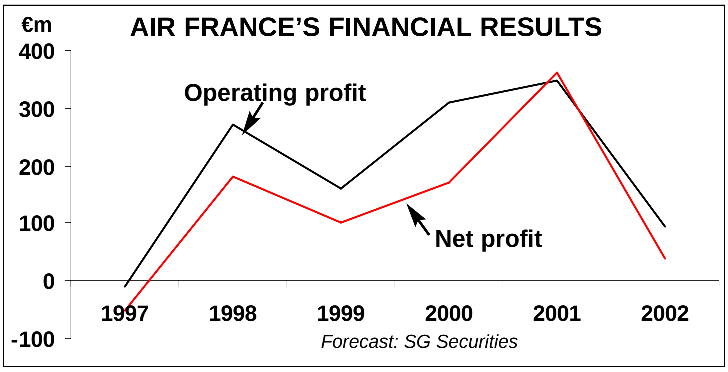
Delta and Continental for its Atlantic services. For both US carriers Air France was a prize - and while Heathrow (Europe's premier gateway) remains a closed shop for US carriers (neither Delta nor Continental are allowed to fly into Heathrow) Paris with its expansion potential was the next best thing.

After the bilateral air service agreement was torn up in the early 1990s, the company had been operating into the US on an equity basis - and no service expansion had been possible for nine years. As a consequence, Air France had severely lost out to BA, Lufthansa and KLM in the number of flights, frequencies and market share on the world's busiest long haul route area. In recognition of this, a new bilateral was signed with the US to provide an orderly progression towards open skies between the two countries allowing Air France to build its services over a five year period - and with the opening of the third and fourth runways at CDG, Air France started expanding at double digit growth rates. Because of an element of catch up, combined with the effectiveness of the hub and the links into its partners, it was able to do this and improve unit revenues.

Domestic operations

Following full domestic deregulation in the early 90s, Air France found increased competition not only by other domestic operators by-passing Paris but also by competitors on its trunk routes into Paris. Its strategic response was to concentrate efforts on shuttle services from Orly to the main provincial cities. The majority of the domestic demand in France is direct into Paris. Because the domestic operations are focussed at Orly, Air France was missing out on feed into its main intercontinental hub at CDG.

It started to franchise smaller operators in the sub-100 seat market to access not only the smaller domestic and hub by-pass routes but also to provide domestic feed to CDG. The advantage here, as the new runways opened at CDG, was that the franchise operators could be treated as new entrants and therefore automatically be granted slots at the airport whereas Air France would have



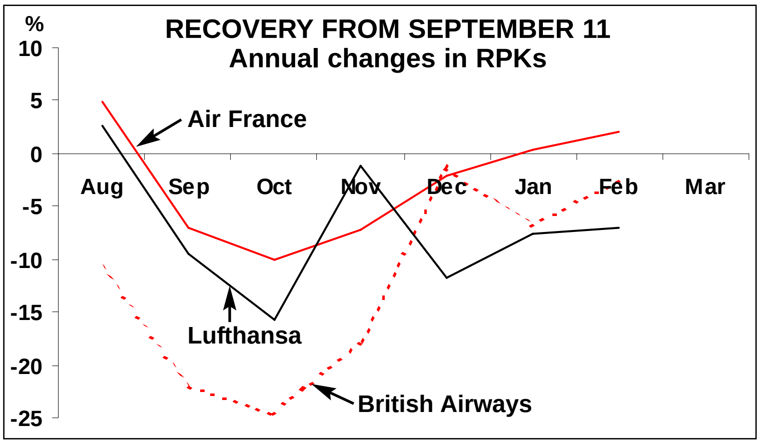
to fight for slots. Once the fourth runway opened it no longer appeared necessary to do this and Air France acquired and consolidated Regional Airlines, Proteus, Flandre Air and BritAir.

The regional network has allowed it to build and operate effectively secondary hubs in France. Regional had originally set up with a hub of operations at Clermont Ferrand - which provides a convenient hub directing traffic through to the South West of Europe. BritAir had started building a hub at Lyons (France's second largest city) on behalf of Air France - to access intra-European traffic in competition with Crossair's EuroHub at Basle/Mulhouse.

The high-speed train network (TGV) is both a competitor and a feeder. In terms of elapsed journey time TGV services from Paris to southern cities like Marseilles, Nice and Montpellier are now comparable, and the TGV offers greater comfort. On the other hand, the TGV and Thalys (the high-speed train to Belgium and Holland) has increased the catchment area of CDG. Some 2m air-rail passengers are expected this year at CDG.

Employees

Prior to the long-awaited IPO in Feb 1999, Air France negotiated with its heavily unionised workforce to arrange a wages for shares swap. The main deal with the pilots involved a wage freeze and no-strike agreement for an initial three-year period, with a potential for a further freeze in wages for another two years, in return for 15% of the equity. That agreement was based on benchmarked net income rates of pilots with



the other major European carriers - and there was an implicit promise to do the same type of benchmarking after the end of the initial three-year period. That has now come to an end - and the pilots recently threatened a four-day strike over the beginning of May. The top management at Air France are tough - but not as confrontational in labour relations as some. The company reached an interim agreement to raise pilot wages by 1.5% from next year and to start negotiations in earnest in the summer.

Teaming up with others

Because of the problems before its IPO, Air France was late in the global alliance game. It finally plumped for Delta as its North American partner and in June 2000 launched the SkyTeam alliance with Delta, Aeromexico, and Korean Airlines. This move severely upset Swissair (who had had a long standing relationship on the Atlantic with Delta under the soubriquet of the Atlantic Excellence Alliance) and they walked out in disgust to join up with American instead.

CSA Czech airlines joined the alliance in March 2001. Alitalia joined last year following the collapse of its alliance with KLM. The alliance also applied for anti-trust immunity on the Atlantic last year - which was granted in January 2002. They applied in March this year to extend anti-trust immunity on the Pacific with Korean.

The principal hubs of the alliance are very powerful: linking Atlanta, Cincinatti, Paris CDG, Milan Malpensa, Prague and Seoul. Although as always the alliance statistics are somewhat irrelevant for anything but marketing, the group currently offers a combined route network touching some 512 destinations and generates some $40bn in revenues. This puts it on a par with Star and oneworld.

The original application document makes fascinating reading - if only to see the number of ways the lawyers could say "give it to us because you gave it to the others". There is currently no cross shareholding between any of the partners - although there is a rather stupid tentative suggestion for a 5% share swap between Air France and Alitalia, and Delta and Air France have each expressed interest in taking a 15% stake in CSA whenever that carrier may be privatised.

Anti-trust immunity will allow them to take the overall level of cooperation to a higher level - including joint inventory management, joint pricing, code share beyond fare incentives and all the trappings of a fully immunised alliance such as enjoyed by KLM/Northwest and Star. The granting of immunity and the signing of a full open skies agreement between France and the US were inextricably linked - and unlike the British attempts to do the same, successful.

On a global basis SkyTeam is a small step behind the Star alliance. It currently has only a small number of participants - but this will make it far easier to start the integration process than Star (or oneworld) have found.

Air France's connection with Alitalia is more involved. The two signed a reciprocal agreement last year to operate all flights between Italy and France as code shares, and have full reciprocal agreements on the frequent flier programmes.

They have committed to treat the joint network as a true multi-hub system covering Paris CDG, Milan Malpensa and Rome Fiumicino. This will put Air France in the lead in the multi-hub stakes in Europe and gives it the greatest level of access to the famous "blue banana" of population distribution within Europe.

As always in such alliances substantial synergies are forecast - €180m by 2005 in the Air France/Alitalia case. Most of this will come from network rationalisation, which logically should mean that Alitalia will cut back its loss-making long-hauls and feed Air France's network at CDG. In practice this strategy will be very difficult to implement.

The two companies are talking about a share swap of up to 5% of capital. This however is fairly meaningless - as all previous alliances in Europe can testify. In time no doubt the two will look to further coordination and potential joint service operations - although while both remain government owned a full merger is impossible.

Recent Results

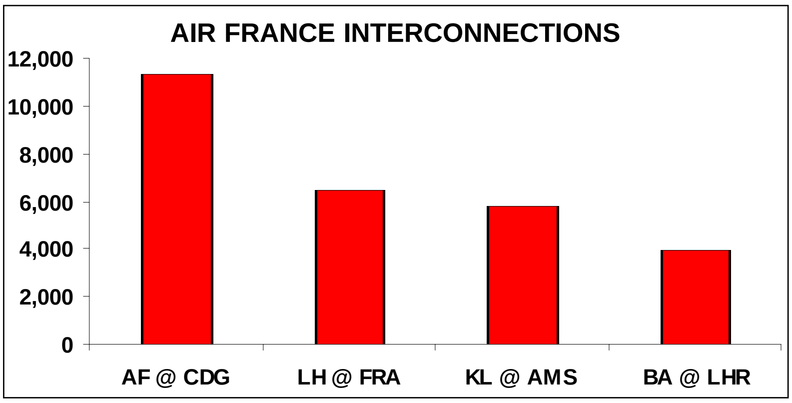
Air France has performed very well since the disaster of September 11. In the quarter ended December 2001, group revenue fell by 7.8% overall compared with same period a year before and underlying cash flow (EBITDAR or earnings before interest tax depreciation and rentals) fell by only 13.6% to €261m. The group posted a net loss for the period of €131m down from a profit of €32m. A large portion of the difference was actually a reflection of differences in the accounting reflection of currency profits and losses on debt and on differences in profits from the sale of aircraft and shares between the two periods. The group estimated that September alone accounted for a loss of €127m.

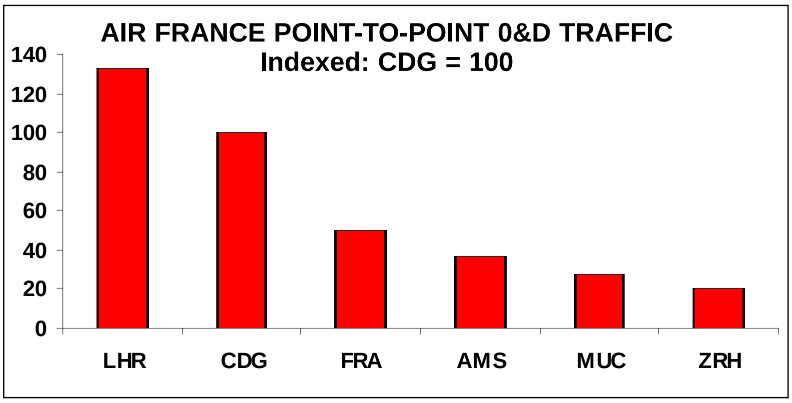
Air France has achieved a much faster recovery from the events of September 11 than many of its peers. Part of the reason behind this is the relatively low exposure to the Atlantic as a proportion of total operations. Part must be due to the success of its hub connections. Its traffic figures turned positive in January - the first of the European majors to do so - and have continued to improve. The company states that the underlying unit revenues have returned to prior year levels. This gives it the confidence to target "an operating profit" for the financial year ended March 2002.

Outlook

Like the leopard it is becoming, Air France has managed to change its spots. It has the advantage of a strong hub, strong natural demand, and an increasingly powerful European and international alliance. However, there are unresolved issues: the unions remain very powerful, which will make it very difficult for Air France to cut costs and compete with more flexible rivals in a protracted downturn. Its continued success depends on resuming a comparable growth rate to that of 1997-2000.

It is not clear that Air France has a coherent strategy to deal with the low-cost threat. It may be that Air France and Lufthansa are just a couple of years behind BA in experiencing the impact of low-costs on point-to-point city pair traffic and the consequent undermining of network economics. Air France implies that its regional airline network and the existence of the TGV will afford protection, which may be valid domestically but not if, for instance, easyJet succeeds in building a European network from Paris Orly.





	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 employees
Alaska											
Year 2000	**2,177**	**2,198**	**-20.6**	**-70**	**-0.9%**	**-3.2%**	**27,834**	**19,277**	**69.3%**	**13,512**	**9,940**
Jan-Mar 01	516	565	-49	-33	-9.5%	-6.4%	7,126	4,659	65.4%	3,198	10,677
Apr-Jun 01	579	568	11.3	4.7	2.0%	0.8%	7,528	5,289	70.3%	3,692	10,966
Jul-Sep 01	583.4	570.6	12.8	25.3	2.2%	4.3%	7,536	5,351	71.0%	3,741	10,826
Oct-Dec 01	462.2	558.6	-96.4	-36.4	-20.9%	-7.9%	6,622	4389	66.4%	3,025	10,500
Year 2001	**2,141**	**2,263**	**-121.8**	**-39.5**	**-5.7%**	**-1.8%**	**28,837**	**19,712**	**68.4%**	**13,668**	**10,742**
Jan-Mar 02	497	548	-51.4	-34.4	-10.3%	-6.9%	7,189	4,791	66.6%	3,193	
American											
Year 2000	**19,703**	**18,322**	**1,381**	**813**	**7.0%**	**4.1%**	**258,951**	**187,507**	**72.4%**	**86,239**	**99,610**
Jan-Mar 01	4,760	4,743	17	-43	0.4%	-0.9%	62,726	42,591	67.9%	19,676	108,900
Apr-Jun 01	4,838	5,586	-748	-494	-15.5%	-10.2%	66,007	47,484	71.9%	21,488	128,300
Jul-Sep 01	4,816	5,374	-558	-414	-11.6%	-8.6%	62,676	45,315	72.3%	20,123	127,200
Oct-Dec 01	3,804	4,952	-1148	-798	-30.2%	-21.0%	54,907	35,580	64.8%		109,300
Year 2001	**18,963**	**20,823**	**-1,860**	**-1,762**	**-9.8%**	**-9.3%**	**161,030**	**176,143**	**69.4%**	**61,287**	**102,093**
Jan-Mar 02	4,136	4,865	-729	-575	-17.6%	-13.9%	64,515	44,766			
America West											
Year 2000	**2,344**	**2,357**	**-12,637**	**7,679**	**-539.1%**	**327.6%**	**43,580**	**30,741**	**70.5%**	**19,950**	**13,869**
Jan-Mar 01	587	612	-25	-13	-4.3%	-2.2%	11,355	7,858	69.2%	5,104	14,204
Apr-Jun 01	587	641	-54	-42	-9.2%	-7.2%	11,098	8,367	75.5%	5,294	13,971
Jul-Sep 01	491	590	-99	-32	-20.2%	-6.5%	10,774	7,973	74.0%	5,034	13,633
Oct-Dec 01	400	538	-138	-61	-34.5%	-15.3%	9,477	6,492	68.5%	4,144	
Year 2001	**2,066**	**2,380**	**-316**	**-148**	**-15.3%**	**-7.2%**	**42,709**	**30,696**	**71.9%**	**19,576**	**13,827**
Jan-Mar 02	460	583	-123	-358	-26.7%	-77.8%	9,780	6,859	70.1%	4,303	
Continental											
Year 2000	**9,899**	**9,170**	**729**	**342**	**7.4%**	**3.5%**	**134,718**	**100,283**	**74.4%**	**45,139**	**45,072**
Jan-Mar 01	2,451	2,375	76	9	3.1%	0.4%	34,534	24,323	70.4%	11,220	
Apr-Jun 01	2,556	2,419	137	42	5.4%	1.6%	36,713	27,443	74.8%	12,256	
Jul-Sep 01	2,223	2,136	87	3	3.9%	0.1%	35,395	26,086	73.7%	11,254	
Oct-Dec 01	1,738	1,895	-157	-149	-9.0%	-8.6%	29,321	20,554	70.1%	9,508	
Year 2001	**8,969**	**9,119**	**-150**	**-95**	**-1.7%**	**-1.1%**	**135,962**	**98,393**	**72.4%**	**44,238**	**45,166**
Jan-Mar 02	1,993	2,180	-187	-166	-9.4%	-8.3%	30,498	22,582	74.0%	10,057	
Delta											
Year 2000	**16,741**	**15,104**	**1,637**	**828**	**9.8%**	**4.9%**	**236,665**	**173,453**	**73.1%**	**105,591**	**79,584**
Jan-Mar 01	3,842	3,957	-115	-133	-3.0%	-3.5%	60,714	40,691	67.0%	26,932	
Apr-Jun 01	3,776	3,890	-114	-90	-3.0%	-2.4%	61,538	44,784	72.8%	28,130	82,500
Jul-Sep 01	3,398	3,649	-251	-259	-7.4%	-7.6%	60,719	43,260	71.3%	26,441	83,500
Oct-Dec 01	2,863	3,457	-594	-734	-20.7%	-25.6%	51,460	32,798	63.7%		
Year 2001	**13,879**	**15,124**	**-1,245**	**-1,216**	**-9.0%**	**-8.8%**	**237,914**	**163,693**	**68.8%**	**104,943**	77,654
Jan-Mar 02	3,103	3,538	-435	-397	-14.0%	-12.8%	54,298	37,384	68.9%	24,618	
Northwest											
Year 2000	**11,240**	**10,671**	**569**	**256**	**5.1%**	**2.3%**	**171,789**	**127,298**	**76.6%**	**56,836**	**53,131**
Jan-Mar 01	2,611	2,847	-236	-171	-9.0%	-6.5%	40,212	29,395	73.1%	13,364	
Apr-Jun 01	2,715	2,751	-36	-55	-1.3%	-2.0%	42,217	32,887	77.9%		
Jul-Sep 01	2,594	2,749	-155	19	-6.0%	0.7%	41,871	31,753	75.8%		
Oct-Dec 01	1,985	2,426	-441	-216	-22.2%	-10.9%	33,985	23,620	69.5%		
Year 2001	**9,905**	**10,773**	**-868**	**-423**	**-8.8%**	**-4.3%**	**158,284**	**117,682**	**74.3%**	**54,056**	**50,309**
Jan-Mar 02	2,180	2,376	-196	-171	-9.0%	-7.8%	35,022	26,611	76.0%	11,899	
Southwest											
Year 2000	**5,650**	**4,628**	**1,021**	**603**	**18.1%**	**10.7%**	**96,463**	**67,961**	**70.5%**	**72,568**	**28,752**
Jan-Mar 01	1,429	1,218	210	121	14.7%	8.5%	25,512	17,170	67.3%	15,716	29,563
Apr-Jun 01	1,554	1,263	291	176	18.7%	11.3%	26,430	18,970	71.8%	17,527	30,369
Jul-Sep 01	1,335	1,242	93	151	7.0%	11.3%	26,217	18,121	69.1%	16,208	30,946
Oct-Dec 01	1,238	1,201	37	64	3.0%	5.2%	26,888	17,343	64.5%	14,996	31,580
Year 2001	**5,555**	**4,924**	**631**	**511**	**11.4%**	**9.2%**	**105,079**	**71,604**	**68.1%**	**64,447**	**31,014**
Jan-Mar 02	1,257	1,207	49	21	3.9%	1.7%	26,586	16,726	62.9%	14,463	
United											
Year 2000	**19,351**	**18,685**	**666**	**96**	**3.4%**	**0.5%**	**282,276**	**204,188**	**72.3%**	**83,853**	**100,976**
Jan-Mar 01	4,424	4,815	-391	-313	-8.8%	-7.1%	67,741	46,268	68.3%	18,860	98,600
Apr-Jun 01	4,658	5,011	-353	-292	-7.6%	-6.3%	71,928	52,652	73.2%	21,331	98,000
Jul-Sep 01	4,107	4,819	-712	-542	-17.3%	-13.2%	69,233	50,610	73.1%	19,815	95,900
Oct-Dec 01	2,949	3,835	-886	-308	-30.0%	-10.4%	56,421	38,140	67.6%	15,450	79,300
Year 2001	**16,138**	**18,481**	**-2,343**	**-2,145**	**-14.5%**	**-13.3%**	**265,291**	**187,701**	**70.8%**	**75,457**	**96,142**
Jan-Mar 02	3,288	3,999	-711	-510	-21.6%	-15.5%	55,056	39,761	72.2%	15,361	
US Airways											
Year 2000	**9,268**	**9,322**	**-54**	**-269**	**-0.6%**	**-2.9%**	**106,999**	**75,358**	**70.4%**	**59,772**	**45,228**
Jan-Mar 01	2,241	2,469	-228	-171	-10.2%	-7.6%	27,752	18,372	66.2%	14,193	44,077
Apr-Jun 01	2,493	2,473	20	-24	0.8%	-1.0%	29,395	21,693	73.8%	16,582	44,673
Jul-Sep 01	1,989	2,739	-750	-766	-37.7%	-38.5%	27,609	19,619	71.1%	14,188	42,723
Oct-Dec 01	1,554	2,101	-547	-906	-35.2%	-58.3%	22,640	14,308	63.2%	11,151	35,232
Year 2001	**8,288**	**9,355**	**-1,067**	**-1,969**	**-12.9%**	**-23.8%**	**107,347**	**73,944**	**68.9%**	**56,114**	**43,846**
Jan-Mar 02	1,709	2,079	-370	-269	-21.7%	-15.7%	22,495	15,419	68.5%	11,825	

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation. 1 ASM = 1.6093 ASK.

	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 employees
Air France											
Apr-Sep 00	5,506	5,132	374	385	6.8%	7.0%	60,088	48,464	80.7%		
Oct 00-Mar 01	4,981	4,988	-7	-25	-0.1%	-0.5%	59,101	44,622	75.5%		
Year 2000/01	**11,148**	**10,746**	**402**	**382**	**3.6%**	**3.4%**	**119,562**	**93,355**	**78.1%**	**42,400**	**52,310**
Apr-Sep 01	5,798	5,511	287	250	4.9%	4.3%	64,474	50,984	79.1%		
Sep 01-Mar 02											
Year 2001/02											
Alitalia											
Jul-Dec 00	2,553	2,753	-200	-209	-7.8%	-8.2%	32,735	24,534	74.9%		
Year 2000	**4,968**	**5,210**	**-242**	**-236**	**-4.9%**	**-4.8%**	**57,483**	**41,433**	**72.1%**	**26,700**	**23,478**
Jan-Jun 01	2,348	2,504	-156	-228	-6.6%	-9.7%	26,437	18,953	71.7%	12,565	24,023
Jul-Dec 01							24,944	17,423	69.8%	12,204	
Year 2001	**4,745**	**5,007**	**-262**	**-818**	-5.5%	-17.2%	**51,392**	**36,391**	**70.8%**	**24,737**	**23,667**
BA											
Jan-Mar 01	3,048	3,136	-88	-111	-2.9%	-3.6%	40,018	26,800	67.0%	9,721	62,425
Year 2000/01	**13,700**	**13,139**	**561**	**189**	**4.1%**	**1.4%**	**162,824**	**116,674**	**71.7%**	**36,220**	**62,844**
Apr-Jun 01	3,277	3,206	71	37	2.2%	1.1%	40,980	28,646	69.9%	11,293	58,989
Jul-Sep 01	3,219	3,116	103	33	3.2%	1.0%	39,629	29,297	73.9%	11,306	59,902
Oct-Dec 01	2,616	2,882	-266	-205	-10.2%	-7.8%	35,449	23,106	65.2%	8,574	55,758
Jan-Mar 02											
Year 2001/02											
Iberia											
Year 2000	**4,136**	**4,075**	**61**	**188**	**1.5%**	**4.5%**	**54,120**	**40,049**	**73.8%**	**24,500**	**26,814**
Year 2001	**4,240**	**4,236**	**4**	**45**	**0.1%**	**1.1%**		**41,297**	**70.8%**	**24,930**	
KLM											
Jan-Mar 01	1,360	1,422	-62	-77	-4.6%	-5.7%	18,056	13,805	76.4%		26,538
Year 2000/01	**6,319**	**6,068**	**251**	**70**	**4.0%**	**1.1%**	**75,222**	**60,047**	**79.8%**	**16,100**	**30,253**
Apr-Jun 01	1,507	1,487	20	17	1.3%	1.1%	19,231	15,200	79.0%		27,211
Jul-Sep 01	1,679	1,596	83	24	4.9%	1.4%	19,554	16,049	82.1%		28,911
Oct-Dec 01	1,291	1,358	-67	-82	-5.2%	-6.4%	17,030	12,483	73.3%		27,738
Jan-Mar 02	1,302	1,414	-112	-97	-8.6%	-7.5%			79.9%		
Year 20001/02	**5,933**	**6,018**	**-85**	**-141**	-1.4%	-2.4%			**78.7**		
Lufthansa											
Year 2000	**14,014**	**12,648**	**1,366**	**635**	**9.7%**	**4.5%**	**123,801**	**92,160**	**74.4%**	**47,000**	**69,523**
Jan-Mar 01	3,222	3,202	20	-80	0.6%	-2.5%	30,223	21,232	70.3%	10,903	72,279
Apr-Jun 01	4,119	4,045	74	41	1.8%	1.0%	30,658	22,930	74.8%	12,236	85,771
Jul-Sep 01	4,188	4,027	161	96	3.8%	2.3%	32,454	24,546	75.6%	12,692	83,447
Oct-Dec 01											
Year 2001	**14,966**	**14,948**	**18**	**-530**	**0.1%**	**-3.5%**	**126,400**	**90,389**	**71.5%**	**45,710**	**87,975**
Jan-Mar 02											
SAS											
Year 2000	**5,185**	**4,853**	**332**	**233**	**6.4%**	**4.5%**	**33,782**	**22,647**	**67.0%**	**23,240**	**22,698**
Jan-Mar 01	1,183	1,175	8	2	0.7%	0.1691%	8,558	5,286	61.8%	5,482	29,985
Apr-Jun 01	1,345	1,329	16	18	1.2%	1.3%	9,144	6,227	68.1%	6,279	30,499
Jul-Sep 01	1,199	1,220	-21	-20	-1.8%	-1.7%	9,629	6,498	67.5%	6,463	30,896
Oct-Dec 01	1,208	1,316	-108	-108	-8.9%	-8.9%	8,509	5,097	59.9%	5,300	
Year 2001	**4,984**	**5,093**	**-109**	**-103**	-2.2%	-2.1%	**35,521**	**22,956**	**64.6%**	**23,060**	**22,656**
Jan-Mar 02											
Ryanair											
Jan-Mar 01	98	82	16		16.3%						
Year 2000/01	**442**	**338**	**104**	**95**	**23.5%**	**21.5%**	**6,657**	**4,656**	**69.9%**	**7,000**	**1,476**
Apr-Jun 01	132	107	25	21	18.9%	15.9%				2,400	
Jul-Sep 01	168	105	63	58	37.5%	34.5%			84.0%	2,900	
Oct-Dec 01	122	97	25	26	20.5%	21.3%			79.0%	2,700	
Jan-Mar 02											
Year 2001/02											
easyJet											
Sep 00-Mar 01	210	225	-15	-15	-7.1%	-7.1%			80.6%	3,200	
Apr-Sep 01										3,915	
Year 2000/01	**513**	**455**	**58**	**54**	**11.3%**	**10.5%**	**7,003**	**5,903**	**83.0%**	**7,115**	**1,632**
Sep-Mar 02	285	279	6	1	2.1%	0.4%			84.2%	4,300	

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation. 1 ASM = 1.6093 ASK.

		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 employees
ANA												
	Apr-Sep 00	5,228	4,793	495	359	9.5%	6.9%	47,586	31,753	66.7%	24,958	
	Oct 00-Mar 01	5,376	5,186	190	-486	3.5%	-9.0%	46,278	29,168	63.0%	24,471	
	Year 2000/01	**10,914**	**10,629**	**285**	**-137**	**2.6%**	**-1.3%**	**85,994**	**58,710**	**68.3%**	**43,700**	**14,303**
	Apr-Sep 01	5,168	4,811	357	136	6.9%	2.6%	45,756	30,790	67.3%	25,876	
	Oct 01-Mar 02											
	Year 2001/02											
Cathay Pacific												
	Jan-Jun 00	2,070	1,765	305	285	14.7%	13.8%	29,839	22,588	75.7%	5,483	
	Jul-Dec 00	2,356	1,983	373	382	15.8%	16.2%	32,070	24,587	76.7%	6,147	
	Year 2000	**4,431**	**3,752**	**679**	**642**	**15.3%**	**14.5%**	**61,909**	**47,153**	**76.2%**	**11,860**	**14,293**
	Jan-Jun 01	2,031	1,898	133	170	6.5%	8.4%	32,419	23,309	71.9%	5,936	
	Jul-Dec 01							30,371	21,497	70.8%	5,378	
	Year 2001	**3,902**	**3,795**	**107**	**84**	**2.7%**	**2.2%**	**62,790**	**44,792**	**71.3%**	**11,270**	**15,391**
JAL												
	Year 1999/00	**14,442**	**14,039**	**403**	**177**	**2.8%**	**1.2%**	**119,971**	**88,479**	**70.2%**	**37,200**	**18,974**
	Apr-Sep 00											
	Oct 00-Mar 01							54,859	40,462	73.8%	16,724	
	Year 2000/01	**15,372**	**14,662**	**710**	**370**	**4.6%**	**2.4%**	**129,435**	**95,264**	**73.6%**	**38,700**	**17,514**
Korean Air												
	Year 2000	**4,916**	**4,896**	**20**	**-409**	**0.4%**	**-8.3%**	**55,824**	**40,606**	**72.7%**	**22,070**	**16,000**
	Year 2001	**4,309**	**4,468**	**-159**	**-448**	**-3.7%**	**-10.4%**					
	Jan - Mar 02	1,113	1,060	54	23	4.9%	2.1%	13,409	9,799	73.1%	5,399	
Malaysian												
	Year 1999/00	**2,148**	**2,120**	**28**	**-68**	**1.3%**	**-3.2%**	**48,158**	**34,930**	**71.3%**	**15,370**	**21,687**
	Year 2000/01	**2,357**	**2,178**	**179**	**-351**	**7.6%**	**-14.9%**	**52,329**	**39,142**	**74.8%**	**16,590**	**21,518**
Qantas												
	Year 1999/00	**5,710**	**5,162**	**548**	**324**	**9.6%**	**5.7%**	**85,033**	**64,149**	**75.4%**	**20,490**	**29,217**
	Jul-Dec 00	**2,745**	**2,492**	**224**	**142**	**8.2%**	**5.2%**	**46,060**	**35,451**	**77.0%**	**11,175**	**31,382**
	Year 2000/01	**5,473**	**5,099**	**374**	**223**	**6.8%**	**4.1%**	**92,943**	**70,540**	**75.9%**	**22,150**	**31,632**
	Jul-Dec 01	**3,050**	**2,904**	**125**	**84**	**4.1%**	**2.8%**	**48,484**	**37,262**	**76.9%**	**13,335**	**32,361**
Singapore												
	Apr-Sep 00	2,864	2,438	426	668	14.9%	23.3%	46,478	36,137	77.8%	7,584	
	Oct 00-Mar 01	2,635	2,317	318	209	12.1%	7.9%	46,171	34,982	75.8%	7,416	
	Year 2000/01	**5,729**	**4,954**	**775**	**892**	**13.5%**	**15.6%**	**92,648**	**71,118**	**76.8%**	**15,000**	**14,254**
	Apr-Sep 01	2,592	2,329	263	90	10.1%	3.5%	48,058	36,091	75.1%		
	Oct 01-Mar 02											
	Year 2001/02											

Note: Figures may not add up due to rounding.

JET AND TURBOPROP ORDERS

	Date	Buyer	Order	Price	Delivery	Other information/engines
Airbus	Apr 30	JetBlue	2 A320s		4Q02-2Q03	Converted from options.IAE V2500
	Apr 16	China Eastern AL	20 A320-214s		1Q 2003+	
	Apr 26	Cathay Pacific	3 A330-300s		2003	
ATR	-					
BAE Systems	-					
Boeing	Apr 15	Midwest Express	25 717-200s		1Q03-05	+25 options. RR BR715A1-30.
	Apr 9	Undisclosed	3 737-700s, 1 737-800			CFM56-7B
	May 1	WestJet	2 737-700s		2Q03+	Converted from options
Bombardier	-					
Embraer	-					
Fairchild	-					

Note: Prices in US$. Only firm orders from identifiable airlines/lessors are included. MoUs/LoIs are excluded. **Source:** Manufacturers.

EUROPEAN SCHEDULED TRAFFIC

	Intra-Europe			North Atlantic			Europe-Far East			Total long-haul			Total Int'l		
	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 %
1994	144.7	87.7	60.6	150.3	108.8	72.4	102.8	76.1	74	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	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
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
Mar-02	15.2	10.3	67.5	14.3	12.1	84.7	10.8	9.1	84.6	36.9	30.7	83.1	54.9	43.0	78.3
Ann. chng	-16.4%	-8.5%	5.8	-23.0%	-15.4%	7.6	-8.7%	-2.9%	5.1	-13.3%	-7.2%	5.4	-14.5%	-7.8%	5.7
Jan-Mar 02	43.5	25.4	60.8	40.3	31.0	76.9	31.0	25.5	82.2	106.3	83.9	78.9	157.5	115.7	73.5
Ann. chng	-15.6%	-9.8%	3.9	-23.5%	-15.4%	7.4	-10.4%	-5.90%	3.9	-13.4%	-8.2%	4.5	-14.3%	-8.8%	4.4

Source: AEA

US MAJORS' SCHEDULED TRAFFIC

	Domestic			North Atlantic			Pacific			Latin America			Total Int'l		
	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 %
1994	886.9	575.6	64.9	136.1	99.5	73.0	107.3	78.2	72.9	56.8	35.2	62	300.3	212.9	70.9
1995	900.4	591.4	65.7	130.4	98.5	75.6	114.3	83.7	73.2	62.1	39.1	63	306.7	221.3	72.1
1996	925.7	634.4	68.5	132.6	101.9	76.8	118.0	89.2	75.6	66.1	42.3	64	316.7	233.3	73.7
1997	953.3	663.7	69.6	138.1	108.9	78.9	122.0	91.2	74.7	71.3	46.4	65.1	331.2	246.5	74.4
1998	960.8	678.8	70.7	150.5	117.8	78.3	112.7	82.5	73.2	83.5	52.4	62.8	346.7	252.7	72.9
1999	1,007.3	707.5	70.2	164.2	128.2	78.1	113.2	84.7	74.8	81.3	54.3	66.8	358.7	267.2	74.5
2000	1,033.5	740.1	71.6	178.9	141.4	79.0	127.7	97.7	76.5	83.0	57.6	69.4	380.9	289.9	76.1
2001	1,025.4	712.2	69.5	173.7	128.8	74.2	120.1	88.0	73.3	83.4	56.9	68.2	377.2	273.7	72.6
Mar-02	81.8	61.3	75.0	12.0	10.1	84.3	8.0	7.0	87.8	7.5	5.4	71.7	27.5	22.5	81.9
Ann. chng	-10.2%	-8.1%	1.7	-17.5%	-12.8%	4.6	-25.7%	-15.0%	11.1	-0.3%	-0.3%	0	-16.2%	-10.8%	5.0
Jan-Mar 02	231.6	158.9	68.6	33.9	24.9	73.7	23.1	19.5	84.2	21.5	15.2	70.7	78.5	59.6	75.9
Ann. chng	-11.9%	-10.3%	1.3	-19.1%	-14.7%	3.8	-24.6%	-15.1%	9.4	-1.8%	-2.1%	-0.1	-16.9%	-11.9%	4.2

Note: US Majors = American, Alaska, Am. West, Continental, Delta, NWA, Southwest, United, US Airways. Source: Airlines, ATA

ICAO WORLD TRAFFIC AND ESG FORECAST

	Domestic			International			Total			Domestic growth rate		International growth rate		Total growth rate	
	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK %	RPK %	ASK %	RPK %	ASK %	RPK %
1993	1,349	855	63.3	1,785	1,205	67.5	3,135	2,060	65.7	3.4	2.0	4.4	4.8	3.9	3.6
1994	1,410	922	65.3	1,909	1,320	69.1	3,318	2,240	67.5	4.6	7.9	6.9	9.4	5.9	8.8
1995	1,468	970	66.1	2,070	1,444	69.8	3,537	2,414	68.3	4.1	5.4	8.5	9.4	6.6	7.8
1996	1,540	1,043	67.7	2,211	1,559	70.5	3,751	2,602	79.4	4.9	7.4	6.8	8.0	6.0	7.8
1997	1,584	1,089	68.8	2,346	1,672	71.3	3,930	2,763	70.3	2.9	4.5	6.1	7.2	4.8	6.1
1998	1,638	1,147	70.0	2,428	1,709	70.4	4,067	2,856	70.3	3.4	5.2	3.5	2.2	3.4	3.4
1999	1,911	1,297	67.9	2,600	1,858	71.5	4,512	3,157	70.0	5.4	5.0	5.7	7.4	5.6	6.4
2000	2,005	1,392	69.4	2,745	1,969	71.8	4,750	3,361	70.8	4.9	7.2	5.6	6.0	5.3	6.5
***2001**							4,713	3,205	68.0					-1.1	-6.0
***2002**							4,737	3,270	69.0					0.5	2.0
***2003**							5,066	3,596	70.9					6.9	10.0
***2004**							5,320	3,830	72.0					5.0	6.5

Note: * = Forecast; ICAO traffic includes charters. **Source:** Airline Monitor, Oct 2001.

AIRCRAFT AVAILABLE FOR SALE OR LEASE

	Old narrowbodies	Old widebodies	Total old	New narrowbodies	New widebodies	Total new	Total
1997	162	104	266	54	13	67	333
1998	187	125	312	67	55	122	434
1999	243	134	377	101	53	154	531
2000	302	172	474	160	42	202	676
2001	368	188	556	291	101	392	948
2002-Feb	358	181	539	305	106	411	950

Source: *BACK* **Notes:** *As at end year; Old narrowbodies = 707, DC8, DC9, 727,737-100/200, F28, BAC 1-11, Caravelle; Old widebodies = L1011, DC10, 747-100/200, A300B4; New narrowbodies = 737-300+, 757. A320 types, BAe 146, F100, RJ; New widebodies = 747-300+, 767, 777. A600, A310, A330, A340.*