Issue No: 90

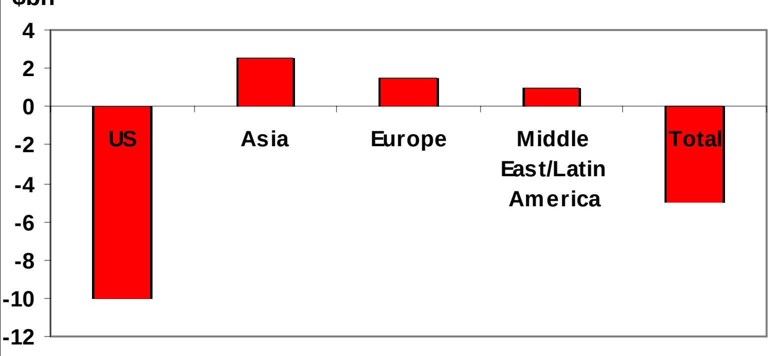
Aviation Strategy

April 2005

Airline finances: a tale of two halves

The past few years have seen airline financial performance diverge significantly in different world regions. IATA's chief economist Brian Pierce, speaking at a recent UBS transportation structured debt conference in New York, called it a tale of two halves - the US legacy carriers' performance being pretty disastrous and the rest of the world faring much better. According to IATA, US airlines lost about $10bn in 2004, while airlines in other regions saw small profits ($2.5bn in Asia, $1.5bn in Europe and $1bn in the Middle East and Latin America).

IATA'S GLOBAL NET RESULTS 2004



It is not just differences in the rate of financial recovery after September 11. Oddly enough, the trends seem to have moved in opposite directions as fuel prices have surged in the past 12 months. While US legacy carriers have incurred deeper losses, European operators have moved into profit and some Asian airlines are now turning in excellent performance.

While differences in the competitive and revenue environments obviously account for much of the variation in the level of earnings, Pierce noted two other significant factors at play in recent months: depreciation in the value of the US dollar and the extent of fuel hedging.

Since oil is priced in US dollars, the falling dollar has offered particularly European airlines partial protection against rising fuel prices. Pierce was brave enough to predict that, given the scale of the US current account deficit (and despite rising interest rates), the dollar was likely to continue to weaken. Of course, this is also increasing the finance costs of the heavily indebted US legacy airlines.

Airlines outside the US also currently tend to have better fuel hedges in place, giving them greater shelter from rising oil prices. Last year roughly 40% of the global airline industry fuel bill was hedged, though Pierce estimated that for 2005 the percentage is

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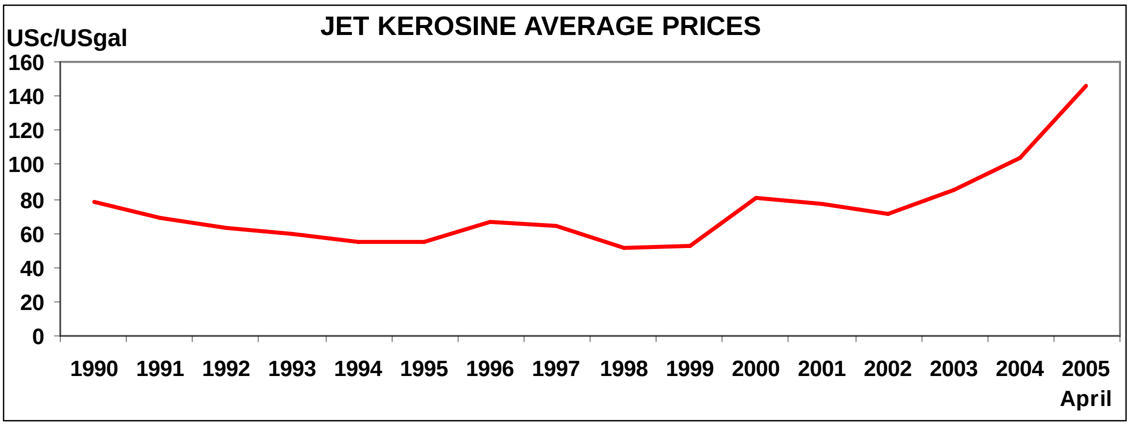

only 20%. He noted that the percentage is considerably less in the US and therefore the US and non-US financial trends are likely to continue to diverge this year.

With the notable exception of Southwest (see briefing, pages 6-11), which has hedged an impressive 85% of its 2005 fuel needs at $26 WTI per barrel, the large US airlines have single-digit or no hedging coverage at all this year.

Some of the US-Asia variation in airline financial performance reflects significant differences in unit labour costs. This is partly structural - US legacy carriers are much more dependent on their shorter-haul domestic markets than large airlines elsewhere - and partly due to absolute differences in labour rates. According to IATA, Asian carriers' labour costs are 3-7 cents per ATK or 18% of operating costs, compared to US carriers' 16-18 cents per ATK or 38% of operating costs.

As regards the differences in the revenue environments, Pierce noted that large European airlines are able to collect significantly higher revenue premiums over LCCs than US legacy carriers are. This mainly reflects differences in the route mix, with the large European (as well as Asian) airlines having a larger proportion of longer-haul international routes. Yields in such markets are more robust, because there is less competition from LCCs and because passengers tend to be more willing to pay revenue premiums on longer journeys.

IATA's analyses suggest that LCCs are now present in just as many short-haul markets in Europe as in the US domestic market. Yields in both of those markets have fallen by 30% in real terms since 1992. However, competition is much fiercer in the US because LCCs there compete with the legacy carriers directly at hubs, rather than indirectly at secondary airports as in Europe. In effect, in Europe the decline in short-haul yields has been moderated by airport capacity constraints.

Large European airlines have higher cost levels than the US legacy carriers. However, due to structural differences, they enjoy much higher yields, which have protected their profitability.

The past month has actually seen modestly positive revenue trends in the US domestic market, thanks to four subsequent fare increases led by the legacy carriers. UBS analyst Robert Ashcroft suggested that the increases have "come close to compensating for oil". However, the fare levels remain extremely low, and profitability will be elusive unless excess capacity is eliminated.

While trends in the European short haul markets offer no reason to celebrate either, there are reports of a distinct recovery in corporate travel demand in longer-haul markets. According to UBS analyst Damien Horth, BA has reported 10% premium traffic growth in long-haul markets in the past few months. However, he noted that because of the sharp decline seen in 2000-2003, when a key market like the North Atlantic lost 30% of its "GDP share" (another measure of the health of the industry), there is still a long way to go.

IATA is forecasting a tougher year globally in 2005 because of a higher average price of oil and a lower overall level of hedging. The aggregate industry loss is expected to be larger than last year's $4.8bn.

Aviation Strategy is published 10 times a year by *Aviation Economics* at the beginning of the month

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ISSN 1463-9254

Lufthansa/swiss: clever structuring

Lufthansa has announced the initial details of its acquisition of swiss. ABN Amro has reported that despite fears that the market might be concerned about certain aspects of the transaction, the deal appears to be cleverly constructed.

A Swiss trust (AirTrust) is to be established by the existing major shareholders of swiss. At the time of writing, swiss's large shareholders had sold almost 84% of the carrier's capital to AirTrust, this is almost all of the 86% previously held by large shareholders such as the canton of Zurich, banks Credit Suisse and UBS and the car import and dealership group AMAG. In May 2005, the trust is to make an offer to the 15% freefloat shareholders of swiss for a price of €45m (CHF71m). After this transaction, Lufthansa will own 11% of the trust.

Upon receipt of the anti-trust authority approval of the deal, expected in the third quarter of 2005, Lufthansa's ownership will rise to 49%, without further payment. The Swiss government plans to negotiate with bilateral partners around the world to secure the traffic rights of swiss under full Lufthansa ownership. Once this is achieved for key trading partners (especially in the US and Japan), Lufthansa's ownership of AirTrust will increase to 100%. At this time, Lufthansa will fully consolidate swiss, including its €400m on balance sheet and €500m off balance sheet debt. The timing of this process is uncertain, but some time in 2006 looks possible.

Lufthansa's payment to the core shareholders is to take place three years from signing of the deal in 2008. Payment will vary depending on the share performance of Lufthansa relative to a basket of BA, AF-KL and Iberia. If Lufthansa underperforms the basket, then payment is zero. If Lufthansa outperforms by 50% or more, payment maxes out at €252m. On the basis of derivative analysis, Lufthansa said it will make a non-cash provision of €30m-50m for this payment. Lufthansa has made no legally binding assurances on the future of swiss, but has committed to develop swiss and the Zurich hub, provided it can be economically viable.

In its announcement, Lufthansa did not elaborate on the strategic rationale for the deal. The deal could moderate competition on long-haul routes. Lufthansa looks set to critically grow its market share of Swiss-originating premium traffic on routes where there is a non-stop form flight from Zurich. Lufthansa should benefit from a monopoly situation in the Germany-Switzerland market.

Lufthansa pointed to synergies of €160m a year through to 2008, but admitted that integration costs would exceed synergies in 2005. As with the AF-KLM merger, synergies appear modest but come on top of the existing restructuring plan at the acquired company. On the basis of initial remarks, ABN Amro expects the market to reduce earnings estimates for 2005, roughly flat to slightly up for 2006 and up in 2007 and 2008. Debt should only be modestly impacted by the €45m cash payment in 2005, but will increase more significantly once swiss's €400m and €500m on and off balance sheet debt is fully consolidated, respectively.

Some issues

ABN Amro's report highlights the following issues that raise some concern:

• More debt - Lufthansa's rights issue proceeds, ostensibly raised to pay for A380s, A340s or reduce risk, were actually used to buy swiss.
• Management distraction - Lufthansa has not yet succeeded in fixing LSG or Thomas Cook. Its own restructuring plan remains behind schedule. It is making progress on these issues, but is not there yet.
• Labour - Lufthansa and swiss will dance the same delicate steps seeking to keep the industrial relations issues at the two companies separate. They will face the same challenge that AF-KLM faced of continuing to force employees to accept the change despite its existence now appearing more secure.
• The network strategy is far from clear. The networks overlap directly - there are not the complementarities that AF-KLM illustrated. Lufthansa already has a dual hub structure, and so adding a third will make it difficult to define hub roles. We see no major regulatory problems, though the Swiss government will not have the benefit of clear European Commission support should any third country oppose the deal.

French airport privatisation

The French national assembly voted in March to privatise (or in French terminology, open the capital of) Aéroports de Paris (AdP) to private sector investors. The State will, however, keep a majority stake in the new limited company. This should provide some comfort to the powerful trade unions which had opposed the move. Also, the 8,200 direct employees will retain their civil service status.

Regional airports, which are currently owned by the State and operated by local Chambres de Commerce (CdC), quasi-state entities in France, will also be privatised, with the CdCs retaining a minority stake, along with regional governments.

A third part of the legislation sets the framework for airport charges, which should guarantee enough income to cover running costs and capital expenditure.

AdP

There was a certain sense of urgency as AdP faces large capital investment programme and was constrained in its ability to raise funds. As a public establishment, AdP could only raise money by borrowing, and it had clearly reached the limit of what the market would allow. And since the coffers of the State are pretty empty, the only alternative left was privatisation.

As part of the deal, ownership of the land and buildings was transferred from the State to AdP, with the exception of infrastructures which are used for public services, such as ATC, runways, and customs and police offices. The jewels in the AdP crown are of course the three commercial airports Charles-de-Gaulle, Orly and Le Bourget. AdP also owns ten small airports in the greater Paris region, as well the only Paris heliport.

In addition to greater access to capital markets, AdP's new statutes finally allow the company to make commercial forays outside France. Under the old regime, there was always a shadow over the wholly-owned subsidiary AdP Management's ventures in a string of countries, including Belgium, Cambodia, Cameroon, Guinea, Madagascar and Mexico. The State's auditors had raised an eyebrow or two.

For a short while, AdP will have a sole owner, the State. When it starts looking later on this year for private sector investors, AdP will have to convince the market that it is run along commercial principles. The remaining majority stake of the State and civil service status for employees could slow the appetite of investors toward what really is a very valuable property.

The need for capital injection could not be plainer. At the end of 2003, net debt was € 2.15bn, an increase of 47% in two years. This represented 150% of equity and 5.5 times cash flow. And AdP is coming up to a major investment phase, requiring some €.5bn by 2007.

AdP currently faces expenditure for the building of temporary structures to replace the collapsed passenger terminal 2E which will have to be completely rebuilt. Another terminal, S3, which is to have a capacity of 9m passengers, is scheduled to open in 2007, and yet another terminal, this one for regional flights, 2G, is to open in 2008 with a capacity of 3m passengers. All this comes on top of significant expenditures on upgrading existing passenger facilities.

Regional airports

The ten or so largest state-owned regional airports will be handed over to their regional authorities before January 2007. It is fully expected that the CdCs will want an equity stake in the new companies which should primarily seek private sector investors. The list of regional airports which will be privatised has not been published but it is likely to comprise the following: (see table, below).

Airport	Region	Pax 2004
Nice	Côte d'Azur	9.1m
Lyon	Satolas	5.9m
Marseille	Provence	5.4m
Toulouse	Blagnac	5.3m
Bordeaux	Mérignac	2.8m
Strasbourg	Entzheim	2.1m
Nantes	Atlantique	1.9m
Montpellier	Mediterranée	1.6m
Pointe à Pitre	Le Raizet	1.8m
Fort de France	Lamentin	1.5m
Saint Denis	Gillot	1.5m
Cayenne	Rochambeau	0.4m

Southwest: prospering in any environment

In periods of turmoil in the US airline industry, equity investors have always had one safe option (other than pulling their money out of the sector): Southwest Airlines. The Dallas-based low-fare pioneer, now the largest US carrier in terms of domestic passengers uplifted, has proved that it can prosper in any kind of environment, thanks to its unique business formula.

Southwest has remained profitable through the post-September 2001 industry slump, albeit at reduced margins. Like other LCCs, it has made significant market share gains in the past three years. However, its financial performance has been particularly impressive in the past 12 months or so - a period that has seen crude oil prices surge from the mid-30s to the mid-50s (dollars per barrel).

Southwest was the only US airline outside the regional sector to make a profit in the fourth quarter of 2004 - a distinction it probably repeated in the first quarter (the reporting round will begin in mid-April). In 2004, which was Southwest's 32nd consecutive profitable year, the airline earned highly respectable operating and net margins of 8.5% and 4.8% respectively. The results were all the more impressive in light of the fact that by the fourth quarter Southwest has accelerated ASM growth back to its customary 10% annual rate.

The latest profits are, of course, attributable to Southwest's industry-leading fuel hedging position. In the fourth quarter, the airline had 80% of its fuel needs hedged at $24 per barrel, resulting in a $174m saving in fuel costs. Without those hedges, it would have reported losses for the fourth quarter.

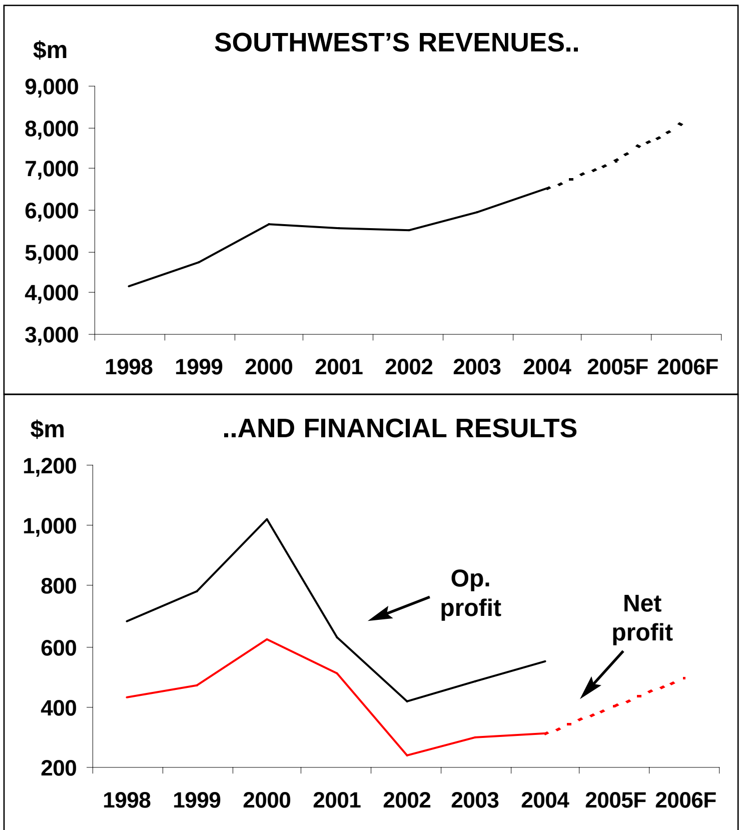
Some people have inevitably drawn the conclusion that not even the Southwest business model is robust enough to produce profits at $50-plus oil prices. However, Merrill Lynch analyst Michael Linenberg recently made the point that, had Southwest not had the hedge protections, its business plan would probably have been very different. In other words, it would probably have grown at a much slower rate than 10% in order to have some leverage to raise fares.

Southwest has the fantastic fuel hedges in place partly due to a mixture of luck and incredible foresight and partly because, unlike most other US airlines, it could afford them. The hedges have been a big feather in the hat of Gary Kelly, who put them in place as CFO. Last summer Kelly became CEO after Jim Parker's retirement.

While Southwest has continued to outperform the industry on the revenue side, its yields and unit revenues took a rare dip in the fourth quarter, reflecting a glut of seats and intense competition in key East Coast markets. However, the airline managed to reduce its ex-fuel unit costs by as much as 4.5% through productivity improvements. A total CASM of 7.77 cents per ASM in 2004 - up from 2003's 7.54 cents but similar to 2000's 7.73 cents - is no mean feat in the current fuel cost environment.

Investor interest in Southwest has again intensified in recent weeks as the oil price outlook has worsened. In mid-March Linenberg, when increasing his 2005 industry loss forecast to $5bn (based on an oil price assumption of $51 per barrel, up from $45 previously), reiterated his "buy" recommendation on Southwest due to its highly advantageous cost position. Linenberg argued that if oil prices remain above $50, there would undoubtedly be capacity cutbacks, bankruptcies and/or liquidations, and that Southwest is well positioned to take advantage of any opportunities that could arise as a result.

Linenberg also thought that now would be an attractive point of entry based on valuation. Southwest's share price has been "treading water", though materially outperforming its peers, in the past 12 months. In recent weeks the shares have traded in the $14-14.50 range, at 18 times estimated



Note: First Call/Thompson consensus forecasts

2006 earnings. Linenberg predicts that the price will rise to $19 within 12 months, representing a P/E multiple of 24. Although that would be at the high end of the company's historical trading range (15-25), "Southwest's relative position vis-a-vis competitors has never been this strong".

As Southwest starts playing a greater role in the industry consolidation process, and with a more aggressive CEO at the helm, investors will be keeping an eye essentially on two things. First, how far is Southwest prepared to risk moving away from its traditional business formula? Second, will the airline strike the right balance between growth and financial returns?

In the past 12 months, Southwest has already made two somewhat uncharacteristic moves. In May 2004 it entered and began aggressively expanding at US Airways' key Philadelphia hub - a departure from its usual strategy of flying to cheaper and less congested secondary, non-hub airports. In December Southwest signed a complex asset acquisition/investment/codeshare pact with bankrupt ATA Airlines - a departure for a company that previously shunned codesharing. Next month (May) Southwest will launch an assault on US Airways' Pittsburgh hub. Do these moves provide any pointers of Southwest's future direction?

Costs under control

Southwest remains well protected on the fuel price front for many years ahead. After adding to its already strong hedging position in the fourth quarter, the airline has now covered 85% of this year's fuel needs at $26 per barrel and 65% of next year's needs at $32. It has also hedged 45% of 2007 needs at $31, 30% of 2008 needs at $33 and over 25% of 2009 needs at $35%.

All of that is in stark contrast with the extremely light hedging positions of most other US airlines. Compared to Southwest's 85% coverage for 2005, Alaska and America West have the next-best coverage at 45-50% and AirTran and JetBlue 20%-plus. Most of the legacy carriers have currently only single-digit or no fuel hedging coverage at all.

Southwest also appears to be coping well with non-fuel cost pressures, which have built up particularly in the wage expenses category. The airline's goal is to actually reduce non-fuel CASM in 2005, which it hopes to accomplish mainly through labour productivity improvements. There are no open labour contracts until the pilots' agreement becomes amendable in September 2006.

Recent initiatives aimed at offsetting cost increases have included a voluntary early retirement programme and consolidation of reservations centres. While it is tough for such a lean and efficient company to continue reducing unit costs, the top executives said recently that there were more ideas than could be implemented.

As a result, Southwest's profit outlook is pretty good. The current consensus forecast is that its earnings per share will rise from last year's 41 cents to 50 cents this year and 61 cents in 2006. The net profit margin is expected to improve steadily, to around 6%

by 2006. CFO Laura Wright indicated recently that the company is aiming to return to its "long-term average net margin of 7.5-8%". In the boom years of the late 1990s, Southwest was achieving 9-11% net margins.

Strong balance sheet

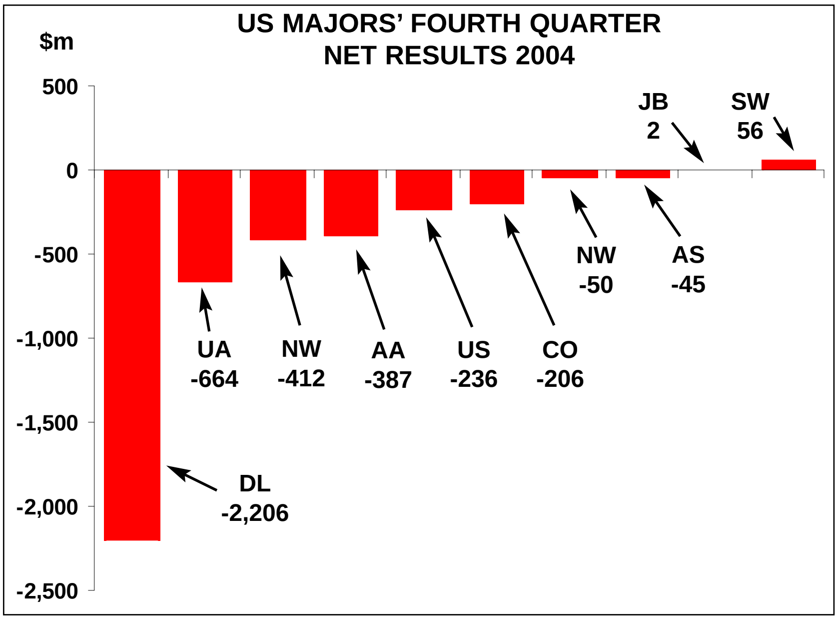
Significantly, Southwest has maintained investment grade credit ratings through the industry crisis. Its balance sheet is stronger than ever, with total assets of $11.3m, shareholders' equity of $5.5bn and long-term debt of $1.7bn at the end of 2004. The lease-adjusted debt-to-capital ratio has remained in the low 40% range for many years (100%-plus is now typical for the other large majors).

Although the year-end cash balance of $1.3bn was down from $1.9bn three months earlier and below the management's goal of $1.5bn (largely because of the ATA transaction), at 20% of 2004 revenues, it was still extremely healthy by industry standards. Furthermore, Southwest has a $575m unused credit facility. It also has more than $6bn of unencumbered aircraft, most of which are Section 11 eligible and would therefore make attractive collateral in financings.

As a result, Southwest enjoys significant financial flexibility, including easy access to the capital markets. It was able to tap the unsecured debt market in February, raising $300m in 12-year notes with an interest rate of only 5.13%. A third of the proceeds were used to refinance more expensive debt - some with interest rates as high as 8% - while the rest added to the liquidity cushion.

Fitch Ratings noted in a recent report that, despite the return to the customary 10% ASM growth, Southwest retains the flexibility to meet heavy capital commitments almost entirely from operating cash flow. Current plans envisage total capital spending of around $1.4bn annually over the next 2-3 years. This year's scheduled debt maturities are only $146m, though the figure will rise to $605m in 2006.

Southwest is therefore uniquely well positioned to meet not just its substantial aircraft capital spending requirements but whatever investment opportunities may arise from industry restructuring.



The ATA transaction: rationale and implications

The ATA transaction, secured through bankruptcy auction in December in a hot contest with AirTran, involved Southwest purchasing six of ATA's 14 gates and a maintenance hangar at Midway, Chicago's secondary airport, for $40m. Southwest also provided $47m of debtor-in-possession (DIP) financing, which will be converted to a term loan when ATA emerges from Chapter 11. Southwest agreed to buy $30m of equity in the reorganised company, representing a 27.5% stake. The fourth component of the deal was codesharing at Midway and other points.

Southwest has made it very clear that it only wanted the Midway facilities and that the other components were there because they were necessary to clinch the deal. Therefore there is nothing strategic about the ATA investment or the codeshares.

The $117m deal represented a relatively small capital investment for Southwest. Also, the airline is probably not taking much risk with the DIP financing, because the loan is believed to be collateralised on ATA's eight remaining Midway gates. In the event that the equity stake is acquired (it would be non-voting), Southwest is expected to liquidate it in an orderly manner over time.

That said, the revenue benefits anticipated from the codeshare alliance, which Southwest and ATA began implementing in early February, are not insignificant - $25-50m annually for each airline. "For a modest investment on our part, we have the potential to add quite a bit of revenue", Kelly observed recently, calling the return on investment "astronomical". He also said that he had always felt that there would be such a scenario for adding incremental revenue.

In other words, Southwest now seems open to the idea of limited codesharing, as long as a deal augments its service and meets its strict criteria on financial return. However, Kelly has stressed that the strategic focus will not change - Southwest will remain a point-to-point nonstop airline, with connecting traffic accounting for only a fraction of its business.

In the past LCCs have avoided codeshares partly for fear of harming their image and service standards or confusing passengers. The ATA-Southwest deal will obviously be helped by the fact that ATA too has a good reputation for customer service and on-time performance. Unlike Southwest, it offers a business class (the codeshares will only cover ATA's coach class).

Another reason LCCs have avoided codeshares is that harmonising booking systems and technology is costly. It takes an effort to do things that are outside the basic simple LCC model. But Kelly made the interesting point that technological advances have eased the problem. He said that he did not think Southwest would have been technologically capable of implementing the ATA codeshares five years ago - now it is just more flexible in that respect. Southwest executives have also said that the ATA transaction is manageable because ATA is only about one tenth of the size of Southwest. The codeshares are expected to add less than 1% to Southwest's connecting passengers.

The codeshare agreement is initially for one year, but it will automatically be converted into an eight-year term once ATA's reorganisation plan is confirmed. The first phase, linking 11 ATA cities with 40-plus Southwest cities via Chicago Midway but not involving FFP cooperation, was due to be fully implemented by early April. On April 3 ATA's Phoenix-Hawaii service was added to the agreement, and more routes are likely to follow in the coming months.

The ATA codeshares are giving Southwest an opportunity to tap into essentially two new types of markets: major hub airports (including New York LaGuardia, Washington Reagan National and Boston Logan) and international leisure destinations such as Hawaii and the Mexican beach resorts. Southwest has not publicly commented on this, but the opportunity to sell tickets to Hawaii is probably especially valued, given that it is a major gap in its nationwide network (Southwest does not have the long-range aircraft). ATA has sizable Hawaii operations from five mainland cities, adding up to 62 weekly flights this summer.

But the codeshare benefits pale into insignificance when compared to the benefits of getting the extra gates at Midway. Before the ATA transaction, Southwest was already the second largest airline at the airport, with 145 daily departures and a 40% traffic share. It now holds 25 gates or 58% of the airport's total 43 gates, giving it the potential to build Midway into an operation rivaling its 26-gate Baltimore operation. Southwest has said that it sees Midway as the largest potential market in its route system. Kelly called it "one of the best expansion opportunities we have had in perhaps a decade or more".

Southwest wanted the extra gates quickly because, like Chicago O'Hare, Midway is gate-constrained, with no near-term facility expansion opportunities. It has a strong local market and, because of the capacity constraints, promising unit revenue growth fundamentals.

The move ensured that no other LCC would be able to establish an early significant presence at Midway. With Southwest and ATA between them controlling about

80% of the Midway gates, the main competitive impact will be on the O'Hare legacy carriers - United and American, which operate major hubs at O'Hare, and US Airways, which has significant nonstop service out of the airport.

Since acquiring the extra gates, Southwest has moved quickly to expand service. Last month it announced the addition of seven new destinations from Midway and frequency increases on existing routes from the early summer. As a result, the airline's daily departures from Midway will increase by 32%, from the pre-ATA 145 to 192.

The ATA transaction and Southwest's Midway strategy offer some pointers of things to come further down the industry consolidation road, for example with US Airways. First of all, Southwest is mainly interested in asset buyouts, not mergers or acquisitions. This is in line with the general industry thinking, reflecting the disappointing results of most large airline mergers in the past, as well as a current lack of investment funds or goodwill on the part of employees, though Southwest's strong corporate culture obviously gives it special incentive to avoid mergers.

Second, and a little more surprisingly, Southwest showed with the ATA transaction that, when a good opportunity arises, it is prepared to go to great lengths to get the assets that it wants, even if it means entering into highly complex transactions. It is going to embrace change and keep adapting to a changing environment, rather than religiously sticking to its basic business model.

East Coast expansion focus

In addition to Chicago, Southwest's expansion this year focuses on two East Coast cities: Philadelphia and Pittsburgh. Philadelphia, added in May last year, was Southwest's first new city since late 2001. The airline has described it as "our most aggressive route start-up ever", having quickly built up the operation to 41 daily flights to 16 destinations within six months of start-up.

Philadelphia was a classic overpriced and underserved market, a US Airways stronghold with only 5-10% of traffic carried by discount airlines. There was a rare opportunity to obtain gates after AMR's purchase of TWA. While US Airways' shrinkage played a major part in Southwest's Philadelphia decision, competitively the move was probably more aimed at JetBlue and AirTran - namely preventing other LCCs from establishing a presence at that airport.

The operation has been a huge success, with the famous "Southwest effect" very much in evidence. The airline plans to continue adding flights at Philadelphia. The only problem is that it currently has only six gates, limiting daily departures to around 60. Southwest has said that it would one day like to have up to 25 gates at Philadelphia.

The immediate focus, however, is on Pittsburgh, which Southwest is adding in early May. The initial operation will be in the typical Southwest pattern - ten daily departures to four destinations, a mix of short and long haul, with walk-up fares in the $79-$299 range, representing savings of up to 65% on prevailing fares.

The move represents another assault on US Airways, which is still the dominant carrier at Pittsburgh. However, this time US Airways was really asking for it because of its heavy downsizing at that airport. After gradually cutting service in Pittsburgh in recent years, in 2004 US Airways decided to abandon it as a hub but maintain sizable operations (still some 220-plus daily departures). This created a perfect opportunity for Southwest (even though other LCCs had already moved in) - similar to its earlier opportunity at Nashville, after American downsized at that airport.

In recent months Southwest has talked about possibly adding another new city in late 2005. Given all the turmoil in the industry, it expects to wait until the last minute before deciding about it. Not surprisingly, there has been some speculation about Charlotte (North Carolina) - another US Airways hub.

It has been at least a decade since Southwest added a new city in the West, and the airline's executives acknowledged recently that there are candidates west of the Mississippi. However, for now the focus appears to be totally on the East.

After a decade of growth in the East, Southwest has now a more geographically balanced domestic network. In the fourth quarter of 2004, its capacity was distributed as follows: West 39%, Midwest 16%, Southwest 16%, Southeast 15% and Northeast 14%.

Alongside with its low fares and strong nationwide network and brand image, one of Southwest's biggest advantages is its extremely strong competitive position in the markets that it serves. According to 3Q04 DoT data, Southwest is the largest carrier in 90 of its top 100 O&D markets. It has a 66% share of traffic in its top 100 O&D markets, with dominant shares in the intra-California, intra-Florida and intra-Texas markets. It also has a strong presence in the Northeast-Florida market and at Chicago Midway, Baltimore, Phoenix and Las Vegas.

However, this year's new pricing developments (Delta's SimpliFares) may prompt Southwest to re-examine some of its strategies. First, relying on secondary airports may make less sense if fares decline at primary airports (though Southwest has pointed out that secondary airports do have advantages - for example, they are easier to get to and have less congestion). Second, the traditional strategy of going for overpriced and underserved markets may have to be revised, because the legacy carriers' fare cuts may have eliminated many overpriced markets.

But Southwest has indicated that none of that is really new - that it was already mindful of the fact that, as time goes by, it will face more and more low-fare competition. In other words, it will have to adjust its strategies over time anyway.

One area that Southwest has certainly re-examined is product and service quality. In February it unveiled refurbished aircraft interiors, featuring leather seats and more personal space. It also continues to keep assigned seating under consideration - apparently a perennial request by some of its customers. However, Southwest does not follow every trend or fad, and often for a good reason. Kelly observed recently that business customers typically like Southwest because of its schedule, frequencies, punctuality and suchlike, so the airline needs to focus on what is most important, including price.

SOUTHWEST'S FLEET

Type	Active	Order Backlog	Options
737-300	192		
737-500	25		
737-700	203	80	86
Total	**420**	**80**	**86**

Could Southwest grow faster?

Southwest's current fleet plan calls for the net addition of 29 aircraft in 2005 - the result of 34 new Boeing 737-700 deliveries and the retirement of the last five 737-200s. This will meet the airline's current capacity needs for Midway, Pittsburgh and Philadelphia, plus possible service from a new city in late 2005. It will result in ASM growth of around 10%, following 7.1% last year, 4.2% in 2003 and 5.5% in 2002.

If good additional growth opportunities cropped up, Southwest could in theory take half a dozen or so more aircraft per year. It is keeping an eye on the used aircraft market. However, Southwest executives say that in the current environment it would be hard to reach that decision.

Kelly estimated in January that in the current environment the right level of growth for Southwest is probably in the 5-10% range. If the excess capacity situation eases and profit margins improve, it would be easier to justify a 10% growth rate. Then again, Southwest is well protected on the energy side and may be able to reach its financial return targets even while growing faster.

By Heini Nuutinen
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Iberia: the challenge of the LCCs

Although Iberia has recorded nine consecutive years of net profit, it is only since part privatisation in 1999 that the Spanish flag carrier has faced the harsh realities of full market competition. In the last five years it has survived challenge after challenge (see *Aviation Strategy*, November 2003), but today faces its greatest ever threat - the LCCs.

Thanks to the Gulf war and SARS, in 2003 Iberia's operating profit fell by 36% to €161m and net profit decreased by 9% to €146m. But the airline bounced back well in 2004, and in late February it revealed an operating profit of €203m for 2004, 25% up on 2003, and a net profit of €220m, 52% higher than a year before, despite operating revenue increasing by just 4%, to €4.8bn. Scheduled passengers carried grew by 4.2% to 26.6m in 2004, and RPK growth of 9.1% slightly outstripped an ASK increase of 8.8%, resulting in a 0.2 percentage rise in load factor to 75.2%, its highest ever annual level.

Despite the good results for 2004, some analysts are unsure whether investors should continue to put their money into the airline. One of their main concerns is costs. Through the 1990s and 2000s Iberia has battled to reduce its cost base through a series of major cost cutting initiatives that it calls "Director Plans". The third Director Plan, covering the period 2003-2005, aims to reduce 2005 "base case" costs by between €350m-€400m, with labour cost savings accounting for up to €75m of this, commercial costs €110m, better asset utilisation €45m, on board service costs €50m and other costs €120m.

Iberia says its improved result in 2004 is partly due to the success - so far - of the Director Plan (and partly to the depreciation of the dollar against the euro), and that the airline is on target to reach the €350m-€400m target savings by the end of 2005.

It's true that cost-cutting in many areas is going well, such as in the unbundling of service on short-and medium-haul routes into a new "pay-as-you-go" business model, including the scrapping of free in-flight meals. However, in other areas cost cutting has been less successful. On labour, the only progress has been an extension of an existing voluntary redundancy scheme called ERE with ground staff unions in December 2004. This allows up to 2,500 voluntary redundancies (out of 18,500 total ground staff), two-year career breaks and early retirement from the age of 50 through to the end of 2007.

Overall, only just over 40% of the targeted savings in labour costs had been achieved by the end of 2004 - two-thirds of the way through the third Director Plan.

The main reason for this sluggishness is pay and conditions for pilots and cabin crew, which were last renegotiated back in 2002. Much therefore depends on the agreement of new collective deals with pilot and cabin crew unions in 2005. The initial signs are not great.

A tentative collective deal was agreed with representatives of SEPLA - the union that represents 2,000 pilots at Iberia - at the end of 2004, but this was overwhelmingly rejected by the SEPLA members in a ballot in November, and instead they elected new union officials with a mandate to renegotiate a better deal (although SEPLA also invited the Spanish arbitration body to step in and resolve differences between the two sides). The pilots' key concern is job losses, and their stance appears to be hardening following the unveiling of Iberia's plans for a low cost operation (see below).

Talks with SEPLA are scheduled to restart this Spring, as are negotiations with unions in other labour areas. Iberia's management insists deals will be struck, and instead prefers to emphasis that cost cutting elsewhere has gone well, particularly in the area of its fleet.

Fleet changes

The Iberia Group operates a fleet of more than 200 aircraft, (see table, page 14), and strenuous effort has been made to reduce costs through better utilisation (hours per aircraft per day grew 3.9% in 2004), wet leasing (which represents around 9% of total capacity) and replacement of older models.

In February Iberia announced an order for 15 A318s, nine A320s and six A321s, along with options for 49 further aircraft. The list price of the order is €3.4bn, but the airline is believed to have negotiated a substantial discount on this from Airbus, which also offered a very competitive maintenance deal. The airline also benefited from the strong value of the euro against the dollar.

The aircraft will be delivered over 2006-2011 and will replace older A320s, 757s, MD-87s and MD-88s. Some analysts question the order of so many A318s, which have the highest unit cost of the A320 family, but Iberia points out they will replace MD-87s on low density routes as well on high density routes off-peak. If demand on Iberia's network increases ahead of current forecasts, then some or all of the 49 options will be turned into firm orders.

The new aircraft will be 20% cheaper in terms of fuel than the aircraft they are replacing, Iberia estimates, and they will have up to a 23% advantage in maintenance costs. 70% of the Iberia's current fleet is held on operating lease and Iberia says the proportion will be maintained for the new order, which the airline claims will help the aircraft achieve the same or better costs per seat than the LCCs.

The announcement was bad news for Boeing, which had hoped for at least part of the short-haul order, but it is still in the running for a possible Iberia order of medium-haul 300-seat aircraft. The choice here is expected to be between the A330, A350 or Boeing's 787.

On long haul, Iberia has received seven aircraft of an order for 12 A340-600s, with the remaining aircraft scheduled for delivery in 2005. These are replacing Iberia's ageing 747-200s. The new A340-600s no longer have a first-class section, instead having a "business-first" section that is essentially a business cabin with a few extra features.

LCC priorities

While the new short-haul aircraft will help to cut unit costs domestically and across Europe, they are surely only a partial response to the challenge of the low cost carriers. While more than 20 LCCs operate to/from Spain, it is the largest two that are causing the most problems for the Spanish flag carrier.

easyJet currently operates 53 routes to 10 Spanish destinations, 20 of which have been launched since the start of 2004. Ominously for Iberia, easyJet is analysing the launch of a Spanish hub for domestic flights sometime this year, which easyJet COO Ed Winter says is a "maximum priority" thanks to anticipated growth in the Spanish market. Likely candidates for a domestic hub operation are Madrid, Barcelona or Malaga - any of which would be a substantial threat to Iberia and its regional operation, Air Nostrum.

Ryanair has been operating to Spain since 2002 and currently offers 50 routes to 12 airports. It is adding a route between London Stansted and Santiago de Compostela in April, and this is causing controversy because the Galician regional government admits that (via a local tourist body) it is paying Ryanair €3.8m over four years to support its marketing for the service - on a route that will compete against Iberia's Santiago-London Heathrow operation.

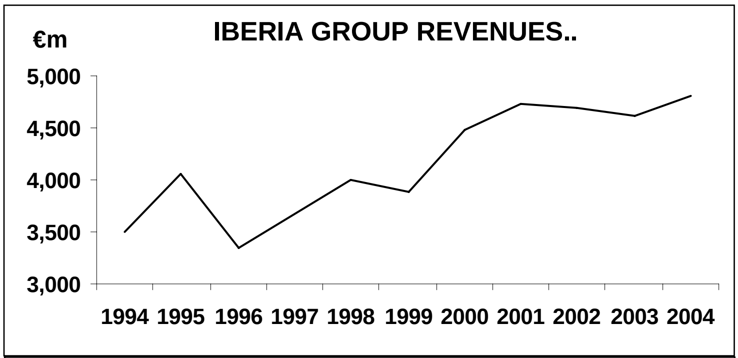
The issue of LCCs receiving aid though Spain's regional airports and/or governments infuriates Iberia. It claims that secondary Spanish airports offer LCCs a subsidy of up to €17 per seat, and that as very few Spanish airports are profitable, these subsidies - which erode traffic on Iberia routes - are not justified. Iberia claims Ryanair also receives an annual subsidy of €1.2m at Santander airport and €6.2m a year at Gerona airport. Unless incentives from secondary airports to the LCCs are stopped, Iberia says it is prepared to close routes out of Barcelona, Andalucia and Galicia, among other places. Along with BA and Air France, Iberia has asked the European Commission to lay down regulations on airport subsidies to LCCs, which are expected shortly.

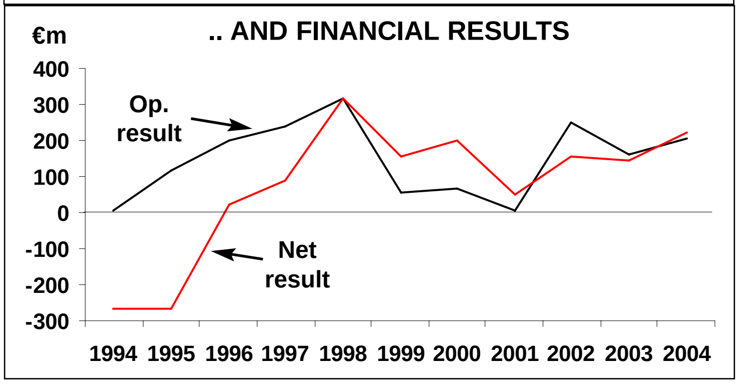
Yet Iberia itself is receiving a huge subsidy through development at Madrid Barajas, where the airline will take full advantage of the new fourth terminal, which is finally due to open in 2006 after almost a two year delay, which forced Iberia to delay delivery of aircraft. The 64-gate terminal, (scheduled to open in February 2006) and two new runways (due to open this summer), will double capacity at the airport from 35m passengers a year to 70m.

AENA, the Spanish airport authority, is handing more than 90% of capacity at the new terminal to Iberia and its fellow oneworld airlines - a decision that Spanair, a subsidiary of SAS and Spain's second-largest airline, is appealing against both to AENA and the EU. The Star airlines will instead use terminal one and part of terminal two, while SkyTeam will operate out of terminal two and terminal three.

Spanair is upset because originally - in June 2004 - AENA declared that Star alliance carriers would share the new terminal. But Iberia appealed, and in November AENA reversed its decision, giving the majority of the new capacity to Iberia and its allies. From Iberia's point of view, it is vital it has most of the capacity at terminal four as that will enable easy transfer between domestic/European flights and its routes to Latin America, and it expects traffic to Latin America to rise considerably as a result (see below). Iberia also argues that AENA uses fees paid by large airlines at major airports to fund regional airports.

But while Iberia is getting flustered over incentives to LCCs, Ryanair is examining the launch of operations at up to eight further Spanish airports over the next couple of years, with at least 20 new routes, as part of general expansion plans for Europe. Interestingly, it hasn't all gone Ryanair's way in Spain - ground handlers at Girona airport recently won a 11% pay rise from the LCC after threatening strike action against "intolerable" working conditions, according to the International Transport Workers' Federation (ITF).





Air Nostrum

Nevertheless, the encroachment of easyJet and Ryanair is a severe challenge to Iberia, and in particular to its regional subsidiary, Air Nostrum.

Valencia-based Air Nostrum became an Iberia franchise and its regional carrier in 1997, and today operates a fleet of seven ATR 72s, 14 Dash-8 Q300s and 32 CRJ-200ERS. It has 19 further CRJs200s on order, worth around €400m and scheduled for delivery from mid-2005 to 2008, as well as options for 33 further of the type. The firm order was placed in July 2004, but Air Nostrum is likely to change half of them to 78-seat CRJ700s or 86-seat CRJ900s, subject to changing the scope of the franchise agreement with Iberia.

Iberia's current deal with Air Nostrum allows the regional carrier to operate aircraft only with a capacity of less than 70 seats. Those franchise terms are likely to be

IBERIA GROUP'S FLEET

	Fleet	Order	Options
Iberia			
A318		15	
A319	6		
A320	58	9	49*
A321	10	6	
A340	26	5	7
747	5		
757	13		
MD-87	24		
MD-88	14		
Total	**156**	**35**	**56**
Iberia Regional/Air Nostrum			
ATR72	7		
Dash-8 Q300	14		
CRJ200ER	32	19	33
Total	**53**	**19**	**33**
Fleet Total	**209**	**54**	**89**

Note: * = 49 A320 family aircraft

altered this year in order to allow Air Nostrum to take over some of Iberia routes currently served by 109-seat MD-87s, most of them routes between secondary cities and from those airports to Barcelona and Madrid. If the plan goes ahead, Air Nostrum would then acquire aircraft in the 90-110 seat capacity range.

But Air Nostrum is under increasing pressure from LCCs. In February the airline said it was abandoning its London Gatwick-Asturias service, only launched in late 2004, following easyJet's announcement it would launch services from Asturias in March. Air Nostrum also operates from Asturias to seven domestic destinations as well as Paris and Brussels, and had been planning major passenger growth through 2005. Iberia too is considering the future of its services out of the airport.

At present, Air Nostrum says it is pressing ahead with expansion plans elsewhere. The airline may acquire selected routes operated by Spanish regional carrier Lagun Air, which collapsed at the start of 2005. Lagun operated out of Leon in northern Spain, and Air Nostrum is believed to be looking at the busiest routes, to Barcelona and Madrid. Starting from February this year, Air Nostrum is also launching six routes out of Santander airport, to Valencia, Seville, Malaga, Alicante, Palma de Mallorca and Las Palmas. Bearing in mind Iberia's complaints against Ryanair, the regional government in Santander insists that no subsidies are being given to Air Nostrum, although it will provide "promotional" support. Ryanair also operates out of the airport (though not on any of the Air Nostrum routes), although the LCC does have plans to expand operations later in 2005.

Despite these plans, the long-term future of Air Nostrum is uncertain. Iberia has traditionally used Air Nostrum as a low-risk tester of demand for new routes though lower capacity aircraft, and as many of Air Nostrum's routes serve low-density secondary routes, the airline has benefited from credit lines from the European Investment Bank to finance leases on new aircraft. But as well as increasing competition from easyJet and Ryanair, Air Nostrum also faces a rising challenge from Air Europa, which Iberia unsuccessfully tried to buy in 2001, and from Spanair (in which SAS owns 95%). From February Spanair has been expanding its fleet by eight aircraft, which will "penalise yield" in Spain, Iberia says. Iberia responded through a 50% reduction on the prices of virtually all domestic flights taken between mid-January to mid-March and booked online. This offer was also available on just two long-haul flights - to Santo Domingo in the Dominican Republic and Caracas in Venezuela. Air Europa and Spanair have also been cutting fares deeply, and domestic and intra-European fare wars look set to be the norm for some time to come.

But perhaps the greatest challenge to Air Nostrum comes from Iberia itself, and its plans to set up a LCC.

Iberia Express

In October 2004 Iberia revealed it was talking with SEPLA about the launch of a LCC, to be called Iberia Express. SEPLA sources indicate the union is very concerned about Iberia's plan, particularly if it is used to erode the pay and conditions of staff at the main airline. The talks on the LCC are being held alongside negotiations on a new collective agreement with pilots at the main airline, which are due to restart soon, and the success of the LCC negotiations is inextricably linked to the main collective talks.

Iberia Express would operate A319, A320 and A321 aircraft transferred from the main airline with - reportedly - a mixture of new pilots and retired Iberia captains (the retirement age for mainline Iberia captains is 60, although national regulations allow them to fly until 65). First officers for the LCC would be hired from outside Iberia.

Bernado Obrador, the new head of SEPLA's Iberia branch, says that the union is ready "to study any option" as part of the collective pay and conditions talks, although the union will reject any attempt to reduce salaries, and any effort to boost productivity significantly is bound to fail as pilots are working at the limit of their allowed hours anyway. Employee productivity rose by 7.7% in 2004 (see chart, page 16), although this is a Group-wide number.

Even if a deal can be thrashed out with SEPLA, there must be some doubt as to how low cost Iberia's LCC will be. For example, it is envisaged that Iberia Express's ground services will be shared with the (higher cost) main airline. And if the Iberia Express concept is successful, there can't be many routes that could be served by 90-110 seat aircraft operated by Air Nostrum and not by 126-seat A319s flown by Iberia Express - which would mean the end for Air Nostrum. It may be unduly pessimistic, but Iberia could end up with the worst of both worlds - an LCC whose unit costs are not as low as competitors', yet an airline that provokes industrial unrest among staff at Air Nostrum and the main airline.

But at least Iberia's management is trying to do something given the relentless erosion of yields, which dropped by a worrying 6.3% in 2004 thanks to increasing competition from the LCCs. Iberia estimates yield erosion cost €175m in 2004, so while unit operating costs fell 5% in the year thanks to the Director Plan, Iberia appears to be caught in a relentless spiral of having to cut more and more costs as yield continues to fall.

Iberia argues that yield erosion is slowing - overall yield fell 8.7% in the first half of 2004, but by "just" 3.6% in the fourth quarter. This was largely due to better revenue management on domestic routes - which focuses on improving yield rather than maximising revenue, even at the cost of a short-term reduction in load factors - where yield actually rose 3.6% in the fourth quarter (with long-haul declining by just 0.1%).

In the longer term, however, Iberia will face stiff competition on the key Madrid-Barcelona route through the launch of AVE, a high-speed train service, on the full route between the cities in 2007.

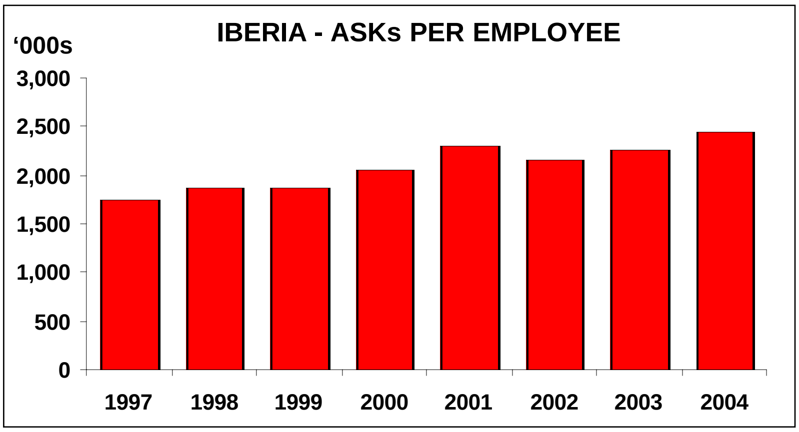
And despite the domestic improvement, yield on European routes - where easyJet and Ryanair compete - still fell by a worrying 7.4% in the last quarter of 2004. Another challenge to Iberia in Europe comes from the cancellation in 2004 of the four-year-old codeshare partnership with Air France on regional routes. Iberia is attempting to fill the gap in its network by expanding Air Nostrum services to France, including services to Bordeaux, and Nice. Air Nostrum benefited from the collapse of Air Littoral in February 2004, gaining more than 100 slots out of the 4,400 slots freed up at Paris Orly. However, for its part Air France is expanding its code-sharing with Air Europa on routes from France to Barcelona and Madrid, and SkyTeam would like to expand that relationship into Air Europa associate membership of the alliance.

Elsewhere, Iberia launched a daily Madrid-Moscow Domodedovo route in March this year, as well as a three-times-a-week service between Madrid and Beirut, both using A319s. The former is Iberia's third attempt to enter the Russian market since the break-up of the Soviet Union, and Iberia is targeting 150,000 passengers a year on a route that currently carries 250,000 a year between Aeroflot and a number of charter carriers.

In February 2005 - the latest reported month - passengers carried fell by 5.1%, with most of the reduction coming on domestic flights, where passengers carried fell 5.6%. February yields did improve year-on-year domestically, although again yield elsewhere fell, and overall Group yield was flat year-on-year.

Fernando Conte, Iberia's chairman, says of the yield erosion: "We don't expect the declines to be reversed; the rate of decline is what will change." That sounds very much like Iberia has little option but to continue with cost-cutting, with an inevitable fourth Director Plan for 2006 and beyond. But - labour aside - how much room is there for further cost cutting? Iberia claims its unit costs are already below the industry average, though behind those of British Airways and the two main LCCs, Ryanair and easyJet.

One area where there must be greater



scope for savings in distribution a - in 2004 internet sales generated €207m, or just 4.3% of total revenue, and an increase of only 23% on 2003. As part of the third Director Plan, in January Iberia cut commission to travel agents from 2% to 1.5%, and will reduce the rate further to 1% from July. Rivals Air Europa and Spanair also cut their rates by 0.5% at the start of the year, though their commission rate is still higher than Iberia, at 2.5% and 2% respectively.

Other than further cost cutting in distribution, labour and a few other areas, Iberia will have to push on with further "non-core" asset sales. In December 2003 Iberia sold its 51% stake in Viva Tours to Spanish tour operator Iberojet for €18m, and its 70% stake in catering subsidiary Iberswiss for €24m, and in March this year sold its 66% stake in Sistemas Automatizados Agencias de Viajes (Savia), the Spanish and Portuguese national subsidiary of Amadeus, to the Amadeus parent company for €82m.

This is the final part of the process by which global distribution company Amadeus has bought full control of subsidiaries across Europe, prior to an expected delisting and sale of 60% of the overall business to BC Partners and Cinven, UK-based private equity firms with which Amadeus is currently holding talks. The deal could be worth as much as €4.3bn, although it is unclear as to by how much Iberia and the other shareholders in Amadeus - Lufthansa and Air France - will adjust their stakes relative to each other. If Iberia reduced its share in Amadeus from 18.2% to 11%, it would raise several hundred million euros. Iberia still has a 4.1% stake in Opodo, the internet booking site in which Amadeus took a majority stake in 2004.

Part of the money raised by the Amadeus deal will be used by Iberia for pay for its short- and medium-haul fleet renewal, some is expected to be used for a special dividend that ABN Amro forecasts to around the €0.30 per share mark, and the rest will go to fund acquisitions.

Acquisitions

Alongside the disposal process, Iberia is also looking to acquire strategic airline stakes, primarily in Latin America, its main operational focus outside Europe.

One possibility is Mexicana. Iberia began codesharing with the airline in April 2004, and speculation over a possible acquisition increased after Iberia expanded its partnership with Mexicana in February through the addition of further codeshares. That same month Iberia confirmed that it was "looking at the process in Mexico with a lot of interest", referring to the privatisation effort by the Mexican government. State holding company Cintra originally envisaged selling Mexicana in a package with a regional airline. However, it now appears that all government's airlines will be sold separately, and Mexicana is firmly in Iberia's sights. It is not clear whether Iberia is looking to acquire a majority or minority stake in the airline, and this depends partly on the lifting of foreign ownership restrictions by the government. Mexicana operates 65 aircraft to more than 50 destinations in North and South America, and is not aligned to a global alliance after leaving Star in early 2004 - although oneworld would love to add it as a member.

At the end of March it was also reported that Iberia was in tentative negotiations to acquire a stake in Uruguayan airline Pluna, which is 49% owned by the state and 49% by Varig. Apparently Iberia is interested in buying both of these stakes, although the first action a new owner would have to carry out is renew Pluna's ageing fleet. Other key Latin American markets for Iberia are Argentina, and Brazil, though acquisitions here appear unlikely in the short-term.

Iberia also looked at potential acquisitions in Europe through 2004, but this has been downgraded as an acquisition region due to concern about EU and national government regulations on cross-border acquisitions. Iberia had also been linked with a potential acquisition of TAP Air Portugal, which the Portuguese government plans to privatise at some point over the next two or three years, but that now appears out of the question. A codeshare deal between the two airlines was ended in November 2004 following TAP's announcement that it would join the Star alliance in March 2005.

Wherever it invests, it is hoped that Iberia doesn't repeat the pattern of its disastrous acquisition policy in Latin America in the 1990s. Iberia insists that the mistakes made then - what it calls "political investments" - will not be repeated now, and that new acquisitions will be based on sound financial and operational analysis.

Long-haul

Long-haul accounted for more than 50% of total capacity in 2004, although it contributed just a third of all revenue. (In contrast, domestic capacity was less than a quarter of total capacity, yet contributed more than a third of all revenue in 2004.). In 2004 international traffic rose by 11.3%, again just above a rise in ASKs, with load factor rising 0.7 percentage points to 76.3%.

Most of Iberia's long-haul routes are to Latin America, where it has just completed out a major operational realignment after having to find an alternative to its Miami hub, where until last year many of its routes out of Madrid connected with intra-continental services operated by a fleet of A320 family aircraft that were based in the US.

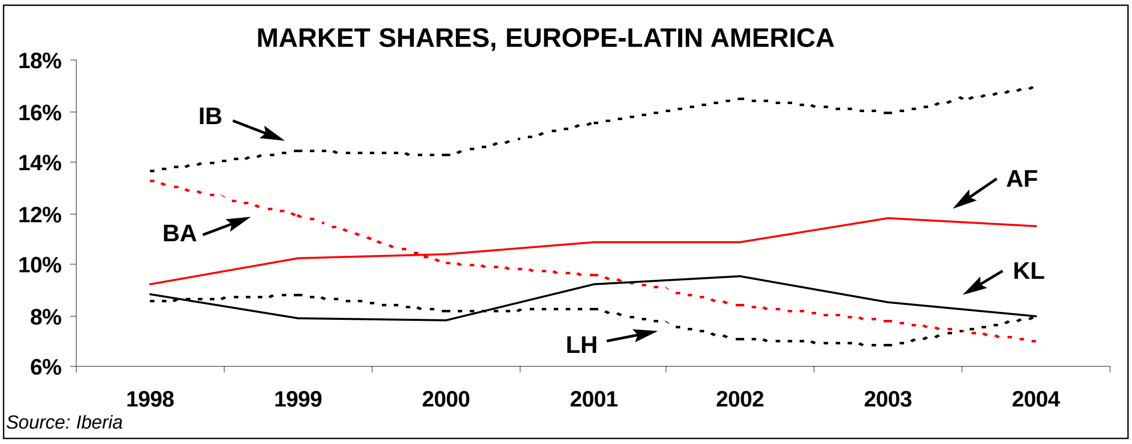
Iberia was concerned that stricter security at US airports - particularly the requirement for transit visas for all connecting passengers - was persuading passengers to avoid connections at Miami. Although Iberia preferred to stay at Miami, all through last year the airline looked for alternative connecting points, including Cancun in Mexico, Santo Domingo in the Dominican Republic and San Jose in Costa Rica. However, an alternative hub faced the problem that it would have less point-to-point traffic than Madrid-Miami, while not having the same liberal traffic rights into other central and South American countries that Iberia enjoyed out of Miami

Nevertheless, in October 2004 Iberia restructured its Latin America operations through the introduction of direct flights to Central America - to Panama, Guatemala and Costa Rica, where mini-hubs have been set up with onward services to Mexico Honduras, El Salvador and Nicaragua - and extra capacity on routes to South America. The Miami hub (where four A319s were based on routes to seven Central American destinations) has been downgraded. A twice a day service to Miami has been cut back to a daily service, although Miami will still be used as a gateway to the US via oneworld partner American.

To provide further links with the rest of the continent, in October a codeshare deal was signed with the TACA Group, which has hubs in Peru, El Salvador and Costa Rica and operates to more than 100 destinations in Central and South America. Elsewhere in Latin America, an improved bilateral between Span and Peru was signed in 2004, allowing Iberia up to eight frequencies a week on Madrid-Lima, although two frequencies were given to a new airline called Air Madrid. In September 2004 a codeshare pact was launched with Colombian airline Avianca, building on an existing maintenance deal.

Iberia's expects its operational reshuffle in Latin America to maintain its share of the total market, which has been steadily rising (see chart, page 18) despite a renewed effort by Air France on services to the region, and the launch of routes from Air Europa (which now operates from Madrid to 10 Latin American destinations) and Air Madrid (which serves seven Latin America destinations from Madrid).

Elsewhere on long-haul, a long-term target is China, which rival Air Europa wants to launch services to as soon as possible. At present Iberia codeshares with Cathay



Pacific on flights to Hong Kong via Amsterdam - a deal agreed after the first-ever bilateral was signed between Spain and Hong Kong in early 2004 - and it believes that there is not enough demand for direct Spain-China operations at present. In 2004 extra services were added on several long-haul routes, including New York, Buenos Aires, Santiago, San Juan and Santo Domingo, while a new route was launched to Lagos, and Madrid-Montevideo was converted into a non-stop route.

The future

Will the launch of a LCC and continued cost-cutting be good enough for Iberia, given that yield is continuing to fall? Some analysts are unsure. ABN Amro, for example, has a hold recommendation on Iberia (as opposed to a buy for BA and Air France/KLM). Iberia remains upbeat, and is raising its 2004 dividend to €0.05 per share compared with €0.03 in 2003, to an amount that represents 21% of profit for the year - although this is still short of the 25% share of profits that the airline says is its long-term goal. Management also points out that adjusted net debt (which includes the capitalisation of operating leases) fell by 7.9% to €1.7bn at the end of 2004 compared with a year before, despite the fleet investment, so that overall its financial position is healthy.

That may be so, but another looming problem is fuel prices. Fuel costs rose 17% in 2004, though hedging offset most of this and Iberia also levied between 5-15% fuel surcharges on all flights last year, which added €140m to the revenue line. In February this year Iberia director general Enrique Donair said that Iberia was working an the assumption that the average price of a barrel of crude oil would be $44 in 2004 - a price that if realised would make "Iberia - along with Ryanair - the only company to make money this year", as Iberia has hedged 90% of its fuel needs for the first half of 2005 and 30% of needs for the second half. However, Spanish sources suggest that even with this hedging, Iberia's fuel costs are expected by rise by around €0.25bn in 2005 - a figure that would be higher than total net profits for Iberia last year. But even if fuel cost and eroding yield do knock a hole in Iberia's 2005 results, the airline has a potential white knight to come to its rescue - British Airways.

BA currently holds a 9% stake in Iberia, bought back in 2000, and speculation about a full takeover has mounted as the relationship between the two gets closer. After the European Commission finally gave six years' antitrust immunity to the Iberia/BA alliance in December 2003, the two airlines moved quickly to tighten their partnership, which began with codesharing in 1999. Further codeshares were added on European and long-haul flights, including BA partner airlines Comair and GB Airways, while marketing and commercial strategies have been aligned globally.

From January this year Iberia and BA began sharing costs and revenues on their flights between Barcelona, London and Madrid as part of merged operations on these routes (to be completed by April) and this model may be extended elsewhere. The two airlines currently codeshare on almost 60 routes, and are working on co-ordinating timetables so that connections on flights to Latin America out of Madrid and to Asia out of London are co-ordinated with feeder flights from the other airline. In terms of network, the airlines fit well together in that Iberia has no routes to Asia, whereas BA has 11 routes, while BA has just 14 routes to Latin America (mostly to the Caribbean), whereas Iberia has 17. A merger between the two may make sound strategic sense.

This year the Spanish government plans to sell its last remaining stake in Iberia - the 5.35% share held by SEPI, the state holding company - now that lock-in period is ending, and British Airways is believed to be interested in acquiring it. A five year lock-in after Iberia's flotation for other key shareholders - BBVA, Logistica and El Corte Ingles, who between them own 17% (see chart on right) - has also just ended, although it is not thought these companies are looking to sell their stakes.

Iberia argues that a merger with BA is out of the question given regulatory restrictions in Europe, which prohibit BA from acquiring a majority stake in the Spanish airline. A KLM/Air France style link-up, with the two airlines run separately, would be a solution, but both Iberia and BA are thought not to be interested in that. Iberia argues that anyway, the current close relationship between the two airlines is sufficient for the moment.

Yet an analysis of a merger with Iberia is believed to be high on the list of priorities for new BA chief executive Willie Walsh when he takes up his position in May, though it is true any move would be dependent on the easing of ownership rules in Europe, which is itself dependent on a wider liberalisation agreement between the EU and the US. But from Iberia's point of view, with the challenge of rising fuel costs, cut-throat competition from LCCs and uncertainty on negotiations with unions, the prospect of a friendly acquisition must look very tempting indeed.

IBERIA SHAREHOLDING

	%
Free float	54.6
Caja Madrid	10
BA	9
Banco Bilbao (BBVA)	7.3
Logistica	6.7
SEPI	5.4
El Corte Ingles	3
Ahorro Corporacion	3
American Airlines	1
Total	**100**

		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
Dec-2004	185	56	241	194	48	242	483

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	321	177	498	1,815	325	2,140	2,638
Dec-2004	20	13	33	169	56	225	258

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 narrow-bodies = 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 %
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
Feb-05	22.1	13.2	59.8	15.1	11.0	72.6	12.3	9.6	77.6	40.5	31.3	77.3	59.6	42.9	72.0
Ann. chng	2.2%	2.2%	0.0	-3.1%	-1.6%	1.1	9.1%	6.5%	-1.9	2.0%	2.7%	0.5	1.9%	2.7%	0.5
Jan-Feb 05	46.0	26.9	58.4	32.1	24.0	74.8	25.8	20.1	77.8	85.5	67.2	78.6	125.5	91.0	72.6
Ann. Change	4.3%	6.1%	1.0	-1.0%	1.1%	1.6	11.1%	9.9%	-0.9	4.0%	6.0%	1.5	4.1%	6.2%	1.4

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 %
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
Feb- 05	76.8	55.6	72.5	11.7	8.2	70.5	8.6	6.7	77.6	8.7	6.2	70.8	29.0	21.1	72.7
Ann. Change	-2.6	1.9	3.2	5.4	9.8	2.8	11.4	5.7	-4.1	11.4	12.8	0.9	8.9	9.3	0.3
Jan-Feb 05	158.6	113.7	71.7	21.5	18.0	72.7	18.2	14.5	79.8	18.2	13.2	72.7	61.1	45.7	74.8
Ann. Change	-1.2%	4.8%	4.1	7.4%	10.5%	2	13.3%	8.6%	-3.3	13.4%	15.9%	1.5	10.8%	11.4%	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	08 March	Air France	4 x 777-300ER	2006 onwards	
	22 March	SALE	20 x 737-800	2006-2009	plus 20 options
	23 March	Gol	4 x 737-800		
	11 April	Korean Airlines	10 x 787	2009-2013	plus 10 options
	11 April	Northwest Airlines	15-18 x 787		
Airbus	17 March	Qatar Airways	1 x A330-200, 1 x A330-300		
	18 March	GB Airways	1 x A320	2007 onwards	IAE V2500
			4 x A321		
	06 April	CSA Czech Airlines	6 x A319	03/06 - 09/08	CFM 56-5B6/P
			6 x A320		CFM 56-5B4/P
Embraer	24 March	China Eastern	5 x ERJ145	2H 2005 onwards	

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

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