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Where will the LCCs' new aircraft go?

Ryanair's new order for 70+70 737-800s for delivery during 2008-2012 has again raised the stakes in the intra-European market.

The three leading LCCs now have over 300 narrowbodies on firm order, more than ten times the combined backlog of the traditional network carriers (and only BA has any significant narrowbody commitment, with 129 A319s on option). If all the LCCs' options are exercised, they will probably catch up with the Euro-majors in terms of fleet size by the end of this decade.

Could it be that the LCCs have made the traditional airline mistake of over-ordering? It's a possibility, but there are still structural changes taking place that favour the LCCs, notably the potential collapse of fragile flag-carriers like Alitalia and struggling hybrids like Swiss, the hastening retreat of the charter airlines, and the bloodbath among the smaller start-up LCCs. The expansion of the LCCs implies the (creative) destruction of large segments of the existing industry.

As to where the new aircraft are to go, Ryanair appears to be aiming at about 35 airport bases by 2012, compared to 12 today. This is an additional 23 bases each averaging 10-11 aircraft, assuming all options are exercised and 100 737-800s are allocated to existing bases. Are there really that many secondary European points with such traffic potential?

easyJet's expansion is focused more on primary airports, which creates both opportunities and threats. The opportunities for the airports lie in latching on to the fastest growing segment of the industry, boosting traffic numbers and retail income; the threats come from acceding to the inevitable demands for discounts in rack rates, risking undermining the airport's pricing policy and endangering the incumbent carriers. The unenviable choice for some airports will be to stick with higher airport charges and a weak incumbent or lower the charges and embrace an LCC.

EUROPEAN NARROWBODY FLEETS

	Current fleet	Firm orders	Options
easyJet	89	94	120
Ryanair	79	157	190
Air Berlin	44	60	42
Leading LCCs	**212**	**311**	**352**
Air France/KLM	191	8	11
Lufthansa	132		
BA	101	7	129
Iberia	112	5	24
Alitalia	121		
SAS	119	6	
Euro-Majors	**776**	**26**	**164**

Source: ACAS, Company reports

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Could EADS become Airbus or FADS?

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Tension is mounting in Toulouse as Airbus prepares for the first flight of the A380 in early April and as power struggles intensify within the company and its parent, EADS. The group is headed for a major shake-up of its top management, followed by its shareholding structure.

The appointment of Airbus chief executive Noel Forgeard as co-chief executive of EADS is bound to be a forerunner of big changes within the Franco-German group. Since its creation in 1999, EADS has been run under a cumbersome management structure, with two chairmen and two chief executives. Late last year Rainer Hertrich, the German co-chief executive let it be known that five years of bicephalism was enough for him, so he would be leaving this summer. He would have been prepared to stay on only if he had become sole boss.

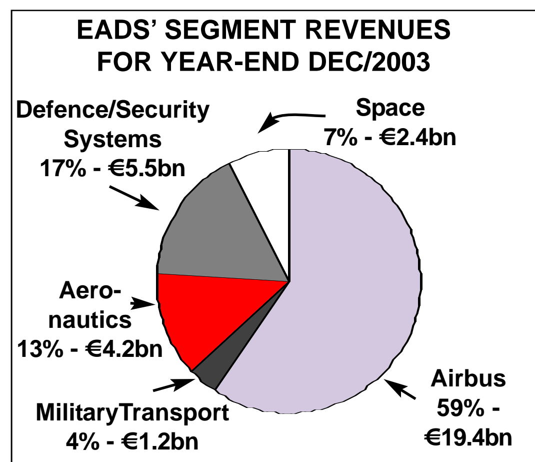
Then Forgeard lobbied to succeed the other co-chief executive, Philippe Camus, a Frenchman whose contract was also coming up for renewal this summer. Helped by his close connections with French president Jacques Chirac, Forgeard won the post, and Camus will return to the Lagardere media group as chief executive. But Forgeard also suggested it might be better if he were to be the single chief executive, giving the company a more normal governance system. This went down badly in Germany, and DaimlerChrysler (owner of the 30% German shareholding) made clear that it was against such a move to increase French influence in the company. So Tom Enders, previously in charge of EADS's defence business, and a protégé of DaimlerChrysler chairman Jurgen Schremp, was put forward to be the German co-chief executive. Enders is seen by DaimlerChrysler directors as enough of a heavyweight to hold Forgeard in check.

That may not be the case, for Forgeard is already manoeuvring to become, in effect, the more important of the two chief executives. Hitherto, the operating divisions of EADS reported to the German CEO, if the line manager was French, and vice versa. But Forgeard wants to retain board oversight of the commercial aircraft business which he has led with considerable success for the past five years. Indeed, Airbus accounts for the bulk of EADS sales and virtually all its profits. Were Airbus directly under his control, he would in effect be boss of EADS, with Enders number two responsible for the growing (but not yet very profitable) defence and space interests.

The German shareholder has blocked the appointment to the top Airbus job of Gerard Blanc, Forgeard's deputy, because he lobbied so toughly for the final assembly of the A380 to be in Toulouse rather than at Airbus's other big plant in Bremen. That leaves two Frenchmen, Fabrice Bregier (who runs the Eurocopter part of EADS) and Charles Champion (in charge of the A380 project) as leading candidates. Since both lack experience of top-level management, either would make a good fit with Forgeard.

Cashing in

Beyond the jockeying for the cockpit controls, there lies more uncertainty for Airbus and EADS. The company was formed when Germany's DASA was merged with



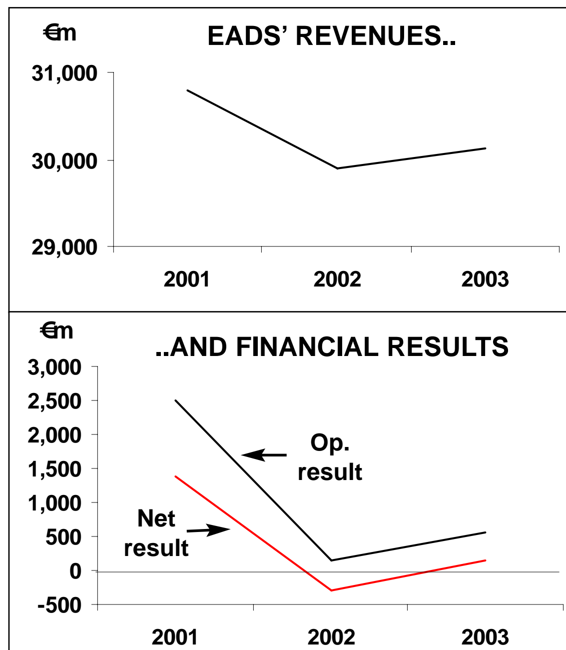
Aerospatiale Matra in 2000. Only 35% of its shares are publicly traded: the French government and the private Lagardere group own just over 30%, as does DaimlerChrysler (which owned Dasa); 6% is held by the Spanish government's industrial holding company, SEPI.

But this ownership structure is temporary, even unstable. Lagardere wants to sell out in the next year or so. DaimlerChrsyler (content for the moment with a more-than-tripling of the shares to nearly €24) will sooner or later want to employ its capital in its core business of making cars. Its Chrysler brand is under intense competitive pressure in America, and Mercedes-Benz will need lots of time and money to recover its slipping reputation for quality and leading products in Europe and around the world.

Significantly, Arnaud Lagardere, chairman of the eponymous group, has just joined the board of DaimlerChrysler. He has made no secret of his strategy of turning the French company into a purely media concern; he has no interest in automobiles. The real purpose could be to keep the Germans and French in touch over a co-ordinated sell-down of their stakes, as more of EADS is floated. The French government, with its worsening budgetary situation, would probably welcome the cash from reducing its 15% stake, and Forgeard has made no secret of his wish for the government to withdraw. And, as we have seen recently, what Forgeard wants, he usually gets.

DaimlerChrysler directors were alarmed late last year not just by the prospect of a Frenchman taking over as chief executive of EADS but by a proposal, floated by the French government, for EADS to take over Thales, a French defence and civil electronics contractor, of which the two main shareholders, the French government (31%) and the troubled Alacatel telecom equipment maker (9%), want to sell out. The Germans, with enough problems of their own in the automobile industry, were averse to the risks involved in absorbing another (French) defence company.

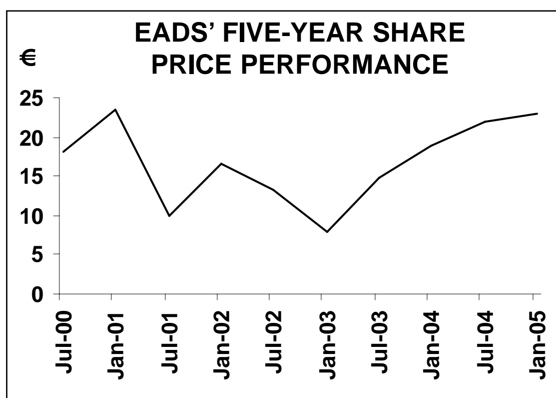
With Thales, EADS would become predominantly French in terms of assets and business. The German shareholders have



also indicated that if EADS is to become more French, with a Frenchman at the helm of both Airbus and the parent, then a precondition is that the French government backs off, leaving EADS to behave as a private company.

At the same time as this uncertainty builds, there is the potentially de-stabilising position of BAE Systems - a 20% owner of Airbus, which accounts for about a fifth of the company's profits, putting it third behind Saudi Arabia and North America as profit centres for the group.

Every time BAE Systems chief executive Mike Turner is asked about selling out of Airbus he replies in terms of finding no reason to sell out of a good investment until the company can find something better to do with



the money.

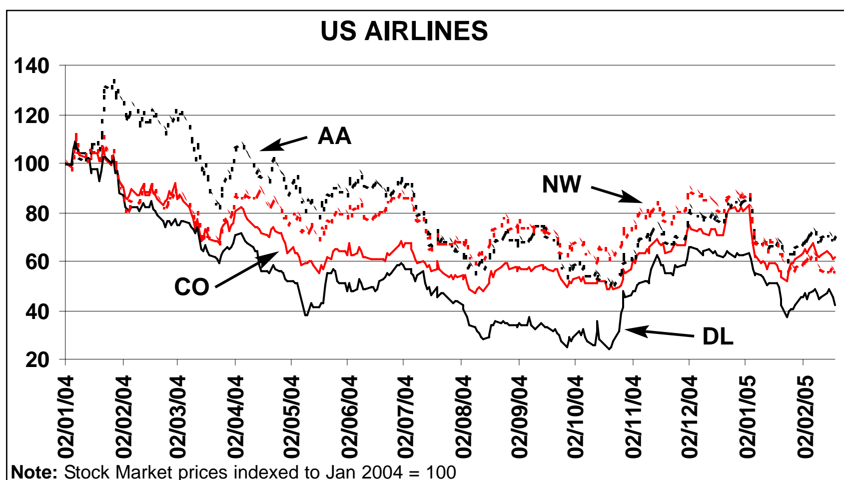
If BAE Systems were an industrial conglomerate such sentiments would put the Airbus stake firmly in the category of "managing for value", in other words, selling when the price is right. For BAE Systems that would probably mean a few years hence once the A380 programme is starting to generate profits as sales reach double their present volume. The most likely buyer would, of course, be EADS, making it even more synonymous with Airbus.

So the future of European Aeronautic Defence and Space Company (EADS) could either be Airbus Aerospace or FADS (French Aeronautic Defence and Space Company).

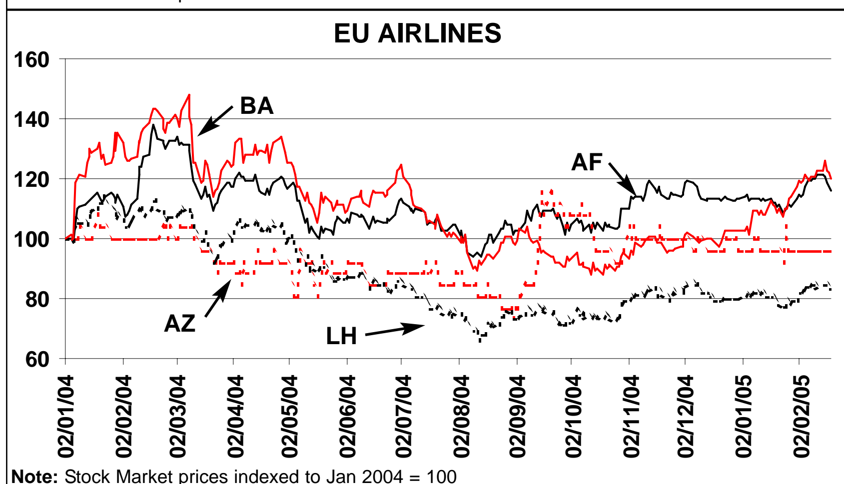
Airline share prices: Up, down and sideways

In the following charts we take a sample of the major quoted airlines by region, with a special chart for the top LCCs. We index their share prices to the beginning of last year to show a simple movement comparison.

For the US carriers there has been nothing but further deterioration in sentiment as the markets continue to believe that all the major network carriers will have to file for bankruptcy.



Note: Stock Market prices indexed to Jan 2004 = 100



Note: Stock Market prices indexed to Jan 2004 = 100

In Europe, there has been more of a mixed view. Here we do at least have some potential for rationalisation and a hope that the industry still has sufficient dynamism to provide returns. The first real cross border merger came through with Air France's acquisition of KLM - (although it is still difficult to see that there can be full synergies given the status of the deal). This has led many observers to put Air France KLM at the top of their stock pick lists. As the chart shows, last year at least, the stock has tracked the path of BA - now regarded by many as stymied in its plans.

For some reason we include the Alitalia share price in the chart - but that, going through another restructuring as it does every cycle, is once again a penny stock making a small movement in the share price equivalent to a large percentage move. The real loser in the past year has been Lufthansa. Having disposed of some of its peripheral businesses it is still seeing losses in some of its aviation related businesses - holding back earnings recovery.

In Asia contrastingly there has been consistent recovery for Qantas at least, while SIA made a year end recovery and Cathay has gone sideways. All have shown good recovery from the additional Asian problems of 2003 with Qantas in particular showing good cost control.

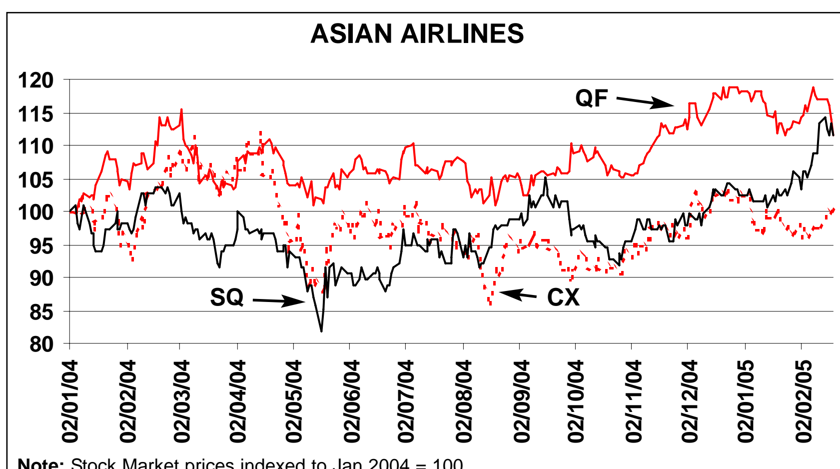
Of the LCCs Southwest remains a bellwether, the European LCCs, the darlings of

the previous two years, have languished. Both EasyJet and Ryanair continue to increase capacity strongly by 15-20% a year, but have been hit by copycat startups and aggressive responses from the network carriers. The share prices had previously been talked up (mostly in comparison with the dynosaur network carriers) with a certain animadversion to the (particularly European) expansion plans.

In hindsight the markets should have realised that capacity increases imply yield dilution in this most commodity-like of aviation segments. Ryanair was hit first by its announcement of fare wars, easyJet a month later. The easyJet share price recovery towards the end of last year was a result of Icelandair's taking a 10% stake.

One analyst recently published a report stating that the industry is currently approaching mid-cycle but that there is no overwhelming case for investment based on current valuations (HSBC Global Research "Make Them Sweat - Use what you've got before you get more" January 2005), partly because this cycle is different and that the next peak will show lower returns than previous peaks, partly because current valuations are not far from his "mid-cycle" valuations.

If that is the market consensus then the market may well be in for a pleasant surprise. Historically in each of the past airline cycles observers have stated that this time the cycle is different. In each case there has been a 50% fall in share prices from peak to trough and 100% rise from trough to peak. The industry always lives in interesting times and its shareholders get a roller coaster ride.



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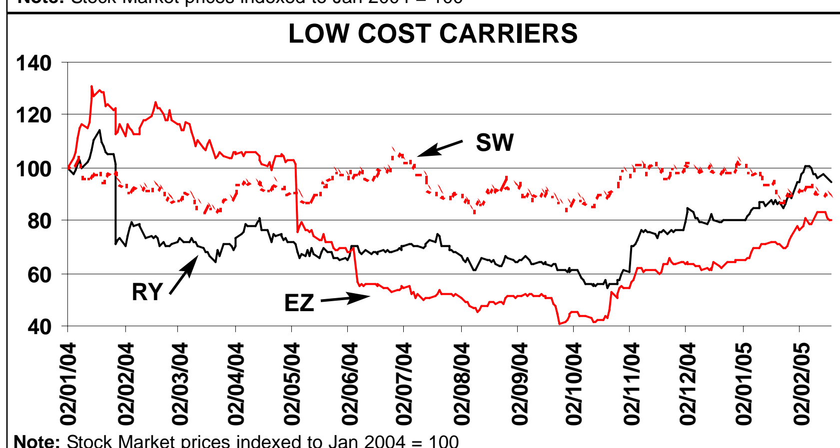

Note: Stock Market prices indexed to Jan 2004 = 100

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Healthy RJ order books

The US regional airline industry recorded 96.7bn ASKs, almost a 27% year-on-year rise for the nine months ending in September 2004, with a traffic rise of 31% to 65.9bn RPKs. The resulting load factor is a two-point increase from the corresponding period in 2003 to 68.1%. The regionals' healthy growth serving secondary markets and picking up routes discarded by the major carriers, is particularly benefiting the RJ market, which now accounts for 53% of the commuter/regional fleet in the US.

Bombardier delivered 178 CRJs in the 2004/05 financial year that ended on January 31, a drop from 214 CRJs in the previous year. The larger CRJ700 and CRJ900 deliveries continue to rise and the only segment slowing down is 50-seat RJs.

Embraer delivered 134 RJs in 2004, it has said that it foresees a "more moderate market for 30-to-60-seat aircraft and "more growth" for 70-to-110-seat RJs. Growth in the larger RJ market is illustrated in the firm order backlog table below, the main players are the US regionals and the European exceptions to this trend are the downsizing Swiss and the Air France franchisee Regional Airlines.

FIRM ORDER BACKLOG

Embraer		Totals	Bombardier		Totals
ERJ 135			**CRJ200ER**		
Luxair	2		Air Canada	4	
South Africa Airlink	15	**17**	Air Nostrum	23	
ERJ 140			Atlantic Coast Airlines	34	
Midwest	20	**20**	Delta	24	
ERJ145			Lufthansa	3	
American Eagle	20		J-Air	2	**90**
China Southern	1		**CRJ200LR**		
Continental	29		Adria Airways	1	
Regional Airlines	8		Delta	7	
Rheintalflug	8	**66**	Northwest	21	
Emb170			US Airways	1	**30**
Finnair	12		**CRJ701**		
GECAS	4		Brit Air	2	**2**
LOT Polish Airlines	4		**CRJ701ER**		
Republic	14		Styrian Spirit	1	
Swiss	15		GECAS	6	
US Airways	63	**112**	Horizon Air	9	
Emb175			Skywest	15	
Air Canada	15	**15**	Undisclosed	5	
Emb190			US Airways	32	**68**
Air Canada	45		**CRJ705LR**		
COPA	10		Air Canada	15	**15**
JetBlue	100	**155**	**CRJ900**		
Emb195			Mesa Air Group	20	**20**
Swiss	15	**15**			
TOTAL		**400**	**TOTAL**		**225**

Sources: Embraer totals from Embraer, as of 31/12/04. Bombardier totals from ACAS, as of 31/01/05.

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Republic Airways: rising star of the US regionals

Republic Airways Holdings, the parent of Chautauqua Airlines and yet-to-be-certified "Republic Airline", has been described as a rising star in the US regional airline sector. With its all-RJ fleet, growing 70-seat operations, super-low cost structure and diversified customer base, the Indianapolis-based company is well positioned to benefit from the restructuring that is likely to take place in the regional sector in the next few years. After going public last year, Republic raised additional funds in a secondary offering in February - something that would allow it to be opportunistic. It is rumoured to be seeking to buy US Airways' owned EMB-170s. It is also talked about as a potential acquirer or investor in Independence Air, which is facing increasing pressure from shareholders to revert back to the fixed-fee regional model.

On the negative side, Republic faces significant partner risk and uncertainty. Of its four major airline codeshare partners (US Airways, United, Delta and American), two are in Chapter 11 bankruptcy and one (Delta) still looks very fragile after averting Chapter 11 in late 2004. It is worth bearing in mind that the recent legacy carrier rescue deals may have only moved their troubles by one year.

There is also growing asset risk associated with 50-seat RJs, for which the market is weak. At year-end, all but 11 of Republic's 111-strong fleet were 50-seat RJs. Unlike some other US regional airlines, Republic actually owns 51 or about half of its 50-seat RJs, and many of the others are on long-term leases.

As illustrated by recent events, there is also the risk of being outmanoeuvered by other regional carriers. In mid-February Air Wisconsin secured the right to place up to 70 CRJ-200s in US Airways Express by providing $125m of DIP financing to US Airways, to be converted into equity when the airline emerges from Chapter 11. This could potentially mean Republic and Mesa losing some of their US Airways business. However, Air Wisconsin is unlikely to exercise those rights because the CRJ-200s are currently in United Express - evidently, the US Airways Express deal represents merely a contingency plan. Even so, the prospect of some the legacy carriers allocating RJ flying on the basis of regional carriers' willingness to provide debt or equity funding, rather than the traditional criteria of low costs or high service quality, is intriguing.

How will Republic deal with such challenges? What are the key components of its business strategy and chances of long-term success?

Six-year transformation

Republic has been extremely fortunate in attracting both a right-calibre owner and a uniquely talented management. In the late 1990s Chautauqua was still a small turboprop operator, albeit with a 23-year history of reliable operations as a feeder for US Airways. In May 1998 Wexford Capital, a private investment firm, purchased it for $20.1m in cash. Wexford brought in a new management team, established a holding company structure and began to aggressively grow the airline.

The top three executives of the new management team, led by Bryan Bedford as CEO, joined the company in July 1999 from another regional airline, Mesaba. They had an impressive track record there but were frustrated by the lack of growth opportunities. At Republic, they have implemented a rapid transformation that has seen major RJ growth with US Airways, addition of new codeshare partners, introduction of a "single-fleet" regional model, establishment of a platform for 70-seat and larger RJs and a significant lowering of operating costs.

After the 1999 launch of RJ service for

US Airways (initially supplementing turbo-prop operations), new partners were added at a dizzying pace: TWA in 2000, American in 2001 (after its acquisition of TWA) and America West also in 2001. Delta followed in 2002, and in 2003 Delta replaced America West after the latter closed its Columbus (Ohio) hub. United was added in early 2004 - significantly, for Republic's first 70-seat EMB-170s - and in December the Delta agreement was expanded to include 16 EMB-170s between mid-2005 and mid-2006.

All of that has meant extremely rapid capacity growth even by regional airline standards. Between 2000 and 2004, Republic's ASMs grew at a compounded annual rate of 50.2%. Its revenues have multiplied six-fold, from $88.3m in 1999 to just under $541m last year.

Republic is currently the fifth largest US regional airline in terms of 2004 revenues, behind ExpressJet ($1.5bn), SkyWest ($1.2bn), Mesa ($897m) and Pinnacle ($635m). At year-end, it operated about 700 flights daily, serving 73 cities in 31 states and the Bahamas.

The ASM growth has been paralleled by strong and steady profit improvement in the past five years, helped by a transition from revenue-sharing to fixed-fee feeder agreements. In Merrill Lynch's estimates, Republic earned a pretax profit of $66.5m in 2004, which would represent a margin of about 12.4% - among the highest in the industry (the actual results will be out on March 3). Republic's operating margins are much higher than those of other regional carriers mainly because it owns a larger percentage of its fleet (paying interest, rather than lease expenses).

Republic first filed for an IPO in early 2002, as Wexford wanted to recoup (and profit from) its 1998 investment and the airline needed funds to meet progress payments on RJs. However, it took the company more than two years to get there, in what reads like a chronology of everything that went wrong in the US airline industry in that period.

Like Pinnacle, Republic was unable to proceed in the wake of ExpressJet's disappointing market debut in the spring of 2002. The IPO was relaunched that summer but had to be withdrawn due to poor market conditions and key partner US Airways' first Chapter 11 filing. A third attempt, made in late 2002 just two days after US Airways secured DIP and equity funding, failed because of the Iraq war and uncertain industry prospects. In the autumn of 2003, when market conditions were ideal, Republic was in the middle of pilot contract talks and had no longer-term growth in feeder contracts. Finally, in May 2004, Republic successfully went public despite a relatively weak market.

The IPO accomplished several important goals. The company raised $75m in gross proceeds and obtained a listing on the Nasdaq under the symbol "RJET". It was able to repay Wexford fully ($20.4m) and boost its cash position to $42.9m at the end of June 2004, from just $1.2m three months earlier. After the IPO Wexford retained a controlling 74% stake in the company. At the IPO price of $13, that stake was worth $247m - quite a return on a $20.1m investment.

Secondary share offering

In early February Republic completed a secondary offering of 6m shares, with Merrill Lynch, Raymond James and UBS as underwriters, again raising $75m in gross proceeds. The offering was increased in size by 1m at the last minute and could raise another $11m if the over-allotment option is exercised fully.

The offering, which came soon after the expiry of the 180-day lockup period after the IPO, seemed very purposefully timed. It was launched immediately after US Airways clinched important labour and financing deals that should enable it to survive at least another year, while waiting longer could obviously have meant potential investment opportunities disappearing at US Airways and Independence Air. The prospectus listed "potential strategic acquisitions and/or investments" as one of the possible uses of the proceeds.

However, contrary to some suggestions

that Republic is now flush with cash to spend on acquisitions, the secondary offering merely restored its formerly relatively weak cash reserves to a healthy level (which is not to suggest that it could not afford acquisitions). Cash and short-term investments have more than doubled from the September 30 level to about $134m, which is 27% of annual revenues - similar to Mesa's but much lower than SkyWest's 48%. The latest share offering reduced Republic's lease-adjusted debt-to-capital ratio by a few percentage points to 84%, which is similar to the regional carrier average.

The offering reduced Wexford's stake to 61.2%, or 59.5% if the over-allotment option is exercised. Despite the inevitable concerns about the size of that holding, as well as potential conflicts of interest (Wexford owns turboprop operator Shuttle America and is likely to invest in other airlines), Wexford's backing is viewed as a very big positive in the current aviation environment.

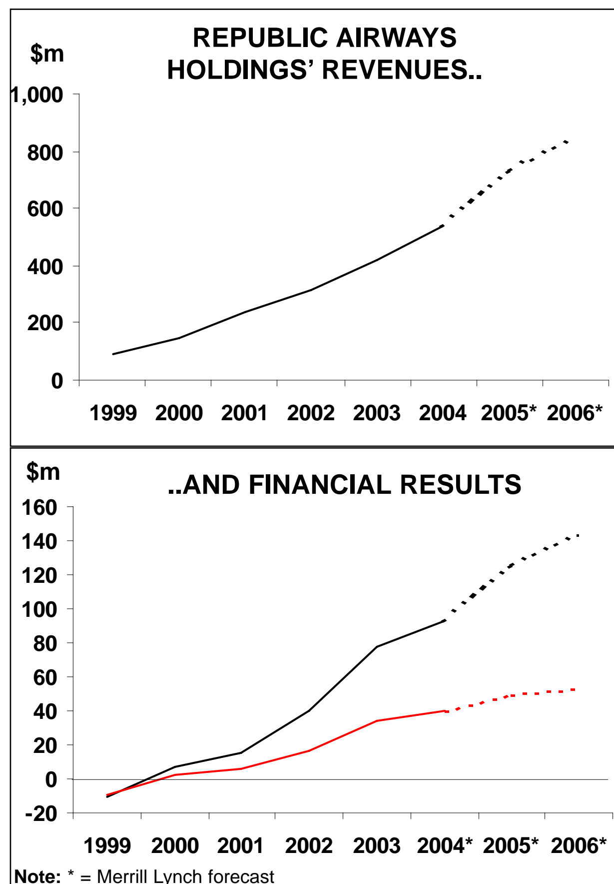
Business strategy

Republic's business strategy is an eclectic mix of the fixed-fee regional airline model, some key concepts adapted from LCCs and many unique strategies developed by the talented management team.

At a time when other regional carriers are considering going independent or returning partly to revenue-sharing, Republic wants to be a pure 100% fixed-fee operator. To diversify risk, it seeks to build relationships with a diverse group of airlines. Like LCCs, its key goals are to maintain extremely low operating costs and a well-trained, highly skilled and motivated workforce. The unique aspects of the strategy include moving aggressively into 70-seat RJs and developing subsidiary platforms for different RJ sizes.

• 100% Fixed-fee operation

Republic has been 100% fixed-fee since 2002. The benefits of the "fixed-fee" or "fee-per-departure" feeder agreements are well known: effectively eliminating the regional carrier's exposure to fluctuations in fuel prices, fares and load factors. Some 58% of Republic's costs are fully compensated for by its partners, including fuel, aircraft ownership, landing fees and insurance. The agreements generally provide for minimum aircraft utilisation levels and include an agreed profit margin, which Republic can exceed if it can reduce costs below contractually agreed levels. The agreements facilitate a healthy revenue stream and a high level of earnings stability.



Note: * = Merrill Lynch forecast

However, United's bankruptcy has shown that the fixed-fee model does not work so well when a major carrier is in financial trouble. Once in Chapter 11, the legacy airlines can reject the long-term feeder agreements and demand new ones that incorporate rate reductions. The new contracts have invariably meant reduced profit margins for the regional carriers that retain the business.

The best-positioned regionals in this new environment are obviously the lowest-cost

operators, which can accept the rate reductions and still make decent profits. In that regard, Republic is probably the ideal candidate to continue to focus on the fixed-fee business. However, it obviously also makes sense to go some extra way to try to diversify risk.

Republic has disclosed in SEC filings that, over the past couple of years, it has granted some type of economic concessions even to its solvent partners, including America West, American and Delta. However, it has invariably negotiated something in return.

For example, in October 2003 it granted American a temporary reduction in monthly fees, in exchange for an extension in the date of American's early termination right. And in December 2004 it agreed to reduce Delta's payments on ERJ-145s by 3% through 2016, in exchange for Delta extending the term and canceling previously issued warrants for 2m shares.

Of course, the original decision to grant Delta the warrants was the equivalent of granting concessions or providing incentives to attract the business. As Republic explained it in last month's prospectus: "To induce Delta to enter into the codeshare agreement with us, we paid Delta a contract rights fee in the form of a warrant to purchase shares".

Examples like that illustrate that, among various other important attributes, Republic may have more imagination and aptitude than the other regionals to do what it takes to attract new growth.

• Lowest-cost producer

It is hard to compare regional airline operating costs, but most analysts believe that Republic's CASM is probably the very lowest. According to the IPO roadshow presentations, discussed by Raymond James analyst Jim Parker in his August 2004 report, Republic's 2003 CASM, including interest costs, was 10.5 cents - the lowest among seven RJ operators, whose CASM ranged between 12.1 cents (Mesa) and 16.1 cents (Independence Air). Significantly, Republic has reduced its CASM by about 25% since 2001.

Republic believes that its cost advantage is due to four factors: low overhead costs, high labour productivity, high aircraft utilisation and a single fleet type.

According to the latest prospectus, the low overhead costs arise mainly through flying for different partners (spreading overheads over a larger base) and operating in a geographically concentrated region. The latter basically means eastern US - Republic flies for American at St. Louis, for US Airways at the key Northeast cities plus Indianapolis, for Delta in Florida and for United at Washington Dulles and Chicago. It enables the airline to "leverage our maintenance and crew base overhead and cross-utilise our employees and also improve the scheduled efficiency of our aircraft".

In contrast, some other regional airlines (such as Mesa) operate for different partners in different, far-flung corners of the nation. Republic has indicated that, to avoid potential conflicts of interest with its strategy, it would consider operating for different partners under different subsidiaries.

Republic pays competitive wages and incentives in exchange for high productivity rates. Labour productivity is high also due to fleet commonality and lack of unproductive work rules.

Average aircraft utilisation, at 10.5 hours per day in 2004, is among the highest in the regional airline industry. Republic said that its agreements with the major airlines include incentives for the partners to increase utilisation.

One reason explaining the strong profit growth is that the airline was able to move quickly from a 33-strong turboprop fleet at year-end 1999 to an all-jet fleet by the end of 2002. It operated an all-ERJ-145/140/135 fleet until October 2004, benefiting from LCC-style efficiencies in crew training, aircraft maintenance and spare parts inventory associated with a single fleet type.

Such benefits will be retained, because the plan is to operate the 70-seat EMB-170s in a separate subsidiary - somewhat confusingly called "Republic Airline" - once it obtains an operating certificate.

• Move to 70-seat RJs

Alongside with its low cost levels, Republic's greatest competitive strength is its early move to 70-seat RJs. It is so far the only EMB-170 operator among the independent regionals, having introduced the type into Chautauqua's United Express fleet in October. By year-end Republic had received 11 EMB-170s out of a total of 100 ordered and on option. Significantly, the company has the right to convert the options for the 100-seat EMB-190s, which have a high degree of commonality with the EMB-170s.

Aircraft in the 70-90 seat category represent the next major growth area for regional airlines. There are still pilot scope clause issues, but things are moving in the right direction. Some analysts have suggested that JetBlue's introduction of the EMB-190 later this year could spur the legacies to press for scope clause relaxation to accommodate that aircraft.

• Single-fleet platform

Republic has to operate the EMB-170 in a separate subsidiary to avoid scope clause issues. American's pilot contract prohibits the carrier from using regional airlines that operate larger than 50-seat aircraft. Consequently, the plan was to operate the United EMB-170s at Republic Airline right from the outset (originally from August 2004), with Chautauqua continuing to operate the 50-seat RJs.

However, Republic Airline has still not completed the certification process - the current expected date is June 2005 - so the company has had to negotiate a special arrangement with American. Under the deal, Republic paid American $500,000 through February 19 and will pay $1.1m through April 22 for the temporary right to operate up to 18 EMB-170s for United through Chautauqua. It will not be able to start flying the EMB-170 for Delta this summer if Republic Airline is still not certified.

Prospective start-up airlines be warned - even the seasoned Republic executives found the certification process "lengthy and complicated". They evidently significantly underestimated the difficulty of obtaining a new airline certificate.

Growth prospects

Assuming that all will go well with the Republic Airline subsidiary, the company has exciting growth lined up through 2006. The plan is to expand the fleet from 111 aircraft at year-end 2004 to 139 by the end of 2006. All 28 new additions will be EMB-170s under firm contract for United and Delta. The United firm orders currently cover 23 aircraft through this June, while the Delta orders cover 16 aircraft through mid-2006.

The new Delta agreement in December was significant in that it gave Republic its first fleet growth in 2006 (the only other US regional that currently has growth beyond this year is ExpressJet). It also helped reduce exposure to US Airways, which last year accounted for 43% of Republic's revenues. The Delta deal followed expanded scope relief - the 70-seat RJ limit was raised from 58 to 150 aircraft. On a less positive note, Delta wanted out of eight 50-seat RJs that were due this year.

US Airways' troubles have kept a firm lid on Republic's share price since the IPO. While that may not change, the late-January lifelines that were extended to US Airways certainly removed much of the immediate concern about the fate of the 35 50-seat RJs that Republic currently utilises for its largest partner. Now it even seems plausible that US Airways could emerge from Chapter 11 by the June 30 target date agreed with creditors.

However, US Airways still has much work to do, not least of all to find more equity capital, and it is possible that it may need to sell some assets. Jim Parker suggested in a February 23 report that Republic is actually in negotiations with US Airways to purchase assets, such as some of the 25 owned EMB-170s, which it could operate for other legacy carriers. Parker also said that be believed Republic would insist on US Airways affirming its existing feeder contract as part of any deal reached.

By Heini Nuutinen
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Lufthansa: return on core business refocussing

After delivering a €1bn net loss in 2003, the Lufthansa Group recovered well last year by focussing on its core businesses, selling off non-strategic business units and driving through cost cutting. Has Germany's flag carrier done enough in the face of a high structural cost base and a continuing challenge from the low cost carriers?

Lufthansa operates to more than 330 destinations in 90 countries, making it the third-largest European passenger airline - after British Airways and Air France - as well as the world's second-largest cargo airline, behind only Fedex.

Although passenger traffic rose by 1.6% in 2003, the Group was hit by not only SARS and the Gulf war, but also by losses at associated tour operator Thomas Cook (which the Group owns 50% of) and at catering subsidiary LSG. So while the Group made an operating profit of €36m on revenues of €16bn in 2003, the net loss for the year was a staggering €984m, of which €700m came from write-downs at LSG.

This prompted Wolfgang Mayrhuber, the new CEO and Chairman of Lufthansa Group (he took over from Jurgen Weber in June 2003), to instigate a twin strategy of cost cutting across the Group, allied with a refocussing on the core businesses of airline and cargo, supported only by subsidiary operations that added real value to these core business units.

Cost cutting targets

The Group targeted cost cutting of €1.2bn by the end of 2006, split evenly between staff, external suppliers, internal suppliers and "production framework/processes" (i.e. aircraft utilisation, regional airlines and Lufthansa's hub operations). Of the overall total, €430m of cuts was to be made by the end of 2004, and in October the Group said it was just about on target to meet that goal, with management concerned only by a delay in cutting labour costs.

Those concerns stemmed from marathon negotiations with pilots, which started back at the end of 2003. In October 2004 Wolfgang Mayrhuber threatened that future growth would be concentrated at low cost subsidiaries (such as Germanwings) or even fellow Star alliance members if agreement with unions couldn't be reached quickly. Not surprisingly, this wasn't well received by unions, who described Mayrhuber's statement as "completely incomprehensible".

Nevertheless, in December 2004 Lufthansa finally agreed a pay round with the pilots, which management estimates will reduce its cost base by €55m in 2005. The deal with the pilots' union Vereinigung Cockpit covers 4,400 pilots at the main airline, the cargo operation and at Germanwings, and includes a pay freeze until the end of March 2006, alterations to the pension scheme and the addition of an extra two hours to pilots' flight schedules every month. In return, the union has an assurance that there will be no job losses over the period.

A separate deal with Verdi, the ground staff union that represents 37,000 Lufthansa personnel, was agreed in the same month. The agreement lasts until the end of 2006 and includes flexible working and overtime measures for existing ground staff as well as a reduction in holiday entitlement and other conditions for new staff. In return, although pay scales will nominally remain frozen, ground staff will receive a bonus of 0.5% of their salary in 2005 and 1.6% in 2006, profit sharing has been introduced and - as with the pilots - Lufthansa has given guarantees that there will be no job losses over the period. Overall, Lufthansa expects the deal to cut ground staff costs by €150m over the next two years.

Lufthansa has also cut costs at its call centre in Kassel, western Germany, by 29% after an agreement with the 380 staff there that includes a longer working week, a reduction in overtime hours and a 75% cut in pay for working on Sundays and holidays. This leaves 13,700 cabin staff, represented by the UFO union, as the last major group yet to agree a pay deal, although management is confident a deal will be agreed before the end of the first quarter of 2005, with terms similar to those agreed with ground staff.

Elsewhere, distribution is another area where Lufthansa has been making real progress in cut-

ting costs, although - inevitably - travel agents have tried to resist the measures imposed by the airline. In September 2004 Lufthansa stopped paying commission to German travel agents on all flight tickets (payments averaged 5%-9% per ticket face value), forcing agents to charge their customers separately for their time and advice. Around 660 travel agents staged a three-day boycott of Lufthansa flights in protest, but they had little choice but to accept the move.

However, the simmering ill-will of German travel agents towards Lufthansa became worse when in January this year the airline reduced its online booking fee from €30 to €10 for tickets to European destinations, and from €45 to €15 for intercontinental destinations. The cuts in the fees are in addition to the €10 discount that Lufthansa gives on all tickets booked via the internet, which effectively means that European tickets can be booked via Lufthansa's web site for no additional cost at all - as opposed to the service charges that travel agents levy when customers book tickets through them.

German agents immediately lodged a complaint with the German cartel office, but it's unlikely the office will overturn Lufthansa's policy, particularly given the precedent set in Austria, the next most important market for Lufthansa. There, Lufthansa ceased paying 5% commission from November 2004 but, after Austrian travel agents filed a lawsuit against Lufthansa, in January an Austrian court ruled that the airline was doing nothing illegal.

Also in January, Lufthansa ended its ongoing dispute with Dusseldorf airport over an increase in landing fees. The airport had imposed a 7.1% increase, but after a boycott of the fee by a dozen airlines - of which Lufthansa was by far the most important - the airport backed down and introduced a 3.5% rise instead.

Profit recovery

The cost cutting through last year helped Lufthansa Group record an operating profit of €251m in the nine months to September 2004, compared with an operating loss of €154m in 1Q-3Q 2003. Turnover rose 7.7% to €12.7bn in the period. The Group's passenger business saw RPKs increase by 16.2% in the three-quarters, year-on-year, ahead of a 14.3% rise in ASKs and resulting in a 0.8 percentage point increase in passenger load factor to 74.3%.

Of the 1Q-3Q Group operating profit, the airline division was responsible for €237m, representing 94% of the total. But other than engineering specialist Lufthansa Technik, all of the Group's other subsidiaries either made losses or small profits at best. Most worryingly, in 1Q-3Q 2004 LSG Sky Chefs - the catering division - and Thomas Cook (which Lufthansa owns jointly with German retailer KarstadtQuelle) made €114m and €142m operating losses respectively.

These are worrying figures, although the underlying performance of the subsidiaries has to be taken into account. While a restructured Thomas Cook is expected to break even for the full year, the prospects for LSG are not so good. Radical restructuring at the catering subsidiary over the last 12 months - including more than 8,000 job losses and the sale of Chef Solutions, which made bakery products for the North American market - appears not to have made much of an impact. In November 2004, Hanns Rech - the CEO of LSG - resigned with immediate effect, reportedly after the Lufthansa Group cancelled plans to float off the subsidiary yet again (an earlier attempt to launch an IPO had to be abandoned after September 11). It appears that LSG will continue to drag down Group results for the foreseeable future.

Nevertheless, the Group is pushing on elsewhere with its strategy of disposing what it considers to be non-core assets. In November 2004 Lufthansa Group added another substantial sum to its coffers from selling its 31% stake in Tank & Rast, a German motorway services firm, which was acquired by Terra Firma, a UK private equity company, for €1.1bn.

Further sell-offs could include Lufthansa's 30% stake in bmi, which it bought in 1999 and 2002. A UK newspaper claimed in January that Lufthansa was looking to sell its stake, partly in order to release the airline from a binding put option that obliges Lufthansa to buy the 50% plus one share that belongs to Michael Bishop, bmi's founder. Bishop can exercise this option anytime from the end of 2005 until 2009, at a fixed cost to Lufthansa of €325m - a sum that analysts estimate is significantly higher than the true market worth of the airline. Lufthansa is reported to be negotiating with both Virgin Atlantic and British Airways, although the German airline will not comment, and sources suggest both potential acquirers would require a

very low price in order to relieve Lufthansa of its investment. However, this may be part of the negotiating game, as bmi controls 85 slot pairs a day at London Heathrow, giving it a valuable 14% share of all slots at the airport.

Even without a forced purchase of further shares, Lufthansa's involvement with bmi has been nothing short of disastrous. The original intention of the deal was to secure feed from bmi's operation at London Heathrow into the Lufthansa network across Europe. However, since Lufthansa bought its stake, bmi has racked up three successive years of operating losses, forcing the German airline to write off the book value of the investment and take its share of the losses, which were €66m in 2002 and €76m in 2003.

Although Lufthansa Group's avowed strategy is to divest rather than increase its portfolio, it may be tempted to make investments in specific circumstances. For example, although Lufthansa's stake in CRS Amadeus is now down to 5.1%, in January a Spanish financial newspaper claimed Lufthansa wants to raise its stake back up to11% by acquiring parts of the equity held by Air France and Iberia. At first sight this would appear to be an odd move given that Lufthansa raised €394m (giving it a book profit of €292m) when placing a 13.2% stake with institutional investors on the Madrid stock market in February 2004. But at the time Lufthansa said it would hold on to its remaining stake, and its strategy may be influenced by the fact that two UK equity funds - Cinven and BC Partners - are trying to acquire the CRS in a complicated deal that involves the de-listing of Amadeus and the setting up of a new holding company. While Air France and Iberia would reduce their stake, the deal may be structured so that the three airlines end up with more equal shares than at present, hence leading to speculation that Lufthansa's stake will increase.

Another possible investment may be in Deutsche Flugsicherung, the German air traffic control service, which the government plans to privatise in 2005. However, this would be a reluctant investment by the Lufthansa Group, going against its disposal policy and essentially forced on it by a fear that the service might become a privately held monopoly.

Less feasible should be an investment in a fellow European flag carrier, which would be expensive, divert management and help consolidate the industry to the benefit of rivals. Analysts were concerned when Lufthansa attempted to acquire Swiss International Air Lines in 2003, before the Swiss airline decided it wanted to join the oneworld alliance. Lufthansa was particularly interested in acquiring Swiss's long-haul routes, a prospect that at the time was not well received by Swiss's management and shareholders, who wanted to retain the independence of the airline. After Swiss's flirtation with oneworld came to nothing following a disagreement with British Airways on FFP linkage, in January 2005 Lufthansa insisted it was no longer interested in acquiring the airline. However, reports to the contrary persistently come out of Switzerland, and the Swiss finance minister stated earlier this year that a partnership between Swiss and Lufthansa is an option the government is considering.

Unconfirmed Swiss sources say a informal deal has been already been agreed whereby as long as Swiss can fulfil certain conditions - including a recapitalisation of at least €200m from existing shareholders, new agreements with pilots and ground staff, and the cancellation of existing aircraft lease contracts - then a partnership will be announced by the two airlines this autumn, potentially leading to a full merger in the summer of 2006.

And in September 2004 Pietro Lunardi, the Italian transport minister, said that Alitalia would do better by aligning itself with Lufthansa than by pursuing closer links with SkyTeam partner Air France. Lufthansa Technik acquired 40% of Alitalia's maintenance subsidiary in 2003, but the suggestion of a link with the German airline was refuted by Giancarlo Cimoli, Alitalia's CEO, and given Alitalia's continuing financial woes it's unlikely that Lufthansa is interested, particularly as Lufthansa owns Air Dolomiti and codeshares with Rome-based Air One already. In any case, in October 2004 Lufthansa joined seven other airlines in complaining to the European Commission about the Italian government's planned rescue of the flag carrier.

Upmarket push

With the brakes applied to significant new portfolio acquisitions, Lufthansa Group is instead investing in its airline product and aircraft. On the former, Lufthansa traditionally has the highest proportion of first and business class customers among the European majors - historically around

the 20% level. However, this dropped to 16% during the first nine months of 2004, and the airline is making a determined effort to recapture its former position.

Lufthansa invested €15m in Frankfurt's new first and business class terminal, which opened in December 2004, and is launching a similar terminal at Munich, scheduled to open in 2006. However, Lufthansa says that no more than 350 passengers will use the Frankfurt facility each day, and analysts are divided as to whether Lufthansa's push for business and first class is a good move, given that these markets may be in a steady and permanent long-term decline.

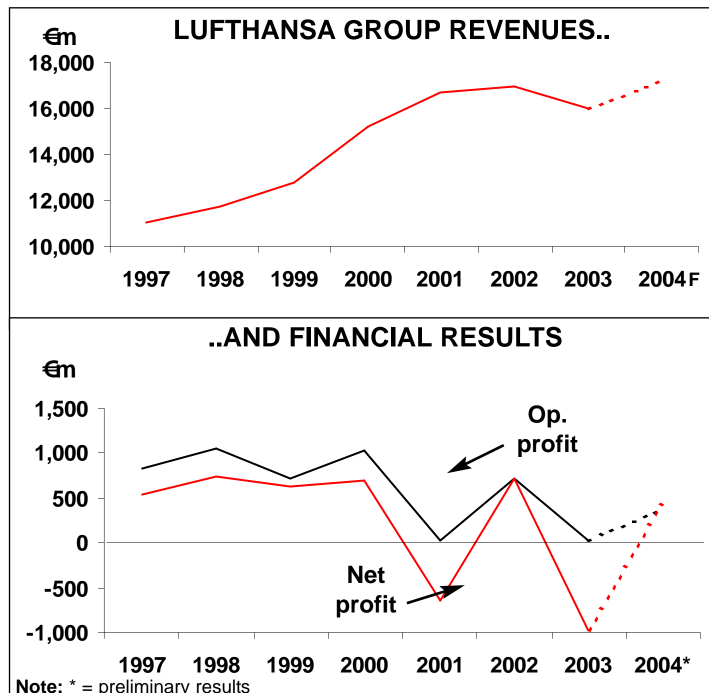
But Lufthansa is pushing on regardless. The Group already offers an executive jet service between Munich and Dusseldorf to Chicago and Newark using aircraft from Swiss charter airline PrivatAir, but this year a European corporate jet service is being launched, enabling first and business class customers to connect to/from Lufthansa's hubs from across Europe. German sources suggest Lufthansa is in talks to launch this service with NetJets, the US corporate jet business that offers fractional ownership to corporations and small companies.

Other product moves include the introduction of broadband internet connection on long-haul services and the launch of an exclusive FFP within the Miles and More scheme, to be called "Hon Circle". It will be open to passengers that fly more than 600,000 miles in a two-year period, giving them privileges such as access to the new first/business terminals at Frankfurt and Munich.

Fleet development

The Lufthansa Group currently has a fleet of 346 aircraft (see table, page 17). On short-haul, the main airline has 59 737s and 73 A320 family aircraft, but some of the 737s-300s and -500s are more than 16 years' old, and now that a pay deal has been done with the majority of airline staff, a short-haul order is likely to be placed sometime this year.

Lufthansa is keen to boost it short-haul network, the improvement of which took a lower priority last year as a result of both pay negotiations and a focus on long-haul expansion (see below). However, this does not necessarily mean a large increase in capacity, as the Group's short-haul plans are linked to the general effort in cost-cutting.



From the summer of 2004 Lufthansa improved short-haul fleet productivity by 10% through cutting turnaround time by five minutes and reducing aircraft scheduling complexity. Peaks at the Munich and Frankfurt hubs were flattened slightly by spreading some peak departures to other parts of the day,

In March 2003 Lufthansa carried out a strategic review of its regional operations, largely as a response to the encroachment of the LCCs (see *Aviation Strategy*, December 2004 and January/February 2005). The result of the review was the launch of Lufthansa Regional in October 2003 to manage the operations of Lufthansa CityLine, Eurowings (49% owned by Lufthansa), Air Dolomiti (in which Lufthansa increased a 21% stake bought in 1999 to 100% by November 2003) and turboprop partners Augsburg Airways and Contact Air. All these airlines, other than Air Dolomiti, use Lufthansa Regional livery, and they coordinate operations and routes within and to/from Germany. Lufthansa Regional replaced the former Team Lufthansa partnership, which included the same airlines (as well as Cirrus Airlines and Cimber Air, which decided not to join the new structure) in a looser regional alliance arrangement. The Lufthansa Regional airlines concentrate on providing feeder flights into the Frankfurt and Munich hubs, although increasingly they also offer regional, point-to-point routes.

However, the rise of the LCCs in Germany - both domestic and foreign - is a severe threat to Lufthansa's regional operations, and the airline is "struggling to keep regional routes alive" according to Werner Korr, senior vice president of Lufthansa Regional. The regional subsidiary, which has a combined fleet of around 160 aircraft, is looking to make a substantial order for aircraft in the near future. New aircraft are critical given the cancellation (after the collapse of the manufacturer) of an order placed by Lufthansa CityLine back in 2002 for 100-plus Fairchild Dornier 728s, which had been scheduled for delivery from 2003 onwards. Bombardier and Embraer types are now being examined, after the A318 was excluded as a possibility early in 2004.

But the order is complicated by the fact that CityLine, which operates a fleet of 63 jets and 18 turboprops to 60 destinations throughout Europe, has an agreement with pilots' union Vereinigung Cockpit that prevents the airline from operating more than 18 aircraft with capacity of greater than 70 seats. However, Lufthansa wants to increase the capacity of its regional feeder routes through a greater average set size per aircraft, so the two sides have to agree a new deal for CityLine equipment. Unions and management are to start negotiations shortly, and if agreement is reached, expansion at other parts of Lufthansa regional is likely to be offset by a smaller fleet at CityLine (by up to 14 aircraft), which will start using larger capacity Embraer 170s and 190s.

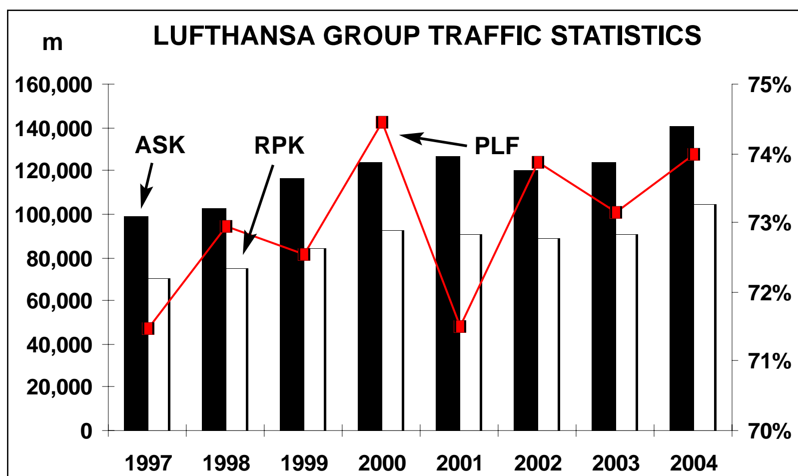
The pilots' union is wary because Lufthansa also has a target of reducing costs at regional operations by €100m in 2004-05. CityLine pilots and cabin crew agreed a pay deal in early 2004, including a pay freeze for 30 months, which - along with greater staff flexibility and other productivity improvements - is cutting around €40m from the CityLine cost base. The union is worried that a switch to aircraft with larger capacity may be used as an opportunity by the Group to make further cost cuts at the expense of its members.

At Eurowings, where Lufthansa increased its stake from 24.9% in 2001 to 49% in April 2004, the Group plans to dispose of 15 ATR-72s and concentrate on RJ operations, some of which will transfer over from Air Dolomiti. The RJs will be partly replaced at the Verona-based airline by five 100-seat BAe 146-300s, which are expected to be ordered shortly.

Once the fleet readjustments are made, it's unlikely that Lufthansa Regional and the mainline operation in Europe will ramp up capacity, at least in the short-term. In 2004 overall capacity rose by 13.4%, but RPKs grew by 14.7%, resulting in a 0.9 percentage point rise in load factor to 74%. However, within this, short-haul capacity rose by only 4.5%, and traffic by 5.6%. In 2005 Lufthansa plans to increase overall capacity by just 5%-6%, and it appears as if short-haul capacity will be level at best.

If there is any increase in capacity, it's likely to be to eastern Europe. In the summer of 2004 routes were launched to Gdansk, Poznan, Krakow, Bratislava, Tirana and Tallinn, while Lufthansa saw an 11% increase in passengers carried between Germany and Russia/CIS in the first three-quarters of 2004. Russian observers believe that Lufthansa is examining a switch of airports in Moscow in the winter of 2005/06, from Sheremetyevo to Domodedovo, a claim that Lufthansa has not denied. Lufthansa operates more than 50 flights a week from Munich, Frankfurt and Dusseldorf, but Domodedovo is upgrading its facilities and wants to attract foreign airlines. Also in eastern Europe, Lufthansa is sponsoring Adria Airways and Croatia Airlines as members of the Star alliance's new "regional membership" scheme.

Meanwhile, codesharing is being extended within Europe. In December 2004 Lufthansa extended its longstanding codesharing agreement with fellow Star member Singapore Airlines (which started in 1998) to flights between Spain and Germany, while in February 2005 Lufthansa began codesharing with TAP Air Portugal on all the airlines' flights between Germany and Portugal. Lufthansa and TAP - which is joining the Star



alliance this year - aim to extend codesharing to long-haul routes into the Asia-Pacific region later this year.

Long-haul plans

The main Lufthansa airline has a total of 93 long-haul-aircraft, but despite increasing long-haul capacity by 18% in the summer of 2004 through extra services on a number of routes, some are still operating on close to 100% load factors.

New aircraft are a priority. Lufthansa has 15 A380s on order, which will start arriving at the end of 2007 and be used on routes out of the Frankfurt and Munich hubs to North America and the Asia-Pacific region using a three-class 550-seat layout. At the launch event for the A380 in January, Wolfgang Mayrhuber said the airline would order further A380s, though he gave no indication of the timing. In December 2004 Lufthansa ordered seven A340-600s, for delivery in 2006 and 2007. These will join 40 A340s in the fleet, with Lufthansa also holding options for eight A340-300s.

Much of the new capacity will be put onto Asia-Pacific routes. Lufthansa currently operates to 19 destinations in 10 Asian countries, with more than 150 flights per week, and after passengers carried on Asia-Pacific routes rose by 25% in 2004, Lufthansa is aiming for double-digit traffic growth again this year.

A key area for expansion is China, with a target of a 50% increase in revenue on services to/from the country over the next two years following a revamped China-Germany air services agreement signed in September 2004, as well as a relaxation of visa requirements. Lufthansa operates more than 40 flights a week to Beijing, Shanghai, Guangzhou and Hong Kong, making it the leading European airline to China. Lufthansa also codeshares with Air China on international routes and with Shanghai Airlines on domestic routes to 15 codeshare destinations, and under the terms of the revised ASA it can double the amount of codeshare destinations.

However, the Air China codeshare deal will be under threat if the Beijing-based airline goes ahead with a plan to sell a 9.9% stake to Cathay Pacific at the same time as it IPOes on the Hong Kong stock exchange later this year. An MoU for this deal was announced in October 2004, but it caught analysts unaware as the Chinese airline previously had close ties to Lufthansa and was expected to join Star in due course. Only two months' before, Lufthansa and Air China had agreed to extend their joint venture agreement for the Aircraft Maintenance and Engineering (Ameco). The profitable Beijing-based Chinese maintenance company was launched in 1989 and is 40%-owned by Lufthansa. The two airlines agreed to extend the company until 2029, along with an injection of $100m in capex between them over the next four years.

Following that deal, it is believed that Air China asked Lufthansa Group to invest in the Chinese carrier - a request that Lufthansa turned down, thus leading Air China to approach a rival airline. And while in public the Star alliance insists that it still wants Air China to join, it's inevitable that the Chinese airline will link with oneworld, thereby forcing Lufthansa to find another codeshare partner into China. With China Southern expected to join SkyTeam, the only realistic candidate left for Lufthansa is Shanghai-based China Eastern. It had had previously been looking to join oneworld, but will now look elsewhere for a global alliance following the proposed Air China-Cathay deal, which Li Fenghua - chairman of China Eastern - described with typical Chinese understatement as "a little bit unexpected".

India is another long-haul market that interests Lufthansa, as it's the second-fastest growing market for the airline. Lufthansa started an extensive codesharing partnership with Air India for the 2004/04 winter timetable, with codesharing on both airlines' routes between Germany and India to be followed later this year by FFP linkage, sales and marketing co-operation and co-ordination on planning new routes. At present Lufthansa operates routes to Delhi, Mumbai, Chennai and Bangalore from Frankfurt or Munich, but plans to double capacity over the next two years. A three-times-a-week Frankfurt-Hyderabad service started in February, and extra frequencies are being added on Munich-Delhi and Frankfurt-Bangalore. Lufthansa's weekly flights between Germany and

LUFTHANSA GROUP FLEET

	Fleet	Order	Options
Lufthansa			
A300-600	15		
A319	14		
A320	33		
A321	26		6
A330	8	4	
A340	40	7	8
A380	0	15	
737	59		
747	30		
Total	**225**	**26**	**14**
CityLine			
CRJ100/200	43		
CRJ700	20		
RJ85ER	18		
Total	**81**	**0**	**0**
Lufthansa Cargo			
MD-11F	16		
747-200	3		
Total	**19**	**0**	**0**
Air Dolomiti			
CRJ200	5		
ATR500/700	16		
Total	**21**	**0**	**0**
Group total	**346**	**26**	**14**

India now total 35, bringing Lufthansa's share of the European-Indian market to more than 15%.

The codesharing partnership may also be a pointer to eventual Air India membership of the Star alliance, which currently doesn't have a member in the Indian sub-continent. And India is a potential destination for Lufthansa's A380s when they arrive in 2007, although there would have to be substantial improvements to the airport infrastructure.

Also as part of the continued long-haul push, in October 2004 Lufthansa launched a Munich-Kuala Lumpur route and added seven flights each week on its Munich-Bangkok service and three flights on the Munich-Ho Chi Minh City route. Frequencies are also being raised this year to Nagoya in Japan, and Singapore, while Lufthansa is launching a route between Frankfurt and Port Harcourt, an oil port in south Nigeria, from April. And in January this year Lufthansa extended an existing codesharing deal with United and United Express to 154 extra domestic North America routes.

Cargo boom

Lufthansa Cargo became a separate operation in 1996 and today operates a fleet of 16 MD-11Fs and three 747-200Fs. After losing market share in the early 2000s (its share of the German cargo market dropped from 30% to 25% in three years) through a policy of boosting profitability at the cost of expansion, Lufthansa Cargo has now done a strategic about-turn. It plans to expand capacity through the year and is acquiring four more MD-11Fs, converted from Lufthansa's passenger fleet, as well as contemplating becoming a customer for Boeing's planned 777-200LR. The freighter variant of the A380 is also under consideration, as well as further MD-11Fs and 747-400Fs. However, fleet expansion comes as the cargo airline cuts another 300 staff through this year, on top of the 180 it shed in 2004, as part of the Group cost cutting push. This represents 10% of the mid-2004 workforce of 4,800. Although revenue rose by 11% in January-September 2004, Lufthansa Cargo made an operating profit of just €4m in the period, due to a combination of the weak dollar, rising fuel prices and tough price competition from other cargo airlines

Lufthansa Cargo traffic has almost doubled since 2001, and is likely to rise again within the first quarter of 2005 after weekly cargo flights between Germany and China rose from 14 to 28 a week in just four months. A cargo service between Frankfurt and Guangzhou was launched in October 2004, and the following month Lufthansa Cargo agreed to set up a joint venture with Shenzhen Airlines and Germany's DEG Bank. Based in Shenzhen, Jade Cargo International will start operations this year using leased A300-600Fs on routes to the US and Europe. Lufthansa Cargo has a 25% stake in the airline, the maximum allowable for this type of JV in China. Last year a joint venture was also established with the Shenzhen Airport Company to operate an air freight terminal at the airport. Both these deals take advantage of the Chinese government's relaxation of rules governing joint ventures with foreign companies.

40% of Lufthansa Cargo's revenues are generated in the Asia-Pacific region, and half of that comes from China. In the first nine months of 2004 a boom in cargo business led to a 4% increase in cargo yield. Martin Schlingensiepen, Lufthansa Cargo's VP for Asia sales, says: "In just over six months the air cargo industry has gone from excess freighter capacity parked in the desert to full utilisation of capacity worldwide." In particular there was been a surge of goods manufactured in China and destined for European and North American retail outlets in the run to Christmas.

Trouble ahead?

At the end of last year Lufthansa said it was on target to report an operating profit of €300m for 2004, despite the ailing German economy and the increase in fuel prices. In the nine months to September 2004 fuel costs rose by 30% (to €1.3bn) compared with 1Q-3Q 2003, and that was after hedging that saved the company approximately €160m in the period. After resisting the move for several months, in August 2004 Lufthansa introduced fuel surcharges on both short- and long-haul routes. In October these surcharges were increased further, with charges on short-haul flights increasing from €2 to €7, and on long-haul from €7 to €17.

Though the Lufthansa Group appears to have overcome the financial blip of 2003 and is weathering the recession in the Germany economy well, as Wolfgang Mayrhuber says: "The current improved figures cannot hide the fact that we need significantly better operating results in future in order to ensure our company's viability".

The cost cutting exercise appears successful,

with only cabin staff yet to sign a new pay round. On the other hand, the jettisoning of non-core assets has been less successful, primarily because LSG is still on the books and continues to rack up a horrendous loss.

Presuming the LSG losses will be resolved one way or another, the one problem that will continue to dog Lufthansa is the intense competition from low-cost airlines - particularly as the Group still gives the impression that it is underestimating the impact of the LCCs (see *Aviation Strategy*, July/August 2003) and is seeking to avoid confrontation where possible, instead allowing Germanwings (the LCC owned by Eurowings, 49% of which is owned in turned by Lufthansa) to engage in the messy business of competing on price.

Other than by cutting costs, Lufthansa's only other discernable tactic towards combating the LCCs appears to be the trimming of capacity. Whereas in the summer of 2005 Lufthansa will increase overall capacity by 1.5%, long-haul seats will rise by 2.4% while short-haul seats will fall by 0.9%. This comes on top of a 2% cut in short-haul capacity in the winter 04/05.

But this begs two questions, the first of which is whether the Group has the discipline to keep doing trimming short-haul capacity over the next few years. More than 50% of Lufthansa's airline revenue comes from short-haul, a higher proportion than at either British Airways or Air France, and at some point revenue erosion may start to worry executives, even if the reward of doing that is better margins on the remaining short-haul routes. And as Lufthansa is planning to increase the size of its workforce through 2005 via 500 extra cabin staff and 240 pilots, if there is any slowdown in long-haul growth then the Group may be tempted to switch resources back into short-haul - particularly if larger aircraft are ordered for Lufthansa Regional.

The second question is: even if Lufthansa sticks to a strategy of cost-cutting and trimming back on loss-making European routes, will this make any difference to the advance of the LCCs? Both Ryanair and easyJet have unit costs that a German-based airline with the legacy of Lufthansa will surely find impossible to copy. Lufthansa's current cost drive follows immediately behind an earlier one - "D-Check", which was carried out over 2001-2004 and lowered costs and/or raised revenue by €1.6bn. But given its geography and historical legacy, it's becoming harder and harder for Lufthansa to cut costs (as evidenced by the recent struggle to get new agreements with unions). There are simply some costs that Lufthansa can never lower to the level of the LCCs. For example, airport and air traffic infrastructure costs are the second-largest cost item for Lufthansa, but according to an internal analysis by Lufthansa, moving its operations from Frankfurt and Munich to London Heathrow would reduce costs by some 30%. Of course the LCCs, largely based at secondary UK and Irish airports, also have a cost advantage over Heathrow. And when Lufthansa's cost-cutting starts to level-off, yields will continue on their relentless drive downwards. In July-September 2004 - traditionally Lufthansa's strongest quarter of the year - the average yield on the Group's European passenger traffic fell by 4.8% compared with 3Q 2003.

Financially, the Group is strong, although in January Lufthansa revealed that as at the end of 2003 it had set aside €491m in reserves to cover the liability on "Miles and More", its FFP that has more than 10m members. However, it is not expected that all of this reserve will have to be used, since approximately 20% of its FFP miles lapse without being redeemed. And in June 2004 Lufthansa raised more than €750m by a rights issue, which will be used largely in paying for the airline's A380 order - although the move was unexpected, and Lufthansa's share price fell sharply on the announcement. Indeed Lufthansa's share price has fallen from €27 in early 2001 to €6.91 in early 2003, although it has since recovered to above the €11 level.

Bullish analysts

On the other hand, analysts are bullish on Lufthansa. As at the end of February, of 21 analysts covering Lufthansa Group, all but four recommended buying or going overweight on the stock. HypoVereinsbank set a medium-term target of €13.50 for Lufthansa shares, WestLB set a price of €13 and CSFB topped the lot by forecasting a target of €14, up from its previous target of €8. In fact CSFB rated Lufthansa as its key European flag carrier tip for 2005. Only time will tell whether this bullishness is deserved, or whether analysts have underestimated the long-term impact of the LCCs on Lufthansa.

		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 2003**	**2,445**	**2,456**	**-11**	**13**	**-0.4%**	**0.5%**	**37,614**	**26,061**	**69.3%**	**19,981**	**13,401**
	Jan-Mar 04	598	657	-59	-43	-9.9%	-7.2%	8,333	5,761	69.1%	3,592	9,984
	Apr-Jun 04	699	719	-20	-2	-2.9%	-0.3%	9,068	6,605	72.8%	4,116	10,255
	Jul-Sep 04	702	626	76	41	10.8%	5.8%	9,675	7,356	76.0%	4,589	10,201
	Oct-Dec 04	656	714	-58	-45	-8.8%	-6.9%	8,774	6,399	72.9%	3,998	9,433
	Year 2004	**2,724**	**2,804**	**-80**	**-15**	**-2.9%**	**-0.6%**	**35,849**	**26,121**	**72.9%**	**16,295**	**9,968**
American	**Year 2003**	**17,440**	**18,284**	**-844**	**-1,128**	**-4.8%**	**-6.5%**	**279,706**	**202,521**	**72.4%**		**96,400**
	Jan-Mar 04	4,512	4,470	42	-166	0.9%	-3.7%	68,551	48,746	71.1%		
	Apr-Jun 04	4,830	4,634	196	6	4.1%	0.1%	70,804	53,627	75.7%		92,500
	Jul-Sep 04	4,762	4,789	-27	-214	-0.6%	-4.5%	71,638	55,777	77.9%		93,300
	Oct-Dec 04	4,541	4,896	-355	-387	-7.8%	-8.5%	69,049	51,325	74.3%		90,700
	Year 2004	**18,645**	**18,789**	**-144**	**-761**	**-0.8%**	**-4.1%**	**280,042**	**209,473**	**74.8%**		**90,700**
America West	**Year 2003**	**2,255**	**2,222**	**33**	**57**	**1.5%**	**2.5%**	**44,880**	**34,270**	**76.4%**	**20,050**	**11,326**
	Jan-Mar 04	577	559	18	1	3.1%	0.2%	11,832	8,539	72.2%	4,897	11,827
	Apr-Jun 04	605	584	21	6	3.5%	1.0%	12,153	9,519	78.3%	5,343	11,936
	Jul-Sep 04	579	607	-28	-47	-4.8%	-8.1%	12,305	10,021	81.4%	5,556	11,936
	Oct-Dec 04	579	602	-24	-50	-4.1%	-8.6%	12,236	9,471	77.4%	5,336	11,845
	Year 2004	**2,339**	**2,357**	**-18**	**-90**	**-0.8%**	**-3.8%**	**48,525**	**37,550**	**77.4%**	**21,132**	**11,904**
Continental	**Year 2003**	**8,870**	**8,667**	**203**	**38**	**2.3%**	**0.4%**	**139,703**	**104,498**	**74.8%**	**39,861**	**37,680**
	Jan-Mar 04	2,269	2,404	-135	-124	-5.9%	-5.5%	32,621	23,678	71.7%	9,735	
	Apr-Jun 04	2,514	2,471	43	-17	1.7%	-0.7%	34,676	27,083	77.6%	10,809	
	Jul-Sep 04	2,564	2,540	24	-16	0.9%	-0.6%	35,371	28,843	81.5%	11,182	
	Oct-Dec 04	2,397	2,558	-161	-206	-6.7%	-8.6%	37,962	29,350	77.3%	14,253	
	Year 2004	**9,744**	**9,973**	**-229**	**-363**	**-2.4%**	**-3.7%**	**95,082**	**73,151**	**76.9%**	**56,482**	
Delta	**Year 2003**	**13,303**	**14,089**	**-786**	**-773**	**-5.9%**	**-5.8%**	**216,263**	**158,796**	**73.4%**	**104,452**	**70,600**
	Jan-Mar 04	3,292	3,680	-388	-383	-11.8%	-11.6%	55,300	39,027	70.6%	25,343	69,900
	Apr-Jun 04	3,961	4,202	-241	-1,963	-6.1%	-49.6%	62,151	47,610	76.6%	28,616	70,300
	Jul-Sep 04	3,871	4,294	-423	-646	-10.9%	-16.7%	63,031	48,952	77.7%	28,247	69,700
	Oct-Dec 04	3,641	5,897	-2,256	-2,206	-62.0%	-60.6%	61,384	45,237	73.7%	27,794	69,150
	Year 2004	**15,002**	**18,310**	**3,308**	**5,198**	**22.1%**	**34.6%**	**244,097**	**182,351**	**74.7%**	**110,000**	**69,150**
Northwest	**Year 2003**	**9,510**	**9,775**	**-265**	**248**	**-2.8%**	**2.6%**	**142,573**	**110,198**	**77.3%**	**51,900**	**39,100**
	Jan-Mar 04	2,603	2,711	-108	-223	-4.1%	-8.6%	35,133	26,883	76.5%	12,500	39,230
	Apr-Jun 04	2,871	2,923	-52	-175	-1.8%	-6.1%	36,634	30,215	82.5%	14,289	39,154
	Jul-Sep 04	3,052	2,973	79	-38	2.6%	-1.2%	38,324	31,774	82.9%	14,800	38,178
	Oct-Dec 04	2,753	3,177	-424	-412	-15.4%	-15.0%	36,964	29,107	78.7%	13,775	
	Year 2004	**11,279**	**11,784**	**-505**	**-848**	**-4.5%**	**-7.5%**	**147,055**	**117,981**	**80.2%**	**55,374**	**39,342**
Southwest	**Year 2003**	**5,937**	**5,454**	**483**	**442**	**8.1%**	**7.4%**	**115,532**	**77,155**	**66.8%**	**65,674**	**32,847**
	Jan-Mar 04	1,484	1,438	46	26	3.1%	1.8%	29,582	18,977	64.2%	15,995	31,522
	Apr-Jun 04	1,716	1,519	197	113	11.5%	6.6%	30,212	23,054	76.3%	18,864	31,408
	Jul-Sep 04	1,674	1,483	191	119	11.4%	7.1%	31,359	22,794	72.7%	18,334	30,657
	Oct-Dec 04	1,655	1,535	120	56	7.3%	3.4%	32,540	21,140	65.0%	17,709	31,011
	Year 2004	**6,530**	**5,976**	**554**	**313**	**8.5%**	**4.8%**	**123,693**	**85,966**	**69.5%**	**70,903**	**31,011**
United	**Year 2003**	**13,274**	**15,084**	**-1,360**	**-2,808**	**-10.2%**	**-21.2%**	**219,878**	**168,114**	**76.5%**	**66,000**	**58,900**
	Jan-Mar 04	3,732	3,943	-211	-459	-5.7%	-12.3%	56,181	42,287	75.3%	15,923	
	Apr-Jun 04	4,041	4,034	7	-247	0.2%	-6.1%	58,313	47,840	82.0%	18,444	59,700
	Jul-Sep 04	4,305	4,385	-80	-274	-1.9%	-6.4%	61,403	50,439	82.1%	19,360	59,000
	Oct-Dec 04	3,988	4,481	-493	-664	-12.4%	-16.6%	58,033	44,824	77.2%	17,143	57,500
	Year 2004	**16,391**	**17,168**	**-777**	**-1,644**	**-4.7%**	**-10.0%**	**233,929**	**185,388**	**79.2%**	**70,914**	**58,900**
US Airways	**Year 2003***	**5,312**	**5,356**	**-44**	**-174**	**-0.8%**	**-3.3%**	**85,673**	**62,408**	**72.8%**	**44,373**	**26,797**
	Jan-Mar 04	1,701	1,844	-143	-177	-8.4%	-10.4%	23,771	16,220	68.2%	12,700	26,854
	Apr-Jun 04	1,957	1,874	83	34	4.2%	1.7%	24,991	19,336	77.4%	25,953	26,880
	Jul-Sep 04	1,799	1,976	-177	-232	-9.8%	-12.9%	25,462	19,382	76.1%	14,274	26,835
	Oct-Dec 04	1,660	1,802	-142	-236	-8.6%	-14.2%	24,514	17,622	71.9%	14,097	24,628
	Year 2004	**7,117**	**7,495**	**-378**	**-611**	**-5.3%**	**-8.6%**	**98,735**	**72,559**	**73.5%**	**55,954**	**24,628**
JetBlue	**Year 2003**	**998**	**830**	**168**	**104**	**16.8%**	**10.4%**	**21,950**	**18,550**	**84.5%**	**9,012**	**4,892**
	Jan-Mar 04	289	256	33	15	11.4%	5.2%	6,790	5,427	79.9%	2,650	5,292
	Apr-Jun 04	320	275	45	21	14.1%	6.6%	7,494	6,333	84.5%	2,921	5,718
	Jul-Sep 04	323	300	23	8	7.1%	2.5%	7,950	6,753	84.9%	3,033	6,127
	Oct-Dec 04	334	322	12	2	3.6%	0.6%	8,200	6,802	82.9%	3,179	6,413
	Year 2004	**1,266**	**1,153**	**113**	**47**	**8.9%**	**3.7%**	**30,434**	**25,315**	**83.2%**	**11,783**	**6,413**

***Note**: US Airways' financial results are for the 9 months up to Dec 31, 2003. Operating statistics are for the full year.

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation. 1 ASM = 1.6093 ASK. All US airline Financial Year Ends are 31/12.

		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												
YE 31/03	**Year 2002/03**	**13,702**	**13,495**	**207**	**130**	**1.5%**	**0.9%**	**131,247**	**99,960**	**76.2%**		**71,525**
	Jul-Sep 03	3,715	3,598	117	56	3.1%	1.5%	35,255	27,544	78.1%		
	Oct-Dec 03	3,933	3,855	78	35	2.0%	0.9%	33,380	25,329	75.9%		71,900
	Jan-Mar 04	3,668	3,680	-12	16	-0.3%	0.4%	33,917	25,026	73.8%		
	Year 2003/04	**15,024**	**14,855**	**169**	**113**	**1.1%**	**0.8%**	**134,444**	**101,644**	**75.6%**		
KLM												
YE 31/03	**Year 2002/03**	**7,004**	**7,147**	**-144**	**-449**	**-2.1%**	**-6.4%**	**87,647**	**69,016**	**78.7%**	**23,437**	**34,666**
	Jul-Sep 03	1,878	1,725	152	104	8.1%	5.5%	18,905	15,874	84.0%		32,853
	Oct-Dec 03	1,838	1,801	36	10	2.0%	0.5%	17,969	14,378	80.0%		31,804
	Jan-Mar 04	1,677	1,645	32	-24	1.9%	-1.4%	17,963	14,455	80.5%		
	Year 2003/04	**7,157**	**7,011**	**146**	**29**	**2.0%**	**0.4%**	**72,099**	**57,784**	**80.1%**		**31,077**
Air France/												
KLM Group*	Apr-Jun 04	5,394	5,205	189	115	3.5%	2.1%	48,944	38,025	77.7%		
	Jul-Sep 04	6,328	5,964	364	248	5.8%	3.9%	57,668	46,767	81.1%		
	Oct-Dec 04	6,628	5,745	883	83	13.3%	1.3%	54,144	42,042	77.6%	15,934	
Alitalia												
YE 31/12	**Year 2001**	**4,745**	**5,007**	**-262**	**-818**	-5.5%	-17.2%	**51,392**	**36,391**	**70.8%**	**24,737**	**23,667**
	Year 2002	**5,279**	**4,934**	**-89**	**101**	**-1.7%**	**1.9%**	**42,224**	**29,917**	**70.8%**	**22,041**	**22,536**
BA												
YE 31/03	**Year 2002/03**	**12,490**	**12,011**	**543**	**117**	**4.3%**	**0.9%**	**139,172**	**100,112**	**71.9%**	**38,019**	**51,630**
	Jul-Sep 03	3,306	2,980	333	163	10.1%	4.9%	35,981	27,540	76.5%	9,739	47,702
	Oct-Dec 03	3,363	3,118	244	148	7.3%	4.4%	35,098	25,518	72.7%	8,453	46,952
	Jan-Mar 04	3,386	3,327	164	22	4.8%	0.6%	35,232	24,932	70.8%	8,142	46,551
	Year 2003/04	**13,806**	**13,067**	**739**	**237**	**5.4%**	**1.7%**	**141,273**	**103,092**	**73.0%**	**36,103**	**49,072**
	Apr-Jun 04	3,479	3,208	271	127	7.8%	3.7%	36,150	27,083	74.9%	9,288	46,280
	Jul-Sep 04	3,645	3,213	432	221	11.9%	6.1%	36,639	28,749	78.5%	9,822	46,179
	Oct-Dec 04	3,801	3,589	212	94	5.6%	2.5%	35,723	25,999	72.8%	8,428	45,888
Iberia												
YE 31/12	**Year 2002**	**5,123**	**4,852**	**272**	**174**	**5.3%**	**3.4%**	**55,633**	**40,647**	**73.0%**	**24,956**	**25,963**
	Apr-Jun 03	1,348	1,265	83	60	6.2%	4.5%	13,516	9,982	73.8%	6,472	
	Jul-Sep 03	1,434	1,301	133	93	9.3%	6.5%	14,819	11,846	79.9%	7,073	
	Year 2003	**5,800**	**4,459**	**202**	**180**	**3.5%**	**3.1%**	**56,145**	**42,100**	**75.0%**	**25,613**	
	Jan-Mar 04	1,325	1,356	-32	-1	-2.4%	-0.1%	14,563	10,721	73.6%	6,136	
	Apr-Jun 04	1,461	1,371	90	95	6.2%	6.5%	14,743	11,106	75.3%	6,913	
	Jul-Sep 04	1,593	1,452	141	110	8.9%	6.9%	16,053	12,699	79.1%	7,314	25,839
	Oct-Dec 04	1,660	1,605	55	74	3.3%	4.5%	15,700	11,398	72.6%	6,329	24,783
Lufthansa												
YE 31/12	**Year 2002**	**17,791**	**16,122**	**1,669**	**751**	**9.4%**	**4.2%**	**119,877**	**88,570**	**73.9%**	**43,900**	**94,135**
	Apr-Jun 03	4,423	4,214	209	-39	4.7%	-0.9%	30,597	22,315	71.7%	10,758	
	Jul-Sep 03	4,923	4,783	140	-20	2.8%	-0.4%	32,895	24,882		12,020	
	Year 2003	**20,037**	**20,222**	**-185**	**-1,236**	**-0.9%**	**-6.2%**	**124,000**	**90,700**	**73.1%**	**45,440**	**94,798**
	Jan-Mar 04	4,742	4,883	-141	76	-3.0%	1.6%	31,787	23,030	72.5%	11,414	93,479
	Apr-Jun 04	5,269	5,045	224	-28	4.3%	-0.5%	36,440	26,959	74.0%	13,336	
	Jul-Sep 04	5,511	5,164	347	154	6.3%	2.8%	38,115	28,883	75.8%	14,053	92,718
SAS												
YE 31/12	**Year 2002**	**7,430**	**7,024**	**78**	**-15**	**1.0%**	**-0.2%**	**47,168**	**30,882**	**68.2%**	**21,866**	
	Apr-Jun 03	1,906	1,705	201	8	10.5%	0.4%	12,278	7,855	64.0%	5,128	
	Jul-Sep 03	1,941	1,715	131	91	6.7%	4.7%	12,543	8,681	69.2%	8,301	34,856
	Year 2003	**7,978**	**8,100**	**-122**	**-195**	**-1.5%**	**-2.4%**	**47,881**	**30,402**	**63.5%**	**31,320**	**34,544**
	Jan-Mar 04	1,652	1,823	-171	-184	-10.4%	-11.1%	11,852	7,031	59.3%	7,238	
	Apr-Jun 04	2,007	1,979	27	13	1.3%	0.6%	13,456	8,960	66.6%	8,879	
	Jul-Sep 04	2,099	1,860	239	9	11.4%	0.4%	13,557	9,198	67.8%	8,591	
Ryanair												
YE 31/03	**Year 2002/03**	**910**	**625**	**285**	**259**	**31.3%**	**28.5%**			**84.0%**	**15,740**	**1,900**
	Apr-Jun 03	280	220	57	46	20.4%	16.4%			78.0%	5,100	2,135
	Jul-Sep 03	407	237	170	148	41.8%	36.4%				5,571	2,200
	Oct-Dec 03	320	253	67	51	20.9%	15.9%				6,100	2,356
	Year 2003/04	**1,308**	**978**	**330**	**252**	**25.2%**	**19.3%**			**81.0%**	**23,133**	**2,300**
	Apr-Jun 04	366	288	78	64	21.3%	17.5%			83.0%	6,600	2,444
	Jul-Sep 04	516	305	211	181	40.9%	35.1%			90.0%	7,400	2,531
	Oct-Dec 04	402	335	68	47	16.9%	11.7%			84.0%	6,900	2,671
easyJet												
YE 30/09	**Year 2001/02**	**864**	**656**	**111**	**77**	**12.8%**	**8.9%**	**10,769**	**9,218**	**84.8%**	**11,350**	**3,100**
	Oct-Mar 03	602	676	-74	-76	-12.3%	-12.6%	9,594	7,938	82.2%	9,347	
	Year 2002/03	**1,553**	**1,472**	**81**	**54**	**5.2%**	**3.5%**	**21,024**	**17,735**	**84.1%**	**20,300**	**3,372**
	Oct-Mar 04	803	861	-58	-36	-7.2%	-4.5%	10,991	9,175	83.3%	10,800	
	Year 2003/04	**1,963**	**1,871**	**92**	**74**	**4.7%**	**3.8%**	**25,448**	**21,566**	**84.5%**	**24,300**	

Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation. * = Preliminary consolidated figures for Air France Group from April-June, KLM Group from May-June

		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												
YE 31/03	**Year 2001/02**	**9,714**	**9,529**	**185**	**-76**	**1.9%**	**-0.8%**	**87,908**	**57,904**	**64.7%**	**49,306**	
	Apr-Sep 02	5,322	5,194	127	-69	2.4%	-1.3%	44,429	29,627	66.7%	25,341	
	Year 2002/03	**10,116**	**10,137**	**-22**	**-235**	**-0.2%**	**-2.3%**	**88,539**	**59,107**	**66.7%**	**50,916**	**14,506**
	Apr-Sep 03	5,493	5,362	131	186	2.4%	3.4%	32,494	19,838	61.1%	22,866	
Cathay Pacific												
YE 31/12	**Year 2002**	**4,243**	**3,634**	**609**	**513**	**14.4%**	**12.1%**	**63,050**		**77.8%**		**14,600**
	Jan-Jun 03	1,575	1,672	-97	-159	-6.2%	-10.1%	26,831		64.4%	4,019	14,800
	Year 2003	**3,810**	**3,523**	**287**	**168**	**7.5%**	**4.4%**	**59,280**	**42,774**	**72.2%**	**12,322**	**14,673**
	Jan-Jun 04	2,331	2,046	285	233	12.2%	10.0%	35,250		76.1%	6,404	
JAL												
YE 31/03	**Year 2000/01**	**13,740**	**13,106**	**634**	**331**	**4.6%**	**2.4%**	**129,435**	**95,264**	**73.6%**	**38,700**	**17,514**
	Year 2001/02	**9,607**	**9,741**	**-135**	**-286**	**-1.4%**	**-3.0%**				**37,183**	
	Year 2002/03	**17,387**	**17,298**	**88**	**97**	**0.5%**	**0.6%**	**145,944**	**99,190**	**68.0%**	**56,022**	
	Year 2003/04	**18,398**	**19,042**	**-644**	**-844**	**-3.5%**	**-4.6%**	**145,900**	**93,847**	**64.3%**	**58,241**	
Korean Air												
YE 31/12	**Year 2001**	**4,309**	**4,468**	**-159**	**-448**	**-3.7%**	**-10.4%**	**55,802**	**38,452**	**68.9%**	**21,638**	
	Year 2002	**5,206**	**4,960**	**246**	**93**	**4.7%**	**1.8%**	**58,310**	**41,818**	**71.7%**		
	Year 2003	**5,172**	**4,911**	**261**	**-202**	**5.0%**	**-3.9%**	**59,074**	**40,507**	**68.6%**	**21,811**	
Malaysian												
YE 31/03	**Year 2000/01**	**2,357**	**2,178**	**179**	**-351**	**7.6%**	**-14.9%**	**52,329**	**39,142**	**74.8%**	**16,590**	**21,518**
	Year 2001/02	**2,228**	**2,518**	**-204**	**-220**	**-9.2%**	**-9.9%**	**52,595**	**34,709**	**66.0%**	**15,734**	**21,438**
	Year 2002/03	**2,350**	**2,343**	**7**	**89**	**0.3%**	**3.8%**	**54,266**	**37,653**	**69.4%**		**21,916**
	Year 2003/04	**2,308**	**2,258**	**50**	**121**	**2.2%**	**5.2%**	**55,692**	**37,659**	**67.6%**	**15,375**	**20,789**
Qantas												
YE 30/06	**Year 2001/02**	**6,133**	**5,785**	**348**	**232**	**5.7%**	**3.8%**	**95,944**	**75,134**	**78.3%**	**27,128**	**33,044**
	Jul-Dec 02	3,429	3,126	303	200	8.8%	5.8%	50,948	40,743	80.0%	15,161	34,770
	Year 2002/03	**7,588**	**7,217**	**335**	**231**	**4.4%**	**3.0%**	**99,509**	**77,225**	**77.6%**	**28,884**	**34,872**
	Jul-Dec 03	4,348	3,898	450	269	10.3%	6.2%	50,685	40,419	79.7%	15,107	33,552
	Year 2003/04	**7,838**	**7,079**	**759**	**448**	**9.7%**	**5.7%**	**104,200**	**81,276**	**78.0%**	**30,076**	**33,862**
	Jul-Dec 04	5,017	4,493	524	358	10.4%	7.1%	57,402	43,907	76.5%	16,548	35,310
Singapore												
YE 31/03	**Year 2001/02**	**5,399**	**4,837**	**562**	**395**	**10.4%**	**7.3%**	**94,559**	**69,995**	**74.0%**	**14,765**	**29,422**
	Year 2002/03	**5,936**	**5,531**	**405**	**601**	**6.8%**	**10.1%**	**99,566**	**74,183**	**74.5%**	**15,326**	**30,243**
	Year 2003/04	**5,732**	**5,332**	**400**	**525**	**7.0%**	**9.2%**	**88,253**	**64,685**	**73.3%**	**13,278**	**29,734**
	Apr-Jun 04	1,588	1,409	179	159	11.3%	10.0%	25,249	18,167	71.9%	3,800	
	Jul-Sep 04	1,780	1,587	193	215	10.8%	12.1%	26,357	19,959	75.7%	4,050	
	Oct-Dec 04	1,956	1,697	259	291	13.2%	14.9%	26,768	20,274	75.7%	4,201	

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

AIRCRAFT AVAILABLE FOR SALE OR LEASE

	Old narrowbodies	Old widebodies	Total old	New narrowbodies	New widebodies	Total new	Total
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	366	144	510	273	102	375	885
2003	275	117	392	274	131	405	797
2004-March	227	94	321	249	110	359	680

AIRCRAFT SOLD OR LEASED

	Old narrowbodies	Old widebodies	Total old	New narrowbodies	New widebodies	Total new	Total
1999	582	230	812	989	170	1,159	1,971
2000	475	205	680	895	223	1,118	1,798
2001	286	142	428	1,055	198	1,253	1,681
2002	439	213	652	1,205	246	1,451	2,103
2003	408	94	502	1,119	212	1,331	1,833
2004-March	32	13	45	215	32	247	292

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.*

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 %
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
2002	197.2	129.3	65.6	181.0	144.4	79.8	129.1	104.4	80.9	447.8	355.1	79.3	679.2	507.7	74.7
2003	210.7	136.7	64.9	215.0	171.3	79.7	131.7	101.2	76.8	497.2	390.8	78.6	742.6	551.3	74.2
2004	220.6	144.2	65.4	224.0	182.9	81.6	153.6	119.9	78.0	535.2	428.7	80.1	795.7	600.7	75.5
Jan-05	17.3	9.9	56.8	17.0	13.0	76.7	13.5	10.5	77.9	45.1	35.9	79.7	65.9	48.2	73.1
Ann. chng	6.0%	11.1%	2.6	1.0%	3.5%	1.9	13.1%	13.2%	0.1	5.8%	9.0%	2.3	6.2%	9.4%	2.2

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 %
1996	925.7	634.4	68.5	132.6	101.9	76.8	118.0	89.2	75.6	66.1	42.3	64.0	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
2002	990.0	701.6	70.9	159.0	125.7	67.2	103.0	83.0	80.5	84.1	56.8	67.5	346.1	265.5	76.7
2003	963.1	706.6	73.4	148.3	117.6	79.3	94.8	74.0	80.5	84.2	59.3	70.5	327.2	251.0	76.7
2004	1,014.5	763.6	75.3	164.2	134.4	81.8	105.1	87.6	83.4	96.4	68.0	70.5	365.6	289.8	79.3
Jan-05	81.8	58.1	71.0	13.0	9.7	74.7	9.6	7.8	81.7	9.5	7.1	74.4	32.1	24.6	76.7
Ann. Change	0.1%	7.7%	5.0	9.2%	11.0%	1.2	14.8%	11.2%	-2.6	15.4%	18.6%	2.0	12.6%	13.2%	0.4

Note: US Majors = Aloha, Alaska, American, Am. West, American Transair, Continental, Cont. Micronesia, Delta, Hawaiian JetBlue, MidWest Express, Northwest,Southwest, United and US Airways **Source**: ATA

JET ORDERS

	Date	Buyer	Order	Delivery	Other information/engines
Boeing	07 Feb	Ethiopian A/L	5 x 787	2008 onwards	plus 5 options
	09 Feb	SpiceJet	10 x 737-800	2006 onwards	plus 10 options/CFM 56-7B
	24 Feb	Ryanair	70 x 737-800		plus 70 options
	28 Feb	Icelandair	2 x 787	2010	
Airbus	23 Feb	Kingfisher Airlines	3 x A319	12/05	IAE V2500
	28 Feb	Iberia	15 x A318 9 x A320 6 x A321	2006-2011	plus 49 options
Embraer					

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

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