AIRLINE weekly®
INDEPENDENT WORLDWIDE COVERAGE

September 22, 2008
Issue No. 206

Earnings

April '08 – June '08 (3 months)
Spirit: $18m net profit
Midwest: $39m net loss
Sun Country: $13m net loss
Air Wisconsin: $11m net profit

January '08 – June '08 (6 months)
Comair: break even

*ex special items

Life After Alitalia

Carrier unlikely to escape its latest near-death experience; who will fill the void?

While Italy's politicians just can't seem to let go, options for saving Alitalia are running out. It may be time, finally, to say goodbye.

Last week, the consortium of Italian investors behind the latest attempt to save the world's most dysfunctional airline walked away. Some of Alitalia's nine unions—counting on political support and perhaps emboldened by years of empty threats and ultimatums—refused to accept pay and productivity terms necessary to ensure the long-term health of a newly reconstructed airline.

Still, as of this writing, politicians were scrambling to do something. There's the possibility of yet another government infusion of cash, though the legal implications make that unlikely—Alitalia is already running on subsidies that violate European Union law. Politicians could browbeat one of Italy's top banks to provide another round of short-term funding, though that wouldn't solve anything beyond a few months at best. Finding a foreign savior is another remote possibility, but none will be willing to help as long as unions remain uncooperative. Air France/KLM, in fact, said recently that its offer to buy Alitalia—a lucrative one that politicians and unions recklessly sabotaged last spring—is off the table now that fuel prices are higher and the economy much weaker. There's still a glimmer of hope, meanwhile, for the latest plan to recreate a new Alitalia by fusing it with Air One and shedding its debt. Investors may have walked away, but they could be called back if unions—notably pilots and flight attendants—change their minds.

See also:
- European financial results, p. 9

Time, though, is running out. Suppliers want cash up front and some, like fuel suppliers, are already threatening to stop doing business with the carrier. Travelers with any sense are no longer booking flights on Alitalia, depriving it of necessary cash. Already, some flights are canceling.

The likelihood of a complete shutdown, therefore, is greater than ever. If that happens, it would constitute the largest casualty of the current industry turmoil, one that's claimed the lives of at least 25 airlines worldwide, but all of them relatively small

CONTINUED ON p. 12

Pushing Back: Inside This Issue

America's economically critical financial system isn't working well right now, with trillions of dollars in unwanted mortgage-related assets blocking up markets.

Unfortunately for airlines, the earthquake on Wall Street isn't all that far removed. Leasing giant ILFC is tangled in the mess, and several major airlines depend on business travel by financial institutions for premium revenue. Most ominously, the lockup of credit markets is already causing many businesses and consumers to travel less.

The good news is that many of the largest airlines aren't dependent on capital markets for funding at the moment, having prepared for the storm by stockpiling cash. Those that didn't or couldn't, on the other hand, find themselves with a painful choice: liquidate or consolidate.

That's especially true in Europe, where the competitive landscape is rapidly changing. Alitalia, once and for all, seems ready to die. So does Olympic Airlines. At the same time, Brussels Airlines will sell itself to Lufthansa.

America's competitive landscape is less tumultuous and may even prove more profitable than originally expected. Delta and Northwest both say they'll make money in the third quarter, and most of their rivals see encouraging revenue, oil and capacity trends. ❍

"Verbulence

This is the time Ryanair's been waiting for. We have $2b in cash, we have a lot of cheap aircraft coming to us this winter… [This] will pave the way to enormous growth and profitability in the next couple of years.

—Ryanair CEO Michael O'Leary

Source: Bloomberg News"

High oil prices, weak markets for new capital and an economic recession are finally forcing what long seemed inevitable: the disappearance of many midsized European airlines, either by liquidation or consolidation. In the case of **Alitalia** (see cover story), union intransigence and political bungling prevented promising mergers with **Air France/KLM** and **Air One**, leaving little hope for anything but complete and utter collapse. The story isn't much different in Greece, where government officials finally decided to close **Olympic Airlines** after years of huge losses, crippling debt and illegal subsidies. To placate unions, politicians will again try to re-launch a new **Olympic** without much of the old carrier's dead weight. But the new airline will be much smaller and—if all goes as planned—controlled by the private sector. **Alitalia** and **Olympic** are the largest European airlines to collapse in a year that's also seen the demise of many small carriers like **Futura**, **XL Airways**, **Eos**, **Silverjet**, **EuroManx** and the Anglo-Canadian company **Zoom**.

Others in Europe are disappearing or losing their independence through consolidation. **Brussels Airlines**, a carrier with roughly 50 planes (about 30 of which are older-generation regional jets), sold 45% of itself to **Lufthansa**, already the world's largest airline measured by second quarter revenues. The $100m transaction, importantly, also includes an option for **Lufthansa** to buy the remaining 55% after 2011, upon securing the Belgian carrier's traffic rights outside the E.U. **Brussels Airlines**, itself a product of merging **SN Brussels** with **Virgin Express** in 2006, started life as a carrier designed to replace state-owned **Sabena** when it died shortly after 9/11. The plan now is for **Brussels Airlines** to retain its identity but operate as a subsidiary in the **Lufthansa** group, much like **Swiss**—and also join the Star Alliance. For **Brussels Airlines**, which earned a $36m net profit on $1.4b in revenue last year, the decision to sell seems obvious enough given the increasingly gloomy operating environment. For **Lufthansa**, the Brussels market isn't huge—its main airport handled 18m passengers in 2007—but offers a wealth of government premium traffic and high-yield demand to Belgium's former colonies in Africa. There's also a tangential link to the **Virgin** Group, still shareholders in **Brussels Airlines**—intriguing because of recent buzz about a three-way London venture involving **Lufthansa**, **Virgin Atlantic** and **bmi**.

An even larger mid-sized European carrier, **Austrian Airlines**, is moving closer to selling itself as well. And once again **Lufthansa** may be the buyer. Austria's government named the German carrier a finalist in the bidding, with **Air France/KLM** and Russia's **S7** also in the mix. At stake is a strong hub to regions east of Vienna and **Austrian**'s membership in the Star Alliance. In the meantime, other potential acquisition targets in Europe include **SAS** and **bmi**, which **Lufthansa** holds an option to buy, which **Virgin Atlantic** would love to own and in which Abu Dhabi's **Etihad** is rumored to have interest.

easyJet, having recently bought **GB Airways**, is one European airline unlikely to be involved in any further mergers. But it is likely to meet its pretax profit goals for the fiscal year that ends next September, according to management's statement to investors last week. That's despite the expectation that revenue per seat will continue to moderate because of a weaker U.K. economy and a weaker British pound. As for **Ryanair**, management told its investors to expect a breakeven result for its fiscal year that ends in March. And in an interview with *Bloomberg*

News, CEO Michael O'Leary said three interesting things: 1) he believes more airlines will fail in the coming weeks and months, leading to a further decline in worldwide jet fuel prices, 2) Ryanair remains interested in taking full control of Aer Lingus if its management and E.U. regulators have a change of heart and 3) the weak U.S. dollar provides huge cost advantages with respect to aircraft acquisitions, meaning now may be the time to place another big order.

One final note from Europe: Slovakia's **SkyEurope**, mired in deep losses, received a $14m loan from its largest shareholder, U.S.-based York Capital. The carrier continues to look for more cash to make it through the slow winter season.

Now to the U.S., where all major airlines except **Southwest** presented at a conference hosted by Calyon Securities. Most sounded rather optimistic about unit revenues and forward bookings, with at least two airlines—the soon-to-be combined **Delta** and **Northwest**—expecting third quarter profitability. All spoke bullishly about ancillary revenues and reassuringly about liquidity. **US Airways** was perhaps the most bullish, noting that it's best positioned to benefit from capacity cuts and falling oil prices, based on its domestic-heavy network and older fleet. **US Airways**, along with **Alaska**, also spoke of vastly improved operational performance, while **Delta** and **Continental** both spoke of sustained strength in international markets. **American** seemed most pessimistic, even though its revenue momentum remains strong, reminding investors that the industry was only marginally profitable in 2006 and 2007, when oil prices were much lower than current levels. Its negativity, however, may be motivated by its unwillingness to sound too cheerful while negotiating new contracts with all three of its major unions. Finally, some airlines warned that their fuel hedges were now out of the money.

One U.S. airline not presenting was Ft. Lauderdale-based **Spirit**. But airline investors would probably want to hear what the privately held carrier has to say after a remarkably profitable second quarter. Figures released by the U.S. DOT* show **Spirit** earned an $18m net profit from April to June, along with a 14% operating margin. That ties **Turkish Airlines** for the world's best. What's going on? Though there's not a whole lot of detailed information to analyze, we do know this: **Spirit**'s unit costs actually fell from Q1 to Q2, a highly unusual trend. Unit revenues fell too, also in contrast with its peers, but by less than costs. In addition, fuel accounted for just 33% of overall operating costs—unusual right now particularly for a low-cost carrier—while a boom in traffic to Latin America also helped. So did seasonal trends, with the second quarter always being **Spirit**'s best—last year its Q2 operating margin was 5%. Looking ahead, the biggest risk to **Spirit**'s success may be its troubled labor relations.

Other small U.S. carriers whose financial results were first reported by the DOT* last week include Milwaukee's newly-recapitalized and restructuring **Midwest**, which lost $39m in the second quarter and suffered a dismal negative 18% operating margin. Minneapolis-based **Sun Country** lost $13m net in the same period, but operating margin was only negative 2%. And regional carrier **Air Wisconsin**, which flies for **US Airways**, continued its profitable ways with a Q2 net profit of $11m. Operating margin was 9%.

In South Africa, **Comair**—which operates a **BA** franchise and the low-cost carrier **Kulula**, broke even during the first six months of 2008. For its full fiscal year that began last July, **Comair** reported an $8m net profit. That was down from $14m the year before, when fuel prices were a lot lower, but revenues did increase a healthy 21%. **Comair** is concerned about deteriorating economic conditions but sees a bright future in expansion opportunities throughout Africa as the continent deregulates.

Etihad CEO James Hogan, speaking at the Wings Club in New York, outlined the factors driving the carrier's enormous growth. Among them is geography: Within a three-hour flight from Abu Dhabi are markets with a combined population equal to that of China. Hogan also told *Dow Jones* that advance load factors for the next three months are currently at about 80% and that plans to break even financially by 2010 remain on track. By then, **Etihad** will have 57 planes and another two U.S. destinations in its network. It's also talking to **American** and **United** about codesharing.

**Extracted from the U.S. DOT Bureau of Transportation Statistics by Airports:USA® DataMiner™ a data and consulting service of The Boyd Group, Inc.*

Airlines in the Media

Pablo Yunis, LAN's vice president for North and Central America as well as the Caribbean, tells *The Miami Herald* that his airline remains strong and growth-oriented despite industry turmoil. LAN's large cargo operation, a key component of its overall business, is performing well, and passenger travel—both leisure and business—is holding up well from the U.S. market, helped by the weak dollar (which shifts vacation preferences from Europe to South America and encourages exports). High fuel prices, moreover, are negatively affecting longhaul routes to Europe more than flights from Miami to cities like Lima (its busiest market from the U.S.). LAN doesn't yet serve Brazil nonstop from Miami, but when asked if it one day will, Yunis replied, "definitely, definitely."

The Wall Street Journal describes Air China's efforts to boost premium traffic as a way to offset a growing number of other challenges like high fuel prices. New products and standards helped premium-class load factors rise three points y/y during the first half of 2008, with premium tickets accounting for 15% of the carrier's total revenue. At the same time, the carrier is aggressively cutting costs, and starting next month—according to a new government policy—won't have to pay travel agency base commissions.

Who We Are and How to Reach Us

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SkyMoney

Developments in Airline Finance

- These are turbulent times on Wall St., where powerful institutions are disappearing overnight, begging for bailouts and forced into shotgun mergers. But how is this affecting the airline industry? Most directly, some of these institutions, including the now-deceased Lehman Brothers, are counterparties to airline fuel hedging contracts, though a few carriers downplayed any meaningful impact (in part because many hedge positions are now out of the money as oil prices tumble). More broadly, the immense downsizing of the financial sector's capital base—their mortgage-linked assets are now worth a fraction of their original prices—means less money to loan to companies, especially risky ones like airlines. Obviously, carriers dependent on financial sector business travel like British Airways are disproportionately at risk. And perhaps most ominously, Wall Street's woes may spread more deeply to Main Street, leading to a downward spiral of corporate downsizing and less money for companies and consumers to spend on air travel. This is clearly happening already in many markets, though capacity cuts are cushioning the impact.
- One of the institutions in the headlines last week was AIG, the world's largest insurance company. Its relevance to airlines is, most importantly, the giant aircraft leasing unit it owns (see Fleet Sheet at right). But the federal government's rescue of the firm also brings airlines to mind. Washington essentially did the same thing for AIG (on a much bigger scale) that it did for the U.S. airline industry after 9/11: provide emergency loans in exchange for equity. Remember the ATSB (Air Transportation Stabilization Board)? Incidentally, taxpayers wound up profiting handsomely from most of those transactions as loans were repaid and equity prices rose.
- In a move that resembles Italy's Alitalia policy for so many years, India's national government will pump about $200m into Air India.

Fleet Sheet

Developments in aircraft markets

- ILFC is by some measures the largest aircraft leasing company in the world, with a fleet (as of June 30) of 947 planes and 179 more on order (including ten A380s and 74 B787s). But it's wholly-owned by AIG, the insurance company now embroiled in crisis. Fortunately, ILFC has nothing to do with its parent's problems—those were about insurance contracts for nearly $60b worth of mortgage-related losses. The leasing market, unlike the housing market, is performing well, and ILFC should easily find a new owner, perhaps a group of its executives or a sovereign wealth fund. During the second quarter, ILFC posted a $214m net profit on $1.3b in revenues. Though based in Los Angeles, roughly 90% of ILFC's revenue comes from airlines outside of the U.S.
- jetBlue will slow its fleet growth once again, this time by providing six E190s to Azul, David Neeleman's soon-to-launch airline in Brazil. Two of the six will be leased directly to the airline while the other four will be sold to leasing company Jetscape, which will then lease them to Azul.
- Air Caraibes, based in the French Caribbean, signed a memorandum for three A350-1000s, the largest version of the new-generation plane. They'll be used to serve Paris from Guadeloupe, Martinique and French Guyana. The carrier currently has three A330s, with three more on the way.
- Airbus delivered two more A380s last week: unit number six for Singapore Airlines and unit number one for Qantas.
- Small and midsized European airlines are an endangered species. But there are still plenty of them. Montenegro Airlines hopes to stay alive in part by taking on a new E195, which will be used for destinations like London and Moscow. The deal with Embraer also includes purchase rights for two additional units.

AIRBUZZ

MARKETING, PRICE & PROMOTION

- When will carriers begin lowering fares in response to lower fuel prices? It's starting to happen already in Canada, where WestJet is completely eliminating the fuel surcharges it first introduced just four months ago. Air Canada, meanwhile, will also remove separate fuel surcharges on North American flights, though base fares will continue to vary with fuel costs. In addition, it will no longer charge for checking a second bag, and excess baggage fees will be levied in a more simplified manner.
- South of the Canadian border, carriers continue to move in the opposite direction. United is now doubling its fee for checking a second bag from $25 to $50. United said last week that bag fees will generate about $300m in incremental revenue next year, part of a $1b pot of ancillary revenues. Many of United's rivals are also expressing revenue bullishness with respect to new ancillary initiatives.
- Malaysia Airlines and Etihad signed a codeshare agreement that will extend each carrier's reach into the other's home market. Malaysia Airlines will place its code on Etihad's from Abu Dhabi to Bahrain, Doha and Muscat, while Etihad will place its code on Malaysia's flights from Kuala Lumpur to Penang, Kota Kinabalu, Kuching and Langkawi. Nether carrier belongs to an alliance.
- Cebu Pacific of the Philippines is now allowing passengers to reserve their seats in advance for a fee, with front and exit row seats costing extra. Travelers may also prepay for excess baggage before arriving at the airport, receiving a discount if they do.

THE BACKEND

SALES, DISTRIBUTION & CORPORATE TRAVEL

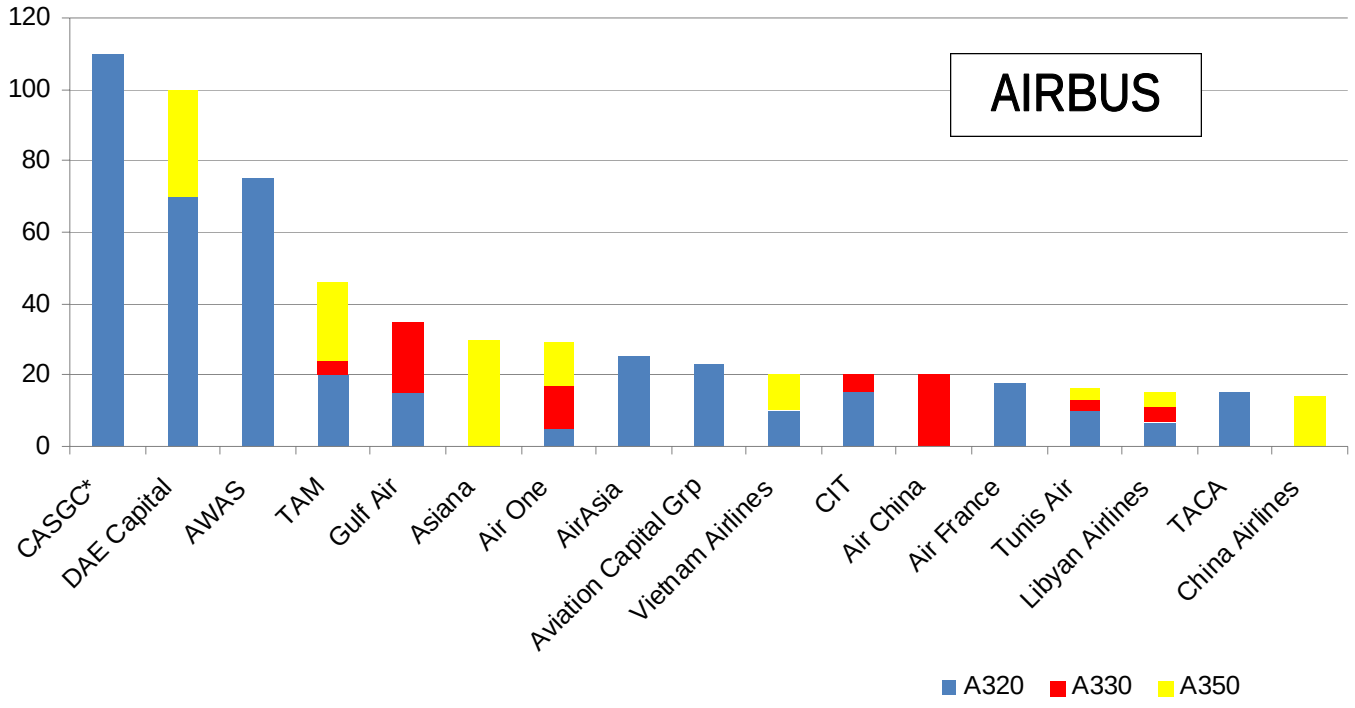
- To no one's surprise, the cost of premium travel is down significantly between London and the U.S., an open skies market since late March. Data from travel management giant American Express shows published business-class fares from London to New York JFK down 25% from the first quarter to the second. London-Newark fares dropped 24%, while London-Los Angeles and London-Seattle fares fell 9%. As for leisure fares, the decline was even more pronounced. The lowest economy fares for travel between all of the U.K. and all of the U.S. plummeted 49% in the second quarter versus the first. Fares may begin to rise again, however, as carriers reduce capacity.
- WestJet joined the growing list of companies signing up to use GuestLogix inflight retail technology. The handheld devices used by flight attendants to collect money from passengers accept both cash and credit cards, as well as coupons, vouchers and other forms of payment. One of the big advantages of such technology is its ability to keep an accurate accounting trail of all sales.
- Though it's generally not high-yield traffic, many airlines get a sizeable amount of traffic from conferences and conventions. Organizers, in fact, often negotiate special discounted rates for attendees. But as *The New York Times* points out, some of these events are suffering as air service cutbacks make them more difficult and costly to attend. One meeting manager talked about a recent conference where attendance was down 30% because—her market research concluded—people couldn't find "convenient, direct flights at a reasonable price."

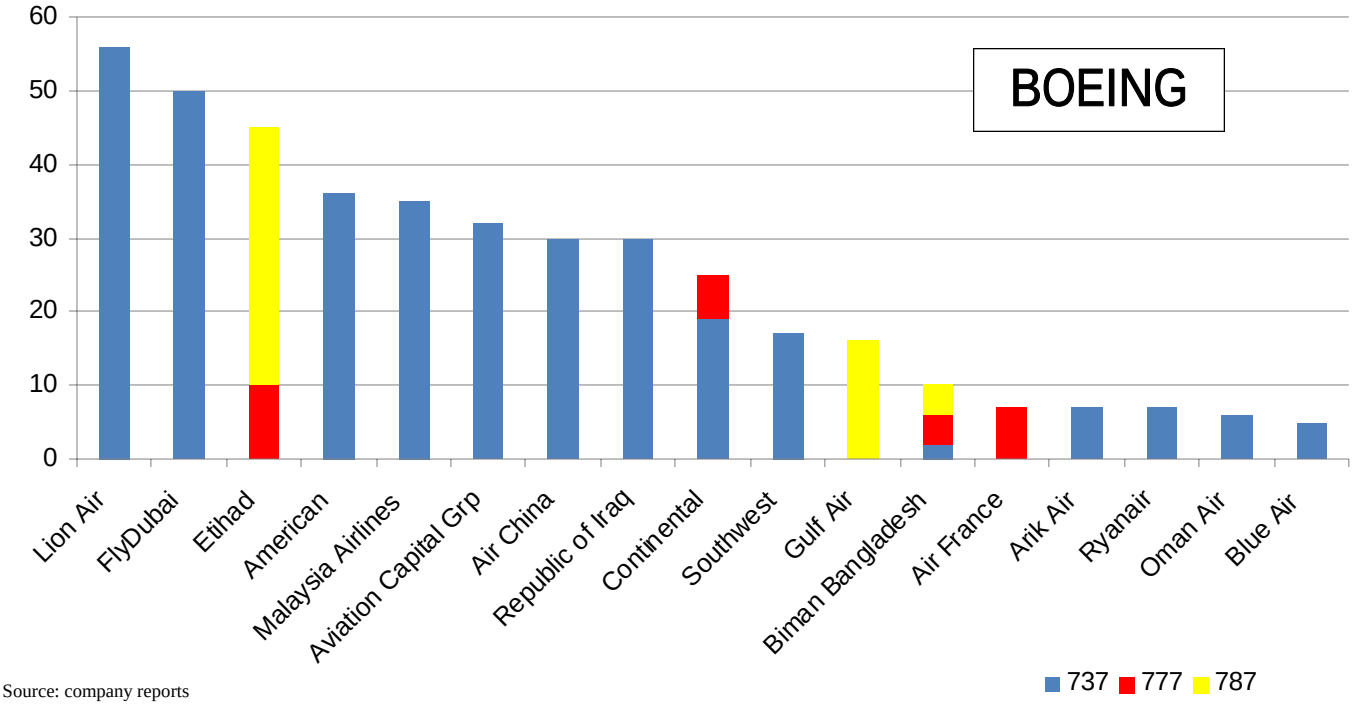
Biggest Plane Orders of 2008, So Far

Airbus has received net orders for 708 planes so far this year (Jan. 1 to Aug. 31)

Boeing's net figure is 586 (Jan. 1 to Sept. 9)

Note: CASGC is the Chinese Aviation Supplies Import & Export Group Corporation, a central-government controlled entity that purchase planes on behalf of the nation's airlines





Source: company reports

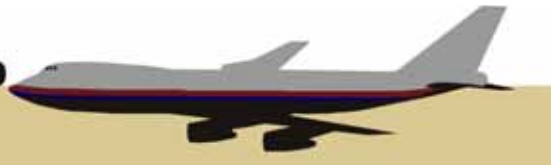
State of the Unions

WORKFORCE DEVELOPMENTS

- Finnair remains a holdout in the European scramble to consolidate. It believes it can stay profitably independent and ride out the current market turbulence in part by reducing labor costs. But not if the company's seven unions can help it. Last week worker representatives rejected all three of the company's proposals to save about $40m annually, which management says could have averted the loss of 400 jobs. Finnair managed to stay profitable during the first two quarters of this year, which is pretty good, all things considered. But operating margin ex special items for the period was just 1%, hardly enough to inspire confidence. If the third and fourth quarters generate weak financial results, government officials may begin to consider a selloff, if they haven't begun to do so already.
- Aer Lingus hasn't yet announced its latest cost-cutting plan—yes, another one—but labor unions are already getting antsy. The airline is reportedly considering a plan to outsource a large chunk of its ground handling. Like Finnair, Aer Lingus is a mid-sized European carrier clinging to its independence.
- Pilots at state-owned Royal Air Maroc remain locked in a tense struggle with management over pay and work conditions. Among the topics of contention are moves to push more flying to the carrier's lower-cost Atlas Blue unit.
- American's pilot union is asking the U.S. government to hold off on approving antitrust exemption for the carrier's alliance with British Airways and three other oneworld members, citing the need to carefully evaluate the implications for "national security, competitiveness and outsourcing issues." The Allied Pilots Association (APA) fears that the alliance might push the most lucrative international flying and best growth opportunities to partner airlines with the lowest labor costs, thereby denying growth opportunities to American pilots. But American's lack of antitrust authority with its key transatlantic partners is a major impediment to growing revenues, the key source of money to pay its workers. The record (including cases like Northwest-KLM, United-Lufthansa and Air Canada-Lufthansa) seems to suggest that both carriers benefit when networks are combined and made more efficient—in other words, a one-plus-one equals three outcome. The APA, though, doesn't see it that way.

The Landing Strip

Airport Developments



- Hong Kong's airline market certainly wasn't immune to the slowdown in mainland China. August traffic there fell 5% y/y in August, reflecting a drop in visitors to the city. Mainland visa tightening related to the Olympics was also a factor, as was the city's large exposure to the battered global financial markets. Traffic year to date through August, however, is still up 5% y/y. Separately, Hong Kong's government-controlled airport authority is undertaking early feasibility studies for a third runway.
- South Africa isn't insulated from the worldwide slowdown in air traffic either—passenger totals at Johannesburg's Or Tambo International airport are down 1% y/y through July. After starting the year with three consecutive months of growth, the airport's April traffic was flat y/y, May was down 2%, June was down 4% and July was down 6%—not an encouraging trend. What's behind the contraction? The responsibility lies with domestic traffic, which is down 6% so far this year (though July) and by double digits from May to July. Domestic passengers, by the way, account for 55% of the airport's total. As a reminder, traffic at Or Tambo grew between 9% and 11% during the past few years, making it one of the world's fastest-growing major markets. That explains why the airport opened a new international terminal earlier this month.
- In Cape Town, South Africa's second busiest market—and one that has also grown by double digits during the past few years—traffic is also shrinking. Passenger totals dropped from year-ago levels during the second quarter and fell 8% in July alone. Here, too, the cause is a domestic slowdown.
- Russian airports, by contrast, are still growing fast. Traffic is up 16% year to date through August, propelled by soaring energy exports. The outlook may change, however, as oil prices plummet and Russia's financial markets swoon (see below for busiest Russian airports this year through July).
- Spain's Ferrovial says it will begin the process of selling London Gatwick airport, a decision motivated by antitrust objections to its control of London's three busiest airports. The Virgin Group, Fraport and Singapore's Changi Airport are some possible buyers, though formal bidding isn't yet underway.
- A *New York Times* article last week, quoting a representative from the Air Transport Association, said there are roughly 600 airports in the U.S. with scheduled air service. But the number will be reduced by 97 because of airline capacity cuts, according to the ATA.

Russia's Ten Busiest Airports

Ranked by passengers handled, January-July 2008; all figures in m

Rank	Airport	Domestic	Int'l	Total	Top airline
1	Moscow DME	5.0	6.9	11.9	S7
2	Moscow SVO	2.9	5.7	8.6	Aeroflot
3	Moscow VKO	2.9	1.7	4.6	Utair
4	St. Petersburg	1.9	2.1	4.0	Rossiya
5	Yekaterinburg	0.8	0.6	1.4	Ural Airlines
6	Novosibirsk	0.9	0.2	1.1	S7
7	Kaliningrad	0.7	0.3	1.0	KD Avia
8	Sochi	0.8	0.1	0.9	S7
9	Krasnodar	0.8	0.1	0.9	Kuban
10	Samara	0.6	0.2	0.8	Utair

Source: Russian Transport Clearinghouse; top airline column based on OAG schedule data for October 2008

WHO'S FLYING WHERE

- Watch out **Spirit**: **jetBlue** likes your idea—apparently very profitable—of flying to the Caribbean from Ft. Lauderdale. This winter, the New York City-based airline will connect southeastern Florida with San Juan, Puerto Rico. In a press release announcing the move, **jetBlue** implicitly pointed to **Spirit**'s limited amenities: "On most airlines, you get what you pay for. On **JetBlue**, you get more." So is this the start of a Caribbean strategy from Ft. Lauderdale? Or merely an opportunity for **jetBlue** to take advantage of **American**'s pulldown in San Juan and Puerto Rico's aggressive route subsidies to airlines? Looking even beyond that, could **jetBlue** and **Spirit** be potential merger partners someday? Their route networks, fleets and cost structures seem to fit well together, though concerns in the area of labor relations would be a major obstacle. Their products, too, are quite different, to say the least: **jetBlue**—with ample legroom, satellite TV and free snacks—has a loyal following, whereas any loyalty to **Spirit** is driven by its low fares.
- **Air Arabia** hasn't forgotten about plans to launch a base in Morocco's capital Rabat. According to *Khaleej Times*, the Sharjah-based LCC will launch operations there later this year or early next. It hopes the venture works out better than the **FlyYeti** operation it started in Nepal earlier this year, which was forced to shut down because of excessive political interference. **Air Arabia** also says it may place more A320 orders to support the needs of its new Moroccan unit.
- In their quest for some wintertime sun, Russians will now have the option of flying to Bangkok on **S7 Airlines**. Starting in December, the carrier will fly to Thailand's capital from Moscow DME three times a week with B767-300ERs. **S7** also serves Bangkok from Novosibirsk and Irkutsk, both in Russia's famously cold region of Siberia. The Russian government, by the way, owns 25% of **S7**.
- **Singapore Airlines** wants to fly from Hong Kong to New York JFK, according to the *South China Morning Post*. But **Cathay Pacific** will naturally lobby its government hard to prevent that from happening, especially now that it's losing money.
- Minneapolis-based **Sun Country** applied for rights to fly from Milwaukee to various Mexican sunshine destinations for the winter. Among them are Cancun and Puerto Vallarta.
- Like its fellow ASEAN-based LCCs **AirAsia** and **Tiger Airways**, **Cebu Pacific** continues to expand rather than retreat despite market turmoil. **Cebu**'s latest route is Manila-Osaka, which will operate three times weekly starting in November. Osaka is the carrier's first destination in Japan, which only recently liberalized access to its markets—those except Tokyo anyway. Though culturally-homogenous Japan doesn't have a large population of foreigners, it does host a sizeable number of Filipino workers.
- **TAM** began flying nonstop from Rio de Janeiro to Miami with B767-300s. Rio-New York JFK flights, also with B767-300s, begin Nov. 1.
- **Jet Airways** continues to build its Arabian Gulf network with the launch last week of B737-800s service to Muscat, in Oman, from Thiruvananthapuram in the southern Indian state of Kerala.

Q2 Financial Results: Europe on the Eve of More Consolidation

Lufthansa one of the best performing global airlines in the world; now emboldened to get bigger through acquisitions
Air France/KLM, helped by strong fuel hedges like its Big Three peers, posts solid springtime results
British Airways troubled by open skies, a weaker pound and weakening economic fundamentals in the U.K. and the U.S.
SAS manages a small profit ex special items but nowhere near enough to offset big Q1 losses; finally seems resigned to sell itself
Iberia, burdened by Spain's weakening economy, dips to a small operating loss, ex special items, just as it prepares to merge with BA
Air Berlin, helped by timely fuel hedges, did relatively well in Q2; still, however, faces balance sheet concerns and longhaul uncertainties
Turkish Airlines, though active in Europe, surrounded by fast-growing regions as well; had the best Q2 operating margin of any airline worldwide
Ryanair, last year's profit champion, pounded disproportionately by high fuel; made bad hedge bets
Austrian, now up for sale, posts surprisingly good Q2 numbers; indicates restructuring plan is bearing fruit
Finnair still making money and holding onto its independence; relaxation of Chinese visa restrictions later this year may provide some help
Norwegian, despite its country's oil wealth, hasn't found a way to consistently make money; carefully watching events at SAS
Aegean performing extremely well and about to get a big boost when bloated Olympic finally gets the hell out of its way
Vueling showing some improvement but still mired in losses; merger with Iberia-backed Clickair may help
SkyEurope scraping by with more cash from core investors; now exploring strategic alternatives; are its days numbered?
Aer Lingus, which had a good 2007, now finds itself in a hole that's getting deeper; will it finally accept Ryanair's overtures?
CSA Czech, yet another airline expected to put itself up for sale, shows meaningful turnaround progress

	Lufthansa	AF/KLM	British Air.	SAS	Iberia	Air Berlin	Turkish	Ryanair
April-June 2008 (3 months)								
Operating revenues (m)	$10,108	$9,825	$4,518	$2,810	$2,166	$1,359	$1,323	$1,214
Operating expenses (m)	$9,280	$9,459	$4,448	$2,818	$2,142	$1,338	$1,135	$1,202
Operating profit/(loss) (m)	$828	$366	$70	($8)	$23	$22	$188	$13
Operating profit ex special items (m)	$828	$366	$70	$59	($6)	$45	$188	$41
Net profit/(loss) (m)	$541	$263	$54	($65)	$33	$13	$108	($141)
Net profit ex special items	$541	$263	$54	$42	$4	$42	$108	$33
Operating margin	8.2%	3.7%	1.5%	-0.3%	1.1%	1.6%	14.2%	1.0%
Net margin	5.3%	2.7%	1.2%	-2.3%	1.5%	1.0%	8.2%	-11.6%
Operating margin ex special items	8.2%	3.7%	1.5%	2.1%	-0.3%	3.3%	14.2%	3.3%
Net margin ex special items	5.4%	2.7%	1.2%	1.5%	0.2%	3.1%	8.2%	2.7%

	Austrian	Finnair	Norwegian	Aegean	Vueling	SkyEurope	*Aer Lingus*	*CSA Czech*
April-June 2008 (3 months)							*JAN-JUN*	*JAN-JUN*
Operating revenues (m)	$1,045	$853	$298	$257	$175	$106	*$989*	*$657*
Operating expenses (m)	$1,006	$820	$312	$238	$194	$128	*$1,023*	*$645*
Operating profit/(loss) (m)	$39	$33	($14)	$19	($19)	($22)	*($34)*	*$12*
Operating profit ex special items (m)	$39	$8	($14)	$19	($19)	($22)	*($34)*	*$12*
Net profit/(loss) (m)	$19	$22	($12)	$15	$0	($27)	*($33)*	*($10)*
Net profit ex special items	$19	($3)	($12)	$15	($70)	($27)	*($5)*	*($10)*
Operating margin	3.7%	3.8%	-4.7%	7.3%	-10.7%	-20.6%	*-3.4%*	*1.8%*
Net margin	1.8%	2.6%	-4.0%	6.0%	0.0%	-25.0%	*-3.3%*	*-1.6%*
Operating margin ex special items	3.7%	0.9%	-4.7%	7.4%	-10.9%	-20.7%	*-3.4%*	*1.8%*
Net margin ex special items	1.8%	-0.4%	-4.0%	5.8%	-40.2%	-25.4%	*-0.5%*	*-1.6%*

Source: company reports & Airline Weekly analysis; all figures are converted at current exchange rates; note that Alitalia, whatever's left of it, hasn't yet reported Q2 results

AROUND THE WORLD

A LOOK AT THE WORLD'S AIRLINES, INCLUDING ENDWEEK EQUITY PRICES

Airline	Price	Last Wk	Last Yr	Comments
American	12.94	10.39	24.26	Says advance bookings are on par with last year's levels but with fewer seats
United	13.24	11.36	46.01	What credit crunch? New financing arranged with JP Morgan Chase, its credit card partner
Delta	9.67	8.08	17.56	Expects a third quarter operating margin of between 1% and 3%
Northwest	11.53	9.85	16.95	Expects a third quarter operating margin of between 4% and 5%
Continental	18.40	18.95	32.70	Impact of Hurricane Ike expected to be about $50m
US Airways	7.91	7.88	29.39	Says the recent $50 drop in oil prices will improve earnings by $1.7b annually
Southwest	15.68	16.19	15.34	Oil has a lot further to fall before its hedges lose their value
Alaska	21.78	23.19	24.19	Not cutting capacity on Seattle-L.A. & S.F. routes, where it competes with Virgin America
jetBlue	5.78	6.00	9.45	Largest unit revenue gains coming from Caribbean markets as rivals like American exit
AirTran	2.75	2.69	10.36	Grew much faster than the rest of the industry during the first half of the year
Frontier	0.17	0.28	6.06	Denver airport traffic still up 4% y/y in July thanks to Southwest's expansion (up 87%)
SkyWest	18.57	19.02	25.14	Delta undecided on how to structure its regional operation post merger
Mesa	0.43	0.47	4.90	China venture disappointing: loads at Kunpeng Airlines much lower than expected
Republic	11.73	11.69	21.80	Will its strong profit margins fall as legacy carriers reduce some regional flying?
ExpressJet	0.22	0.28	3.62	August system load factor was 80%
Pinnacle	5.11	4.82	16.22	Still no new developments with respect to long and frustrating pilot negotiations
Air Canada	4.66	4.37	12.75	Said fuel hedges were, two weeks ago, still at below market prices but not by much
WestJet	13.54	14.60	17.45	Says new advance seat assignment fees doing "very well"
LAN	7.99	8.25	11.43	Strong Latin currencies influencing international passenger and cargo flows
TAM	38.10	38.44	48.00	Approximately 50% of its costs exposed to foreign exchange fluctuations
Gol	8.19	9.15	23.28	New rival Azul launches website: www.voceescolhe.com.br
Copa	35.94	40.38	45.69	Will fly to 45 destinations in 25 countries by year end
Emirates	(not publicly traded)			Will it decide to sell shares to the public if equity markets improve?
Air Arabia	1.39	1.38	1.19	The Arabian Gulf certainly not immune to a worldwide recession
Turkish Airlines	6.40	7.15	9.00	36% of its costs, but only 8% of its revenues, in U.S. dollars; likes when the dollar is weak
Kenya Airways	46	48	74	Plans to launch flights to the Congo (Brazzaville)
Jet Airways	436	516	907	SpiceJet still interested in merging with Jet or Kingfisher, according to *Livemint.com*
Crude oil futures (for delivery next month; source: New York Mercantile exchange)	$105	$101	$82	GM unveils the Chevy Volt, a car (expected to hit the market in a few years) that runs mostly on electricity rather than petrol. It won't be cheap though. Of the 20.7m barrels a day of oil used by Americans in 2007, 9.3m were used as motor gasoline and 1.6m as jet fuel (*EIA*).

Note: several stocks traded on multiple exchanges; not intended for trading purposes

Around the World

A Look at the World's Airlines, Including Endweek Equity Prices

Airline	Price	Last Wk	Last Yr	Comments
British Airways	219	258	375	Not eager to see Lufthansa join forces with bmi and/or Virgin Atlantic
Air France/KLM	16.50	17.65	24.73	Still says it will maintain original profit target for the current fiscal year despite slowdown
Lufthansa	15.19	15.04	19.59	Brussels Airlines has just four widebodies; A330-300s used for African routes
Iberia	1.99	2.07	3.29	Longhaul traffic now represents almost two thirds of total RPKs
SAS	57.50	55.25	114.75	Would Lufthansa or any other potential buyer keep all 8 airline units, each with its own hub?
Austrian	5.84	6.17	7.13	August traffic figures show a y/y decline on "Focus East" routes for the first time
Alitalia	x	x	0.83	Thanks for the memories
Finnair	4.60	4.58	11.71	Reportedly interested in buying longhaul routes from SAS if they're willing to sell (*Reuters*)
Aeroflot	2.50	2.50	2.97	Will stop allowing independently owned Aeroflot Don and Nord to use its brand
Aer Lingus	1.59	1.58	2.38	Codeshare with United starts Nov. 1; jetBlue cooperation started in April
Virgin Atlantic	(not publicly traded)			Will start a major ad campaign to block BA/AA alliance
easyJet	396	339	511	47% of its passengers originate outside the U.K.
Ryanair	2.59	2.57	4.99	Not impressed by BAA's decision to sell Gatwick; wants it to sell Stansted
airberlin	3.83	4.03	12.56	Deliveries outstanding as of Jun 30: 98 B737s, 34 A320s, 25 B787s and 10 Q400s
SkyEurope	0.55	0.55	2.62	Introducing flexible fares catering to business travelers
Japan Airlines	226	225	256	Now expects to receive its first B787s next Oct., though Boeing strike makes dates uncertain
All Nippon	392	378	446	Japan updates air bilateral with Singapore and four Scandinavian countries
Singapore Airlines	7.36	7.72	8.60	All regions experienced y/y August load factor declines; largest was in the Americas
Cathay Pacific	13.56	14.76	22.70	Beginning to see weakness in corporate demand
Korean Air	35.77	38.82	69.38	Korean won continues to lose value versus the U.S. dollar; bad for Korean Air's cost base
Air China	3.48	3.65	11.84	Scrapping plans, for now, to buy China Eastern
China Eastern	1.32	1.45	9.72	Government lowering interest rates; could help demand but may depreciate currency
China Southern	1.62	1.72	13.90	SkyTeam offering discounted multi-trip passes for travel within China
Malaysia Airlines	3.58	3.76	4.26	Busy festival season (Hari Raya Aidilfitri) coming up later this month and into October
AirAsia	1.20	1.18	1.84	Tiger boosting flights to Thailand as other LCCs cut capacity or disappear
Thai Airways	13.20	14.80	41.75	Recently exited the Bodhgaya and Varanasi markets, both religious pilgrimage sites
Qantas	3.33	3.54	5.55	Trying to reassure its best customers after numerous highly publicized safety incidents
Virgin Blue	0.44	0.53	2.30	Brisbane airport, where traffic was growing 7% y/y, grew just 1% in August
Air New Zealand	0.90	0.88	1.90	Advance bookings weak on European routes relative to Asian and Australian routes

Note: several stocks traded on multiple exchanges; not intended for trading purposes

Life After Alitalia: *Carrier unlikely to escape its latest near-death experience; who will fill the void?*

CONTINUED FROM p. 1

compared to Alitalia. Its death would have a much bigger impact, including the disappearance of roughly 175 airplanes and about 500,000 seats per week. Even when Swissair collapsed shortly after 9/11, the impact wasn't as dramatic because a new airline (Swiss International) was formed to take its place. Same for Belgium's Sabena when the creation of SN Brussels followed its collapsed.

Naturally, rival airlines will be eager to fill the Alitalia vacuum. Italy's domestic air transport market is the third largest in the European Union, behind only Spain and France, and the country is the fourth most visited in the world. Its economy, moreover, is larger than all but six other countries and is heavily dependent on international trade. In 2007, the Italian airline market generated 76m passengers, including nearly 5m each to and from the Americas, Asia and Africa. Eight Italian airports handled more than 5m travelers last year—three facilities in Milan, two in Rome and one each in Venice, Sicily and Naples. Growth was healthy last year as well, with total traffic up 8% versus 2006.

The spoils of this rich Italian market, in the wake of Alitalia's demise, could go to Air One. But that's not inevitable. Though perhaps arm-twisted by politicians to participate in the latest Alitalia restructuring, Air One might have improved its strategic position had the merger come to pass. The plan would have created a largely debt-free and cost-efficient airline with new planes and a tight grip on lucrative markets like the one between Rome and Milan. Left on its own, however, Air One is a mid-sized carrier with $1.2b in annual revenue (compared to $33b for Lufthansa and Air France/KLM) and presumably a lot of debt, though it hasn't published any recent balance sheets. In 2007, when industry conditions were relatively favorable, it managed a net profit margin of less than 1%.

Fortunately, Air One does have aircraft on order, including 45 more A320s, ten A330-200s and—looking far ahead—12 A350s. Provided it can finance these deliveries despite tight credit conditions, Air One may be able to jump on Alitalia's abandoned routes relatively quickly. It may decide to buy some of Alitalia's planes and hire some of its workers as well. Already, Air One is starting to fill the Alitalia vacuum left at Milan Malpensa by launching flights to Boston and Chicago. It has also expanded aggressively within Italy and Europe during the past few years, contributing to Alitalia's woes. But such aggressive expansion entails considerable risk. In the meantime, other Italian carriers like Sardinia-based Meridiana (and its partner Eurofly) and WindJet, an LCC whose traffic jumped 20% y/y in August, will also be trying to fill the void.

Perhaps the biggest uncertainty centers on Alitalia's longhaul routes, now flown mostly from Rome.

Non-Italian low-cost carriers like Ryanair and easyJet will find big expansion opportunities as well. Ryanair will be Italy's largest airline by passenger count if Alitalia disappears, and airports around the country are asking it for more service. It already has bases in Milan Bergamo, Rome Ciampino and Pisa and nearly entered Milan Malpensa earlier this year before failing to reach an agreement with the airport on fees and charges. easyJet, also growing rapidly in Italy, does operate a base at Malpensa, one of its top strategic priorities. Capacity this winter will be nearly double last year's levels. It's already the busiest carrier at the airport, and load factors are running about 20 points higher than Alitalia on routes where they compete. Other major LCCs serving Italy include Air Berlin, Vueling/Clickair, Wizzair and SkyEurope.

An Alitalia collapse would also have major implications for SkyTeam, which depended on it for access to Italy's smaller markets. This was one reason why Air France/KLM offered to buy Alitalia earlier this year, and why it may now decide to expand in Italy on its own. Lufthansa, which makes no secret of its desire to capture lucrative Italian business traffic through its German and Swiss hubs, is already doing just that. With the help of its wholly owned Italian regional subsidiary Air Dolomiti, the German carrier will base six A319s at Malpensa this winter. The slower growing and less aggressive British Airways may have some Italian maneuvers up its sleeve as well.

Perhaps the biggest uncertainty centers on Alitalia's longhaul routes, now flown mostly from Rome. Will Air France/KLM, Lufthansa or BA try to fly to the U.S., for example, from Italy now that open skies allows that? Speaking of which, OpenSkies the airline, BA's new premium longhaul unit, has mentioned Milan as a possible base for New York flights. Other busy longhaul markets to and from Italy include Brazil, Japan and China, which are all currently served by Alitalia. Its collapse, therefore, may open some opportunities for airlines like TAM, LAN, JAL, ANA, Air China and Korean Air. Medium-haul international routes to Turkey, Egypt, Russia, Israel, Tunisia and the UAE, all high-volume markets from Italy, will also be up for grabs. Nevertheless, Italy stands to lose a significant amount of international capacity in the short term, which could have a negative economic effect. Then again, subsidizing Alitalia to operate those flights has an adverse economic effect as well.

Throughout the past decade, Italian air travelers received more shorthaul service for lower fares thanks to the entrance of airlines infinitely more efficient than Alitalia. The impact has been less profound, however, on intercontinental flights because rival carriers didn't have the resources, appetite for risk, airport assets or even the legal right to establish the large hub networks necessary to profit. Unlike Ryanair's flights between Rome and London, for example—which can operate without connecting traffic—flights between Rome and the Americas or East Asia require a substantial feeder network. With Alitalia out of the way, one of two things will happen: Either another carrier like Air One or Lufthansa will recreate hubs in Rome and Milan, or Rome and (more likely) Milan will go the way of shuttered midsized U.S. hubs like Pittsburgh.

Whatever happens, the death of Alitalia would prove beneficial to industry yields in the short run. Average fares on routes to and from Italy would surely increase, and aircraft prices might even fall as more planes get dumped on the market. All of that lucrative Italian premium traffic coveted by Europe's Big Three—especially from wealthy northern industrial regions—would be diverted through hubs like Paris, Frankfurt and even Helsinki. If markets calm a bit, entrepreneurs may even step in. The scenario looks quite good for Europe's survivors. Even if Alitalia is salvaged, it won't be as big as it was before.

But opportunists should keep a few things in mind. For one, Italy's economy is in recession, which may limit the ability to profit from Alitalia's routes. Markets like Rome and especially Milan are divided into multiple airports, making it hard to concentrate and amass connecting traffic for longhaul flights. And Italy has bad geography for key Asian markets and few of the overseas ex-colonial links so critical to the fortunes of other European air markets. Finally, and perhaps most importantly, Italy has politicians that just can't seem to let go of Alitalia. Though its prospects look dimmer by the hour, the story is not over until the planes stop flying.❍