



Lufthansa Consulting

**Current Trends in The Airline Industry
– A Global Perspective**



Welcome

Disclaimer

This document was created for the exclusive use at the AVMAN CEO Conference “The Glass is half Full”, held in Miami 01-02 MAY 2006. It is only complete in conjunction with the underlying detailed analysis and the oral presentation by Lufthansa Consulting.

The opinions expressed are those of Lufthansa Consulting GmbH, not necessarily those of Lufthansa German Airlines and/or its affiliates/partners.

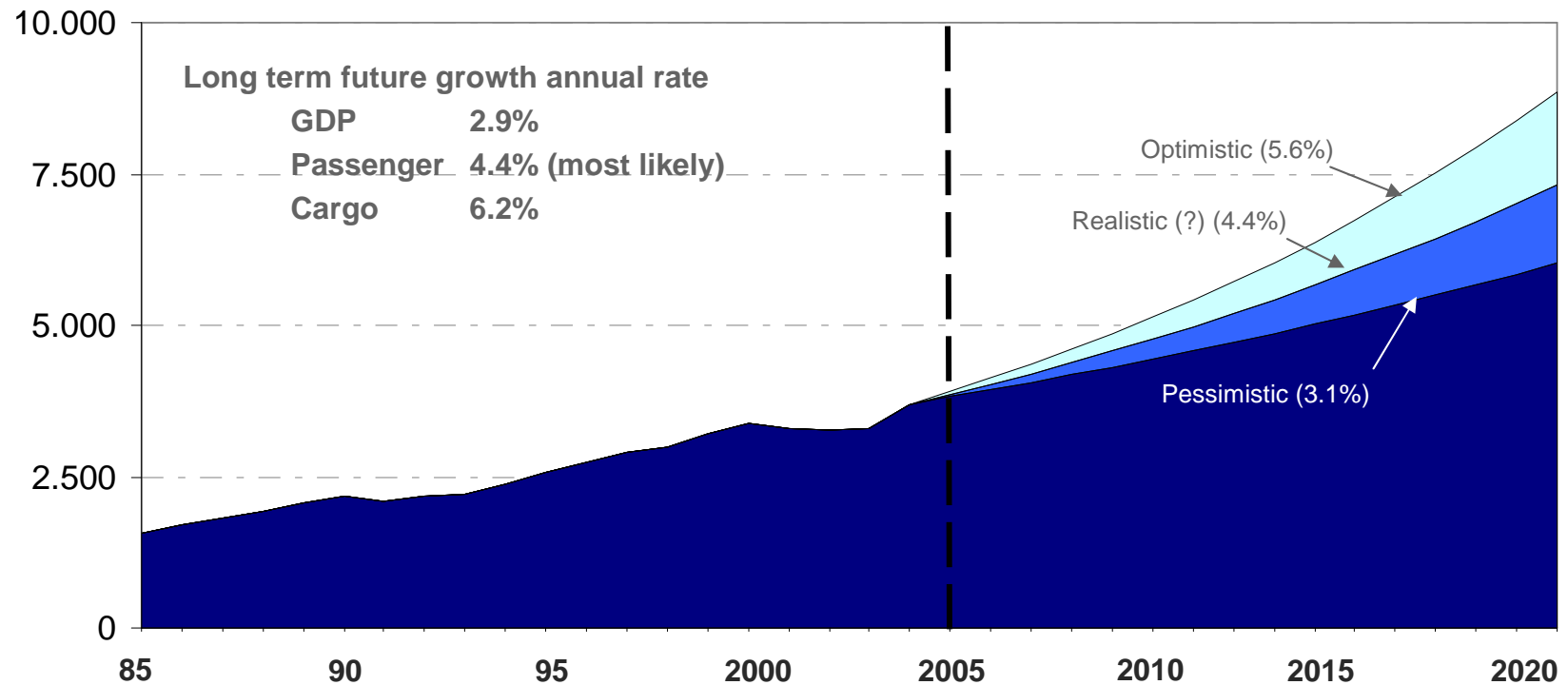
.

1. The airline business – an attractive industry....?
2. Three elements of an airline strategy

RPK annual growth is estimated at 4,4% until 2020 – equal to 1,5% points above the average GDP growth (World)

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RPK development since 1985 (billions)



Note:

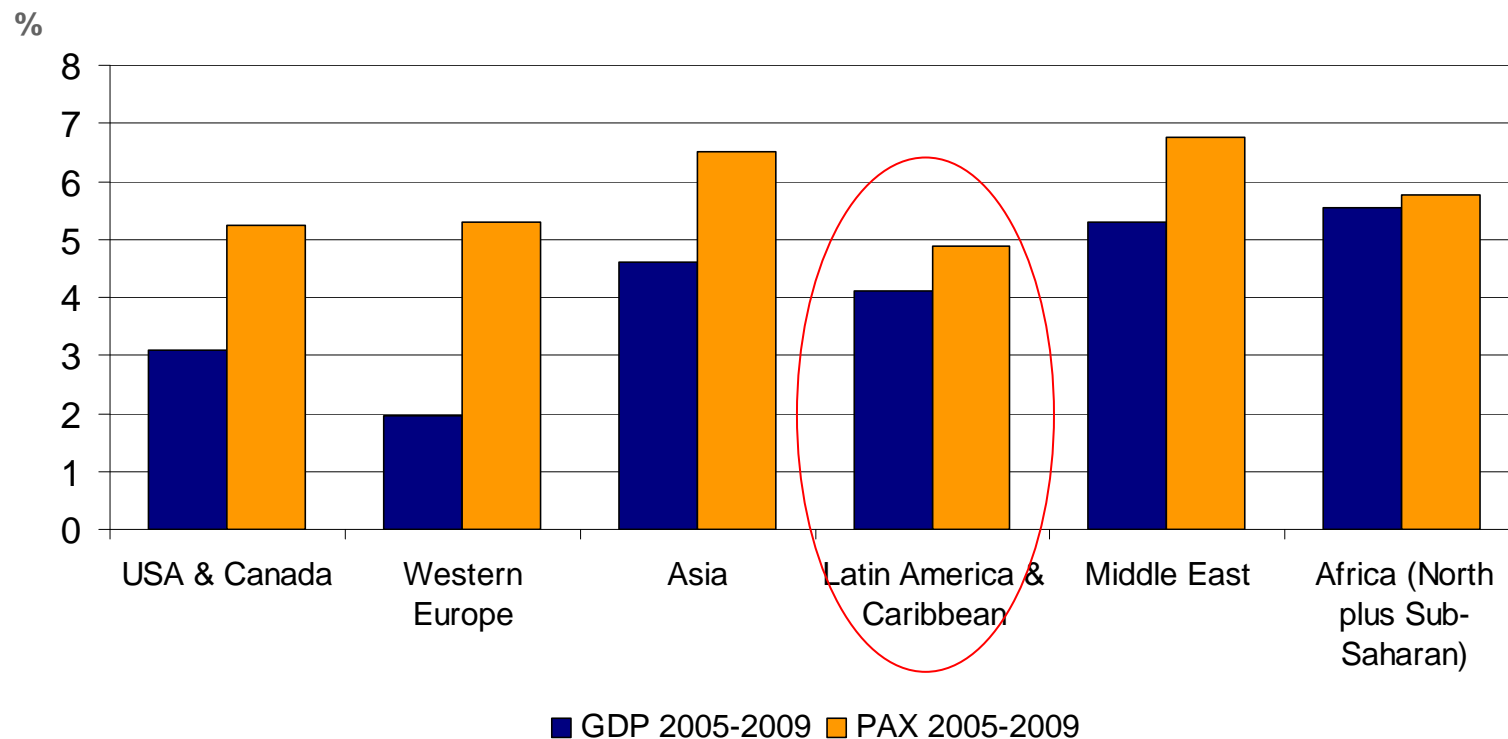
1. The pessimistic and optimistic are according to ICAO estimates.

Source: ICAO (<http://www.icao.int/icao/en/atb/fep/Longterm.htm>)

Forecasts imply that PAX growth in Latin America and the Caribbean will closely correlate GDP performance.

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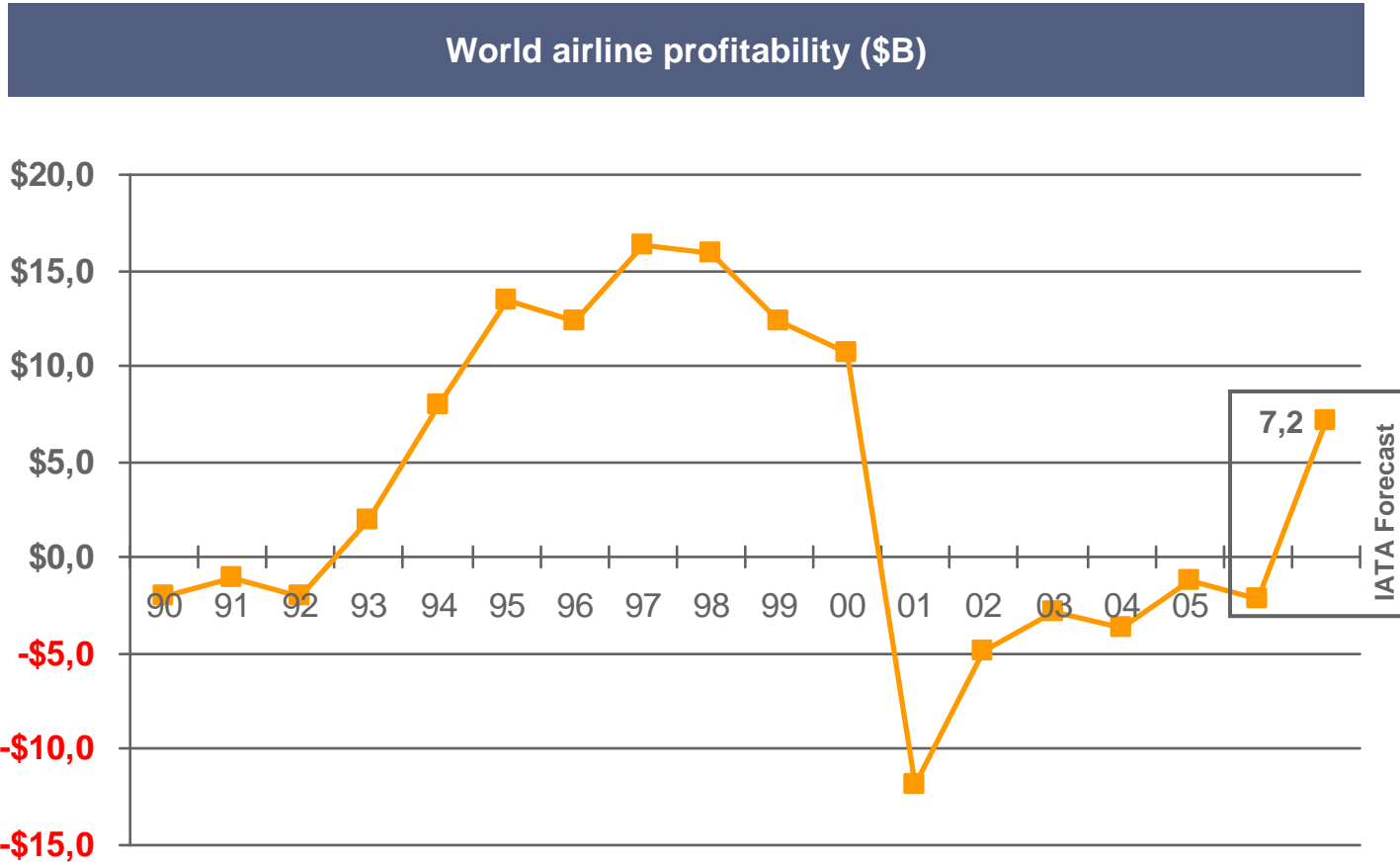
GDP vs Passenger Development (2005-2009)



Source: Global Insight, Airport-Information.com (2006)

World airline profitability is projected to go into black in 2006-07

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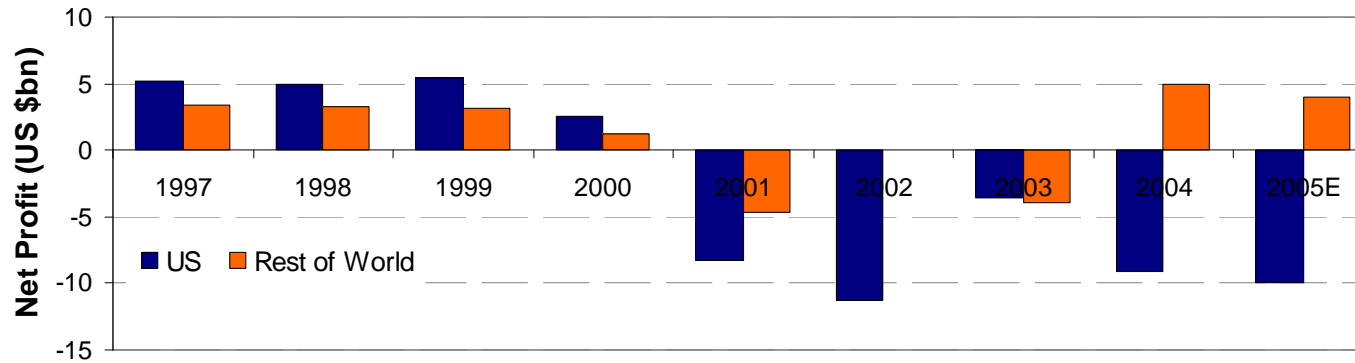


Source: World Air Transport Statistics, IATA (2006), June 2004, Air Transport World, Jan. 2005

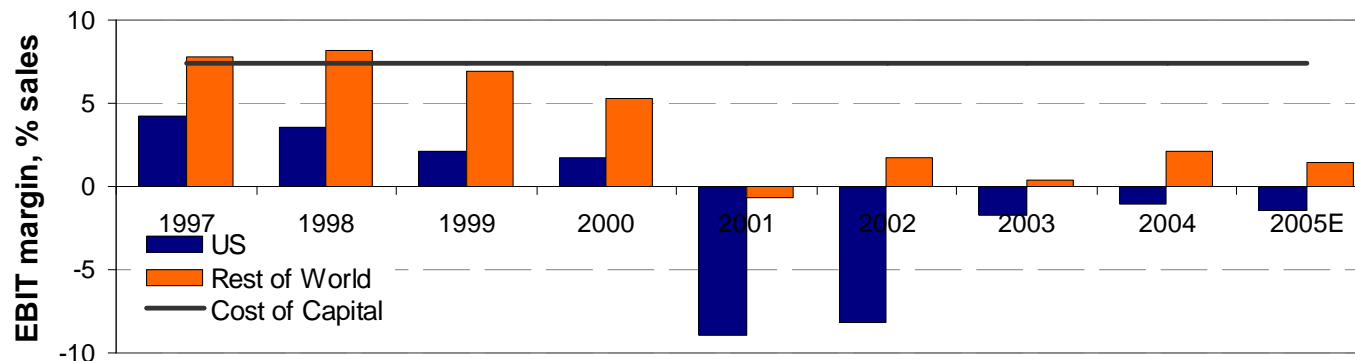
Profitability is cyclical: The airline industry rarely create value, in particular the US players

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Development of net profit since 1997-2005(e)



Development of EBIT margin compared to Cost of Capital since 1997

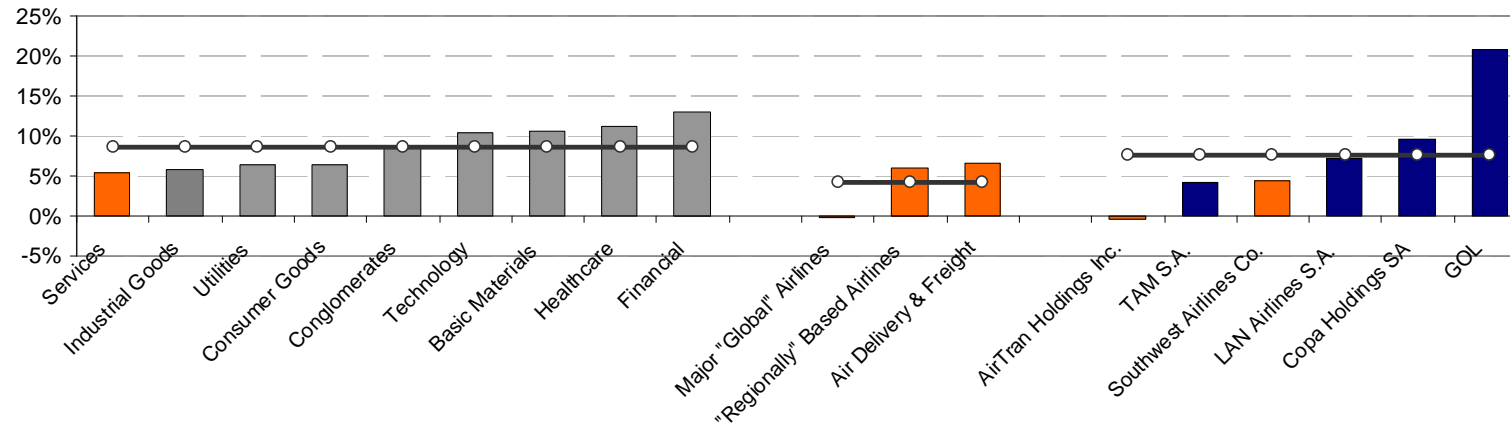


Source: IATA March 2006

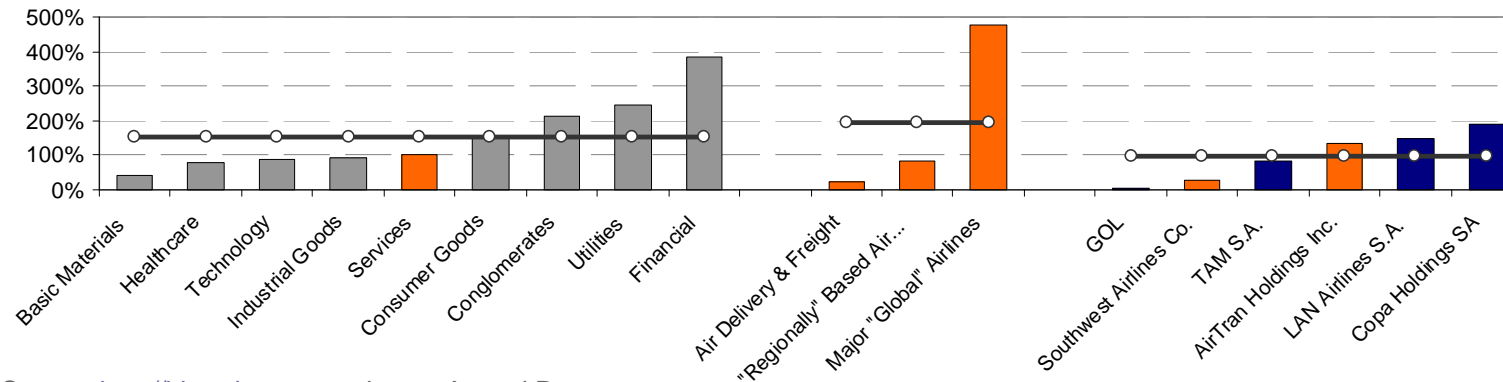
A cross industry analysis shows the relative poor profit performance of the major carriers and a high level of gearing

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Net Profit Margin (cross sector analysis and comparison to the air travel segment)



Debt/Equity Ratio (cross sector analysis and comparison to the air travel segment)

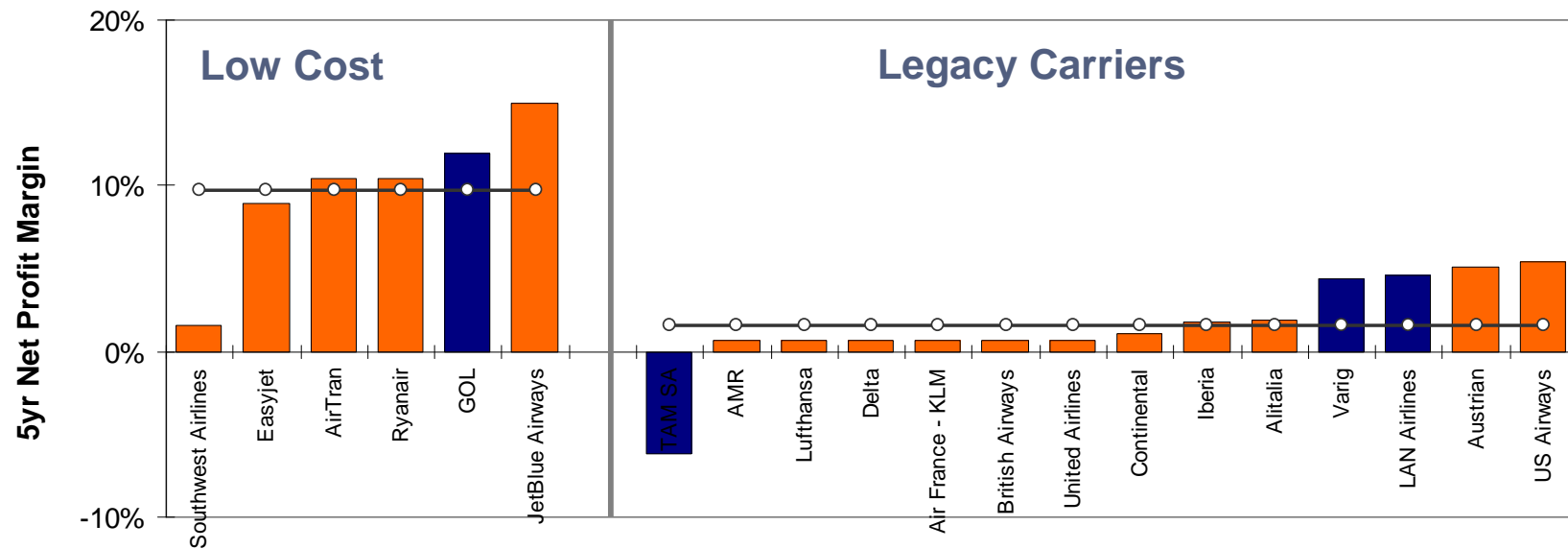


Source: <http://biz.yahoo.com> – Latest Annual Reports

A 5-Year average profitability comparison underlines the resilience of the low-cost business model

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Average 5-Year Net Margin 2001-2005 (Net Margin / Net Income)



■ South American Carriers

Note:

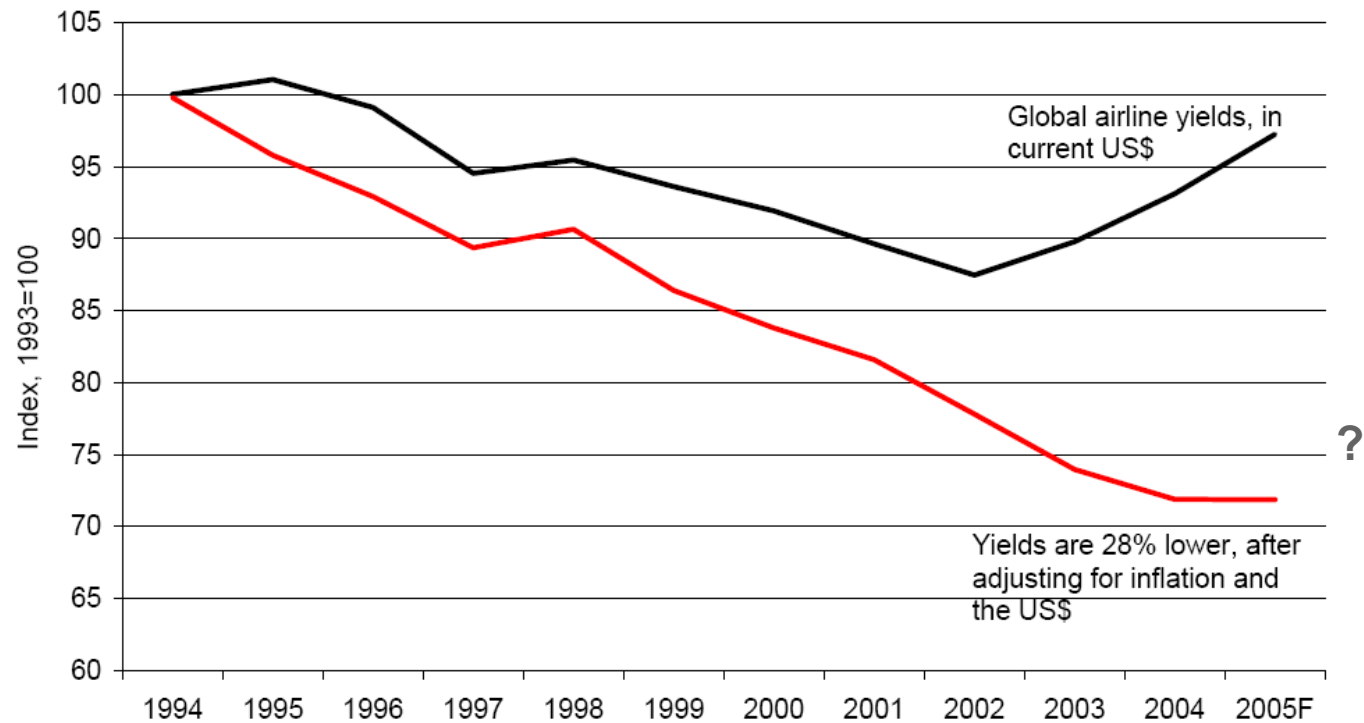
1. All figures cover the period 2001-2005 wherever figures are available.
2. Legacy carriers AF-KLM, AMR, BA, Continental, LAN, and US Airways all cover the period until FYR 2005.
3. The remainder are FYR 04.

Source: Thomson Financial. Annual Reports. All ratios consolidated according to Thomson Financial – similar to USGAAP

The downward trend in yield has stopped but remains 28% lower in comparison to 1994

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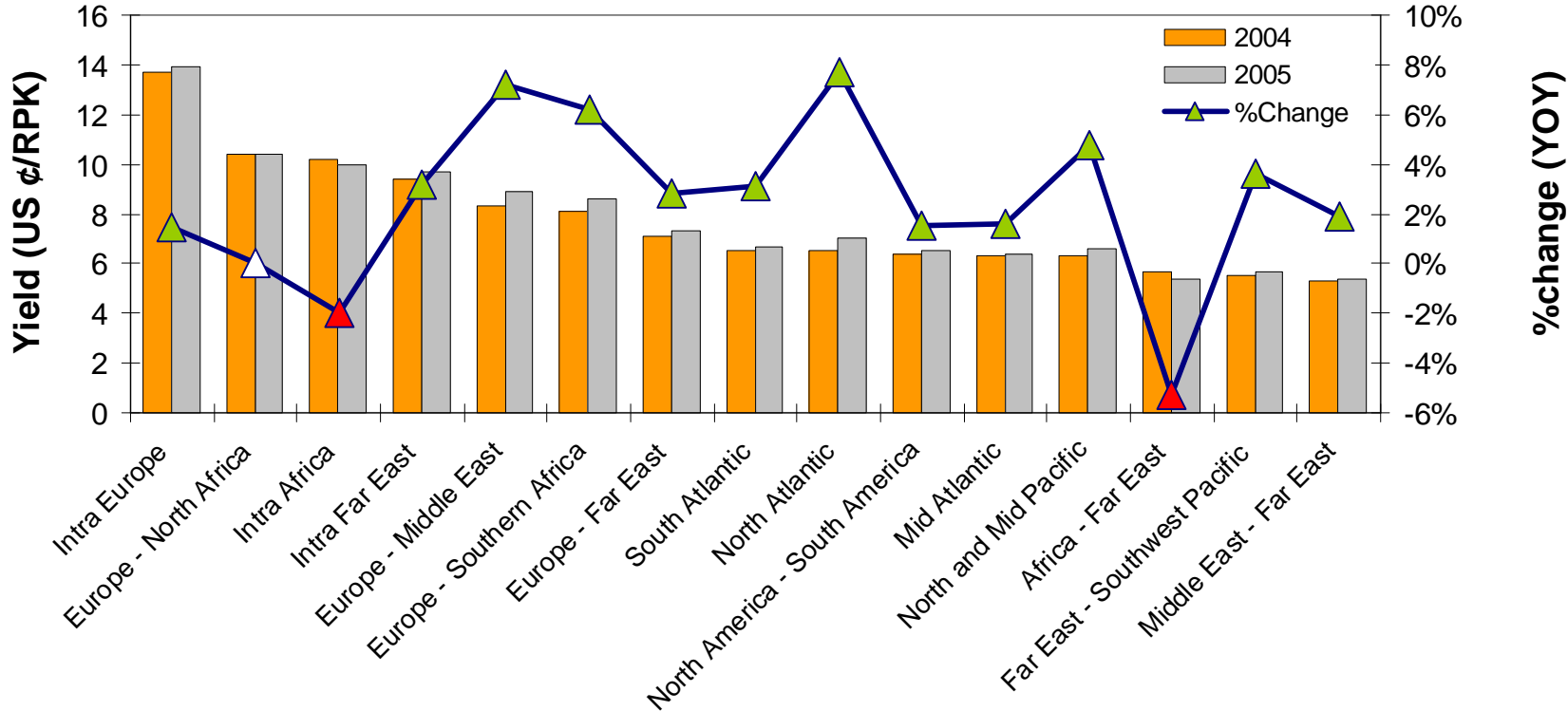
Development Airline Yield (1993=100)



Source: IATA Economics Forecast, March 2006

Intra European traffic shows the highest yield/RPK. North - South America has a relatively low level of yield/RPK ranking 10 out of 15

Yield ¢ /RPK. 2004 - 2005

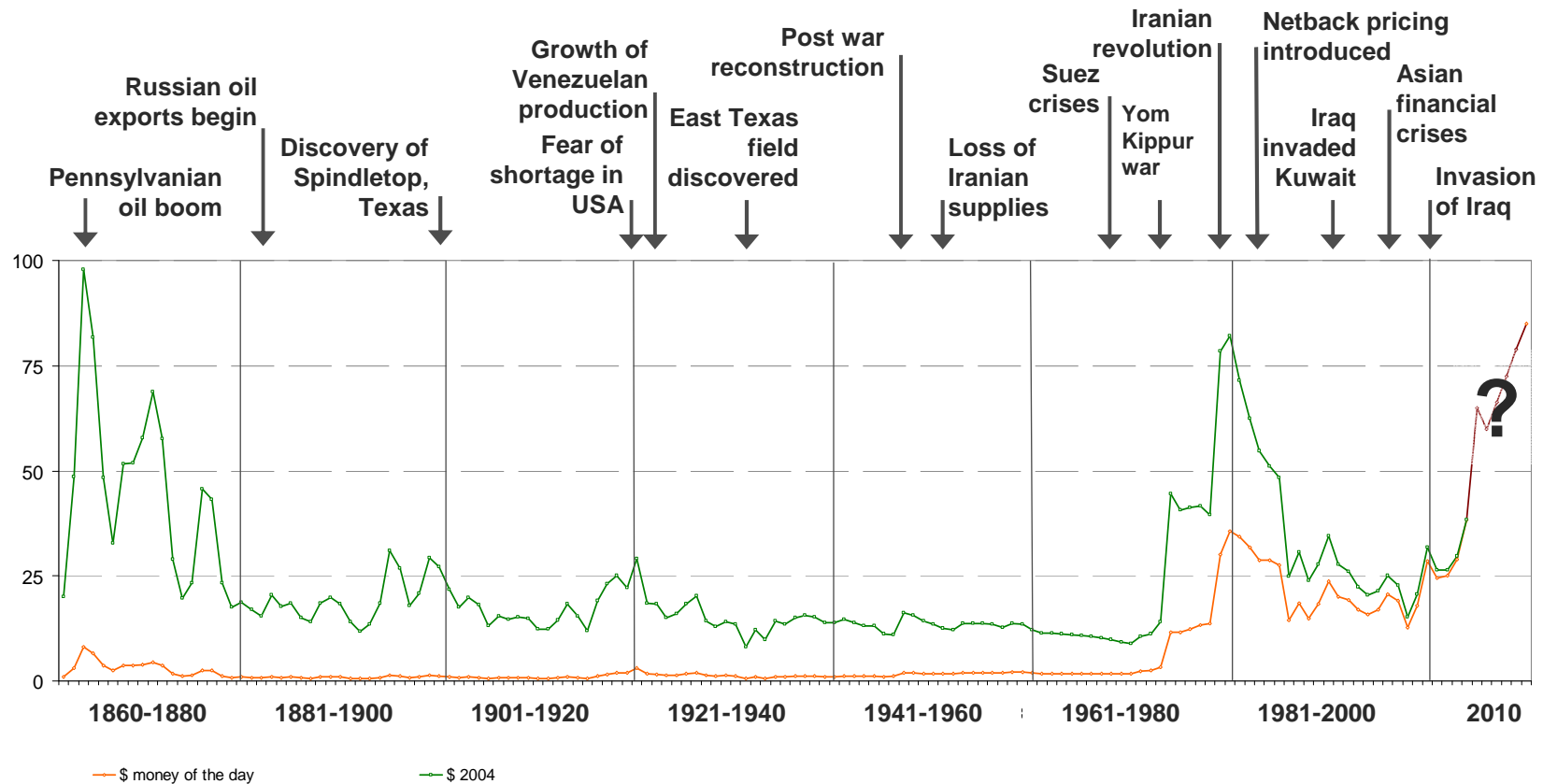


Source: IATA (2006)

Fuel price poses a risk with the last 20 year period showing large swings. Such risks will drive profitability and innovation

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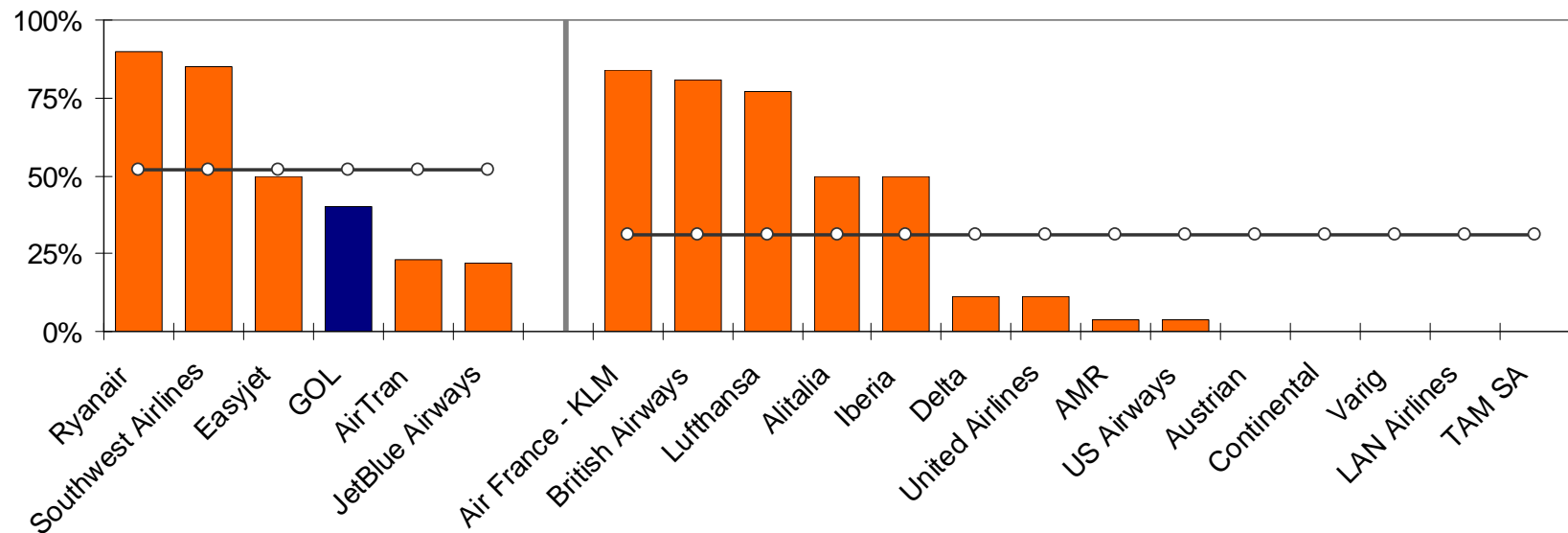
Crude oil price development 1860-2010, current vs 2004 prices



Source: British Petroleum

In average legacy network carriers show lower hedging levels than low cost carriers

Comparison of fuel hedging according to business model (2004/05)



Note:

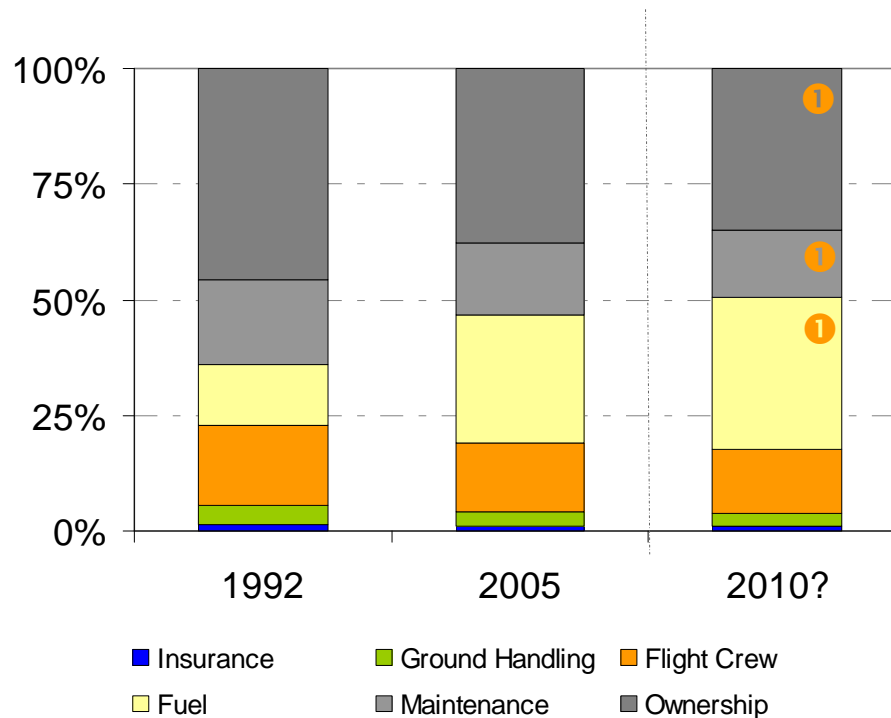
1. Fuel hedging varies year by year. The above is based on the latest known information February 2006.
2. The length of hedging contract and value of the hedge (fuel price) also influence the overall impact of the contract.

Source: Annual reports, Citibank

Increases in the price of fuel have raised its share of costs from 4th to 2nd. Fuel could become the largest cost segment by 2010

1

Airline DOC Analysis



Note:

1. Fleet mix will influence the cost shares. Short haul has a much lower contribution than long haul
2. The extrapolation until 2010 assumes 2,5% annual escalation of the cost base until 2010. Fuel escalates by 40% compared to 2005.
3. No allowance for accelerated fleet rollover to new equipment assumed.

Source: National Materials Advisory Board Dec. 05. Lufthansa Consulting

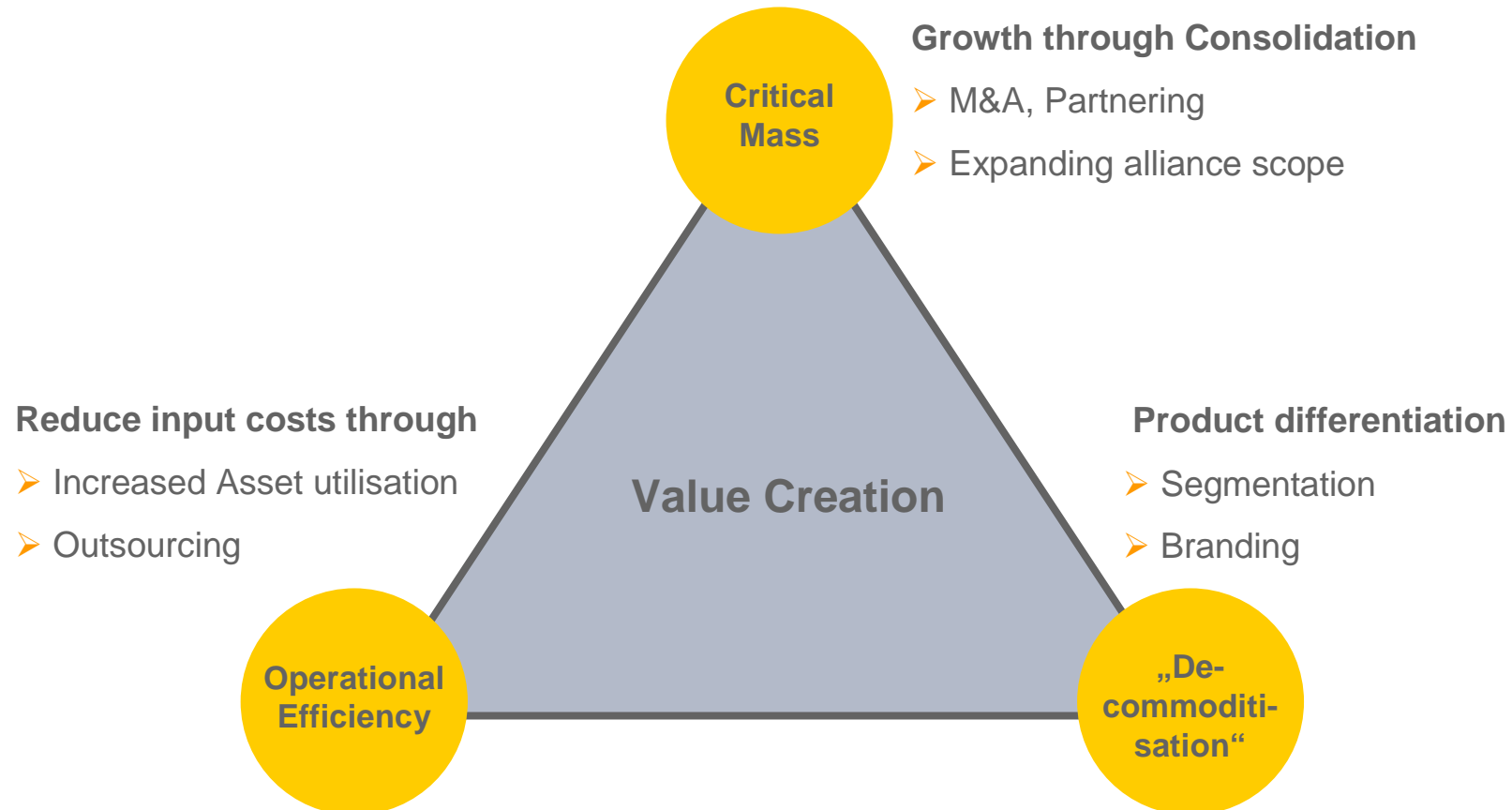
The dilemma

- Fuel, MRO and ownership costs are interdependent.
- A higher price of fuel will:
 - Accelerate the phase-out of older equipment lowering the MRO burden,
 - Be passed on to the customer potentially forcing demand downwards or
 - Reduce EBITDA and the ability of the market to support CAPEX.
- ① **The airline cost equation is dynamic – increased fuel costs will force change elsewhere**

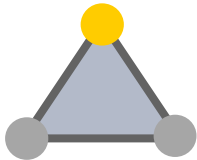
- **Encrusted industrial relations**
- **State Interference**
- **Poor management**
- **Complexity penalties**
- **Fragmented Business**
- **Ownership**
- **Regulatory Requirements**
- **Lack of bargaining power**
- **Lack of competitive pressure**

- **Globalisation**
- **Liberalisation**
- **Shareholder/Investor Pressure**
- **Innovation**
- **www..**

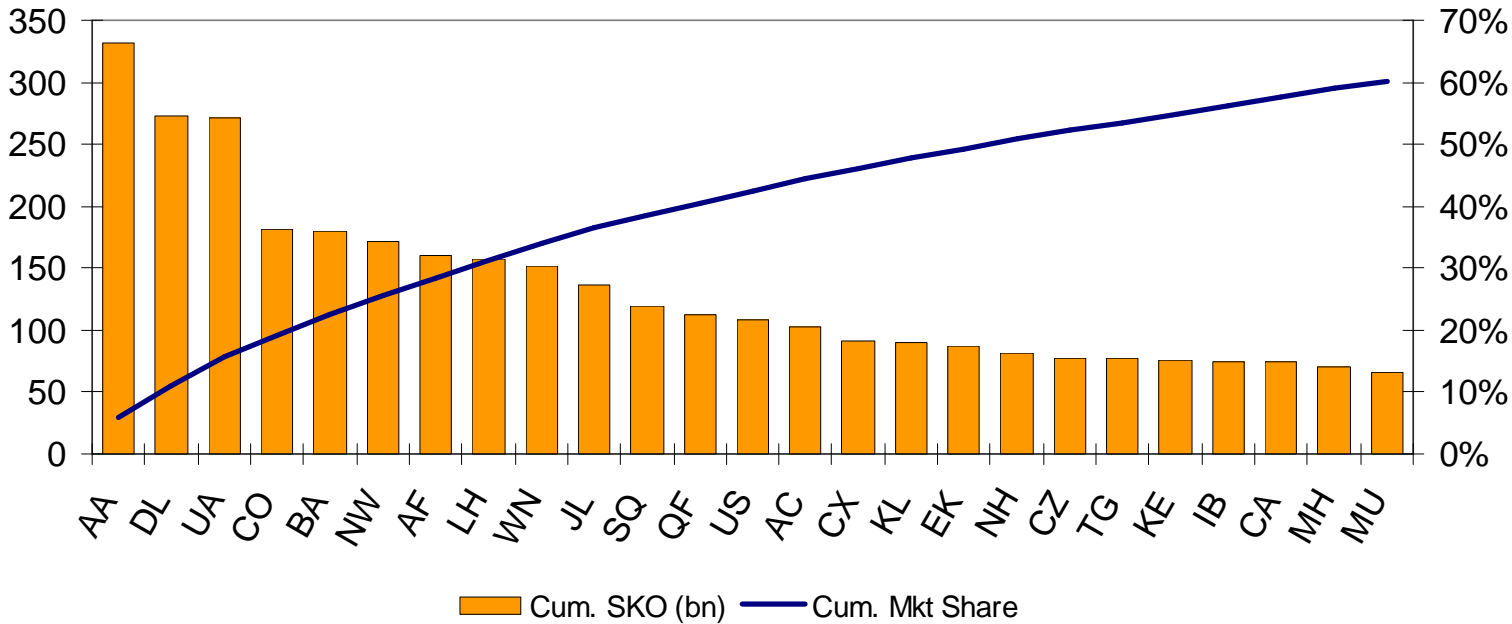
- The airline business – an attractive industry....?
- Three elements of an airline strategy



The Global Airline industry is fragmented: The largest player has 6% share of supply, the top 10 airlines have a 35% share

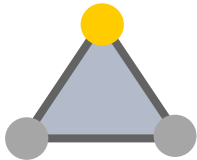


SKO (bn) Global Market (March 2005 – March 2006).

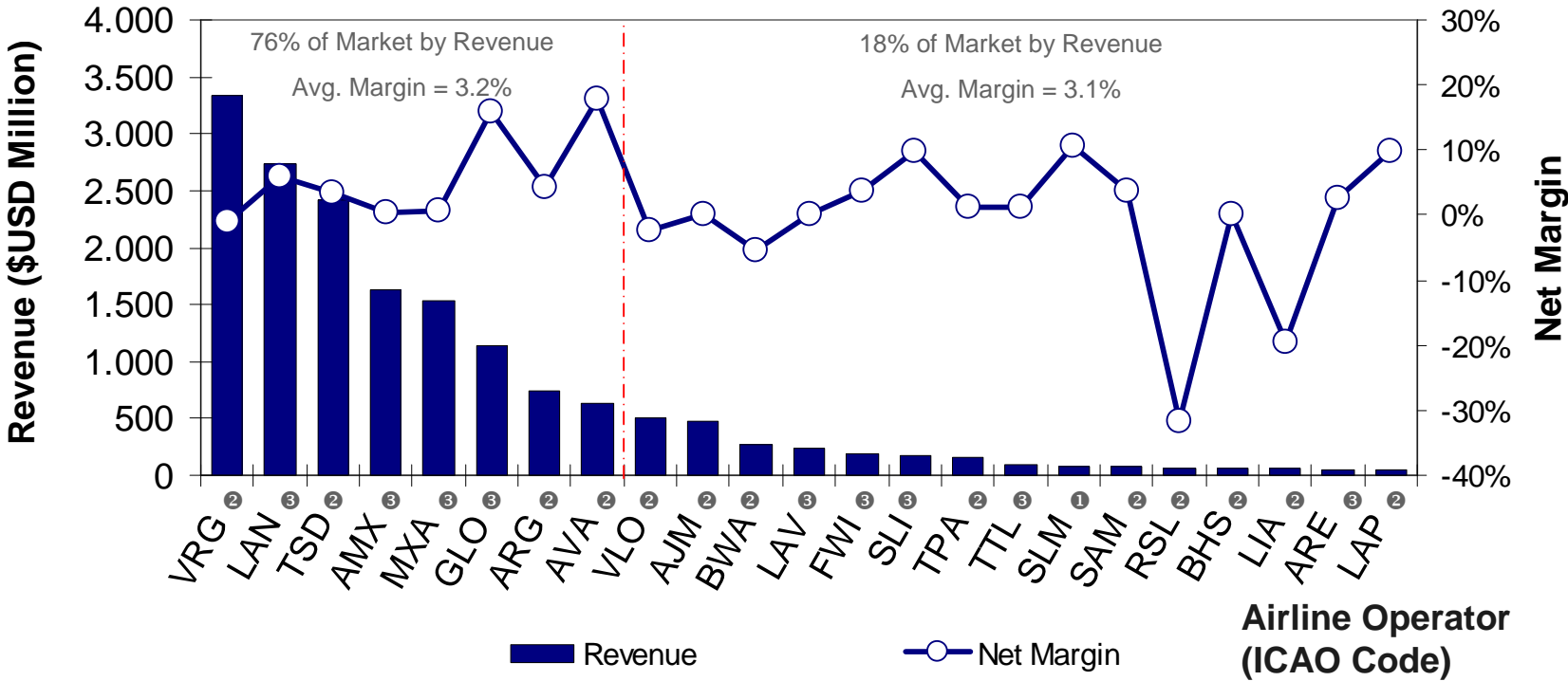


Source: IATA Global Market Statistics - 2006

The Latin American Airline Industry show the same trend...



Revenue and Net Margin (2003-2005): Latin American Carriers (with annual revenue greater than \$50 Mil)



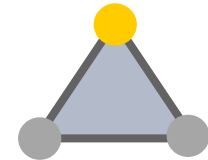
Note:

1. Aeropostal, AirJamaica, and Bahamasair are not depicted due to lack of available data.
2. Data represents the year ① 2003, ② 2004 and ③ 2005.
3. Poor reporting of the sector means that the above is only a small component of operators albeit a large component of revenue.

Source: Thomson Financial, RATI.

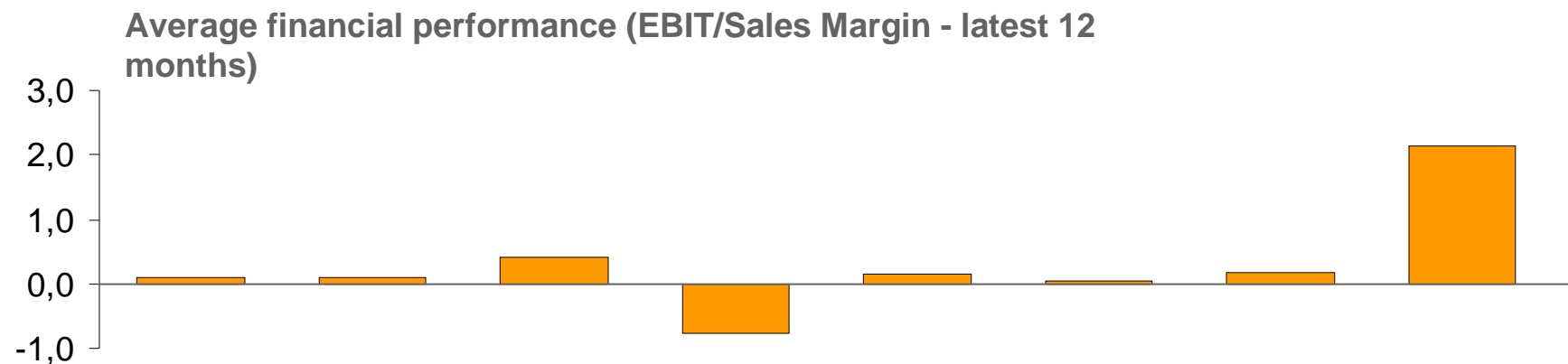
The airline sector shows relatively poor financial returns in the value chain

2



Competitive dynamics in the value chain – concentration and profitability

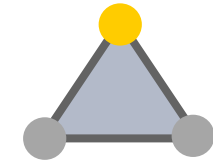
3 or more suppliers per sub-system	2 major suppliers Oligopoly Airbus & Boeing	2 Lessors > 50% market share	1685 airlines despite overcapacity and fierce competition	Limited competition at airports	Market consolidation occurring plus OEM's entering the business	Limited competition	Monopolist
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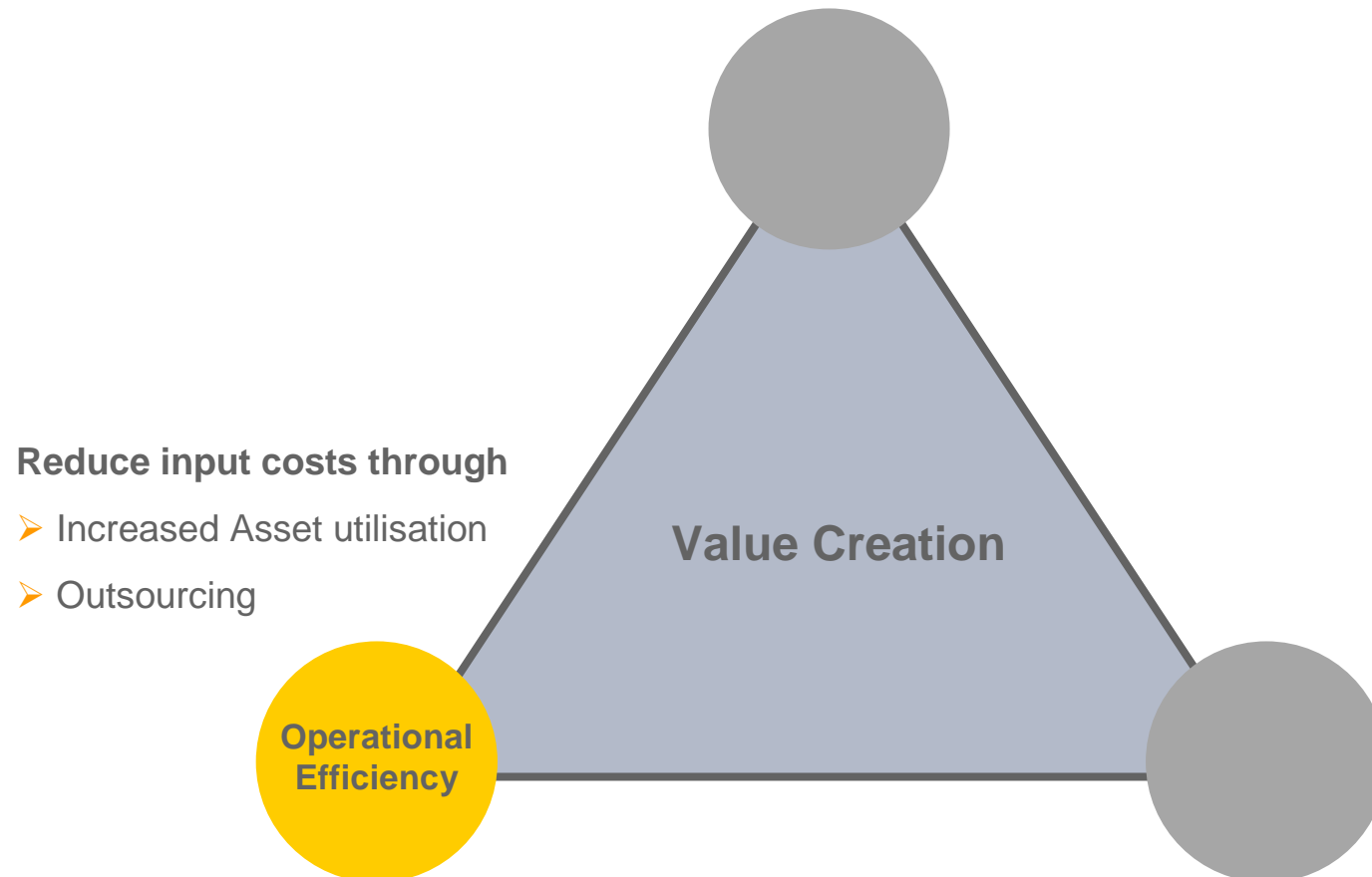
Source: Thomson Financial (Worldscope). Lufthansa Consulting Research.

An M&A driver analysis show industry need for consolidation though regulation is a hindering factor

2



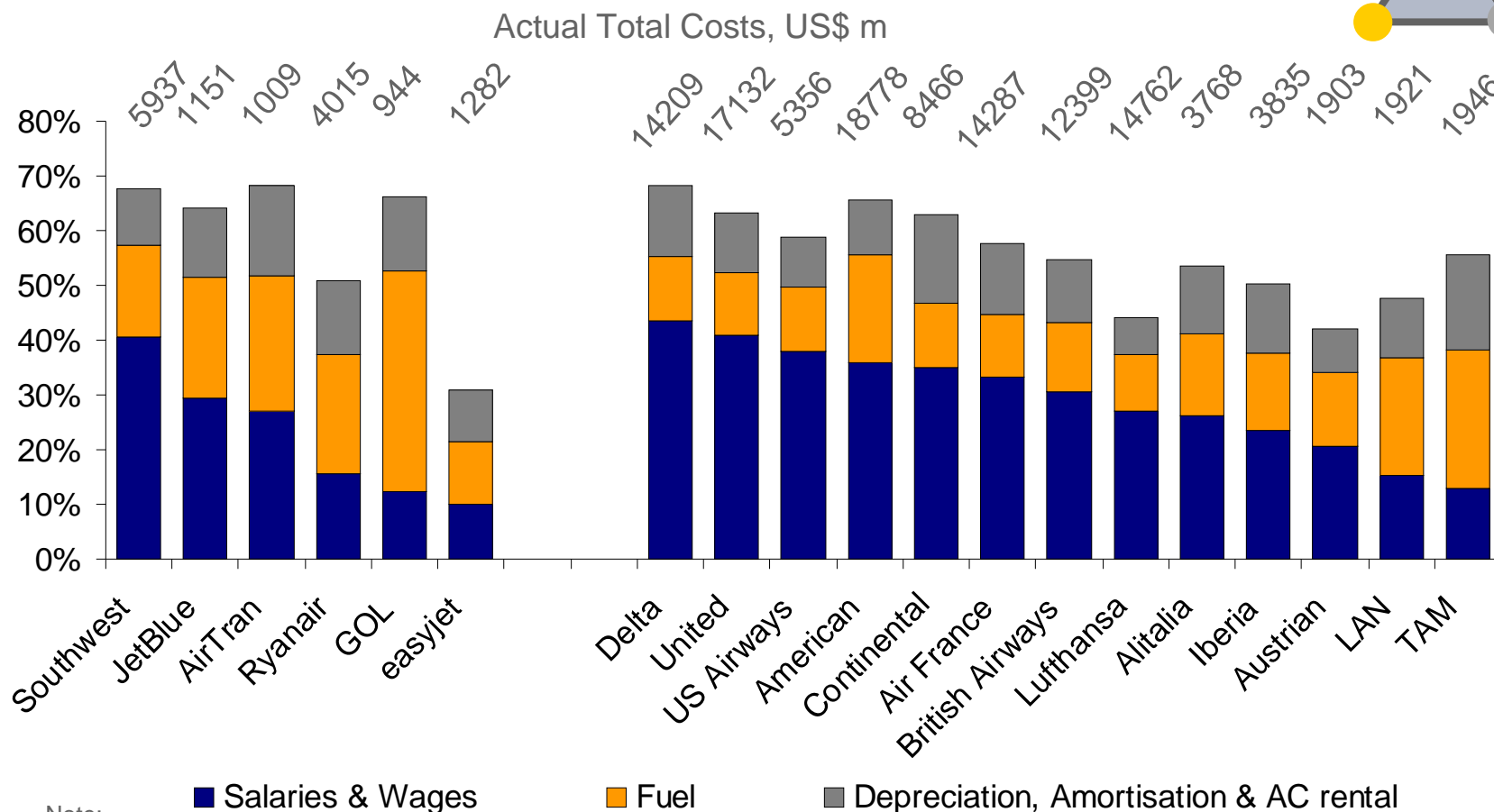
Region	Consolidation in Europe		Consolidation, International	
	Development	Implication	Development	Implication
Market deregulation	High		Low (On bilateral level)	
Industry concentration	Low		Low	
Financial performance	Low		Low	
Product differentiation	Middle		Low	
Pricing	Decrease + (LCC)		Decrease	
Strategy differentiation	Predictable		Low	
Capital requirement	To cover debt and fund growth		To cover debt and fund growth	
Alternatives to M&A	Available		Highly available	



The salary cost block for the European and South American low cost carriers are up to 50% lower than their “legacy” rivals

2

Main Cost Drivers of selected carriers, 2004 (% of total operating costs)



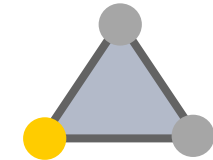
Note:

1. Latest annual reports not available for all carriers. AirTran, Delta, United, US Airways, Continental, and JetBlue based on data from FY02/03

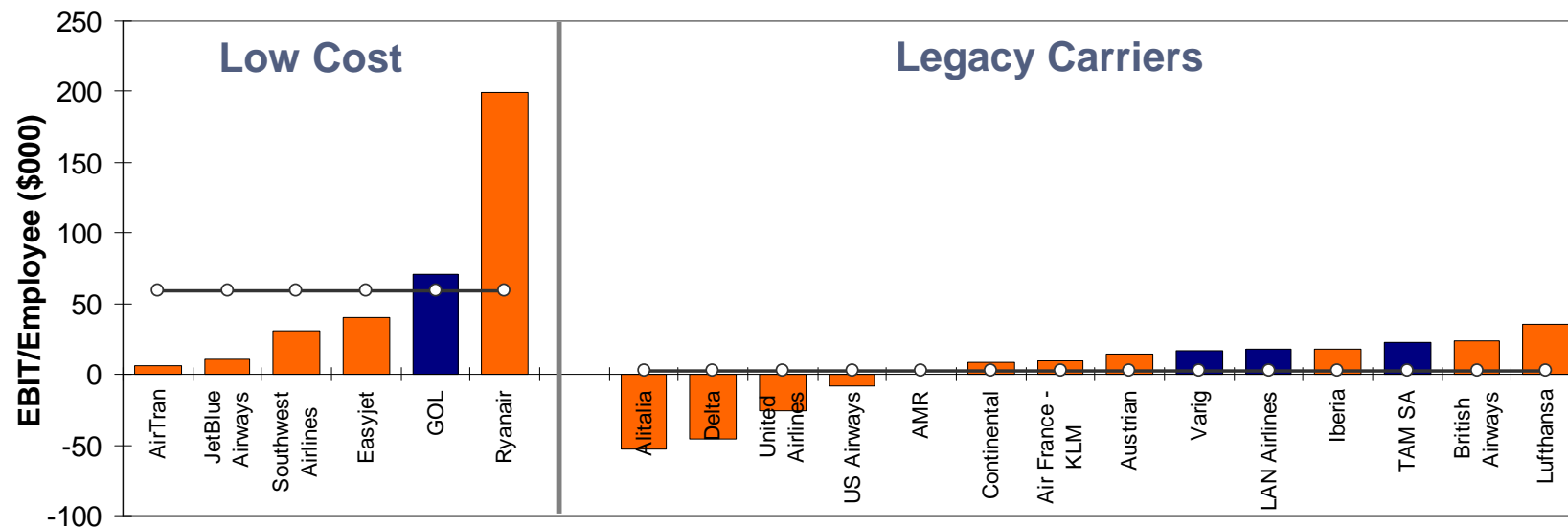
Source: Lufthansa Consulting, company reports; Average Exchange Rate, source oanda.com

The average LCC EBIT/Employee is more than 20 times higher than the Legacy Carrier average

2



Comparison of value generation according to EBIT/Employee



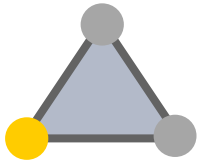
 South American Carriers

Note:

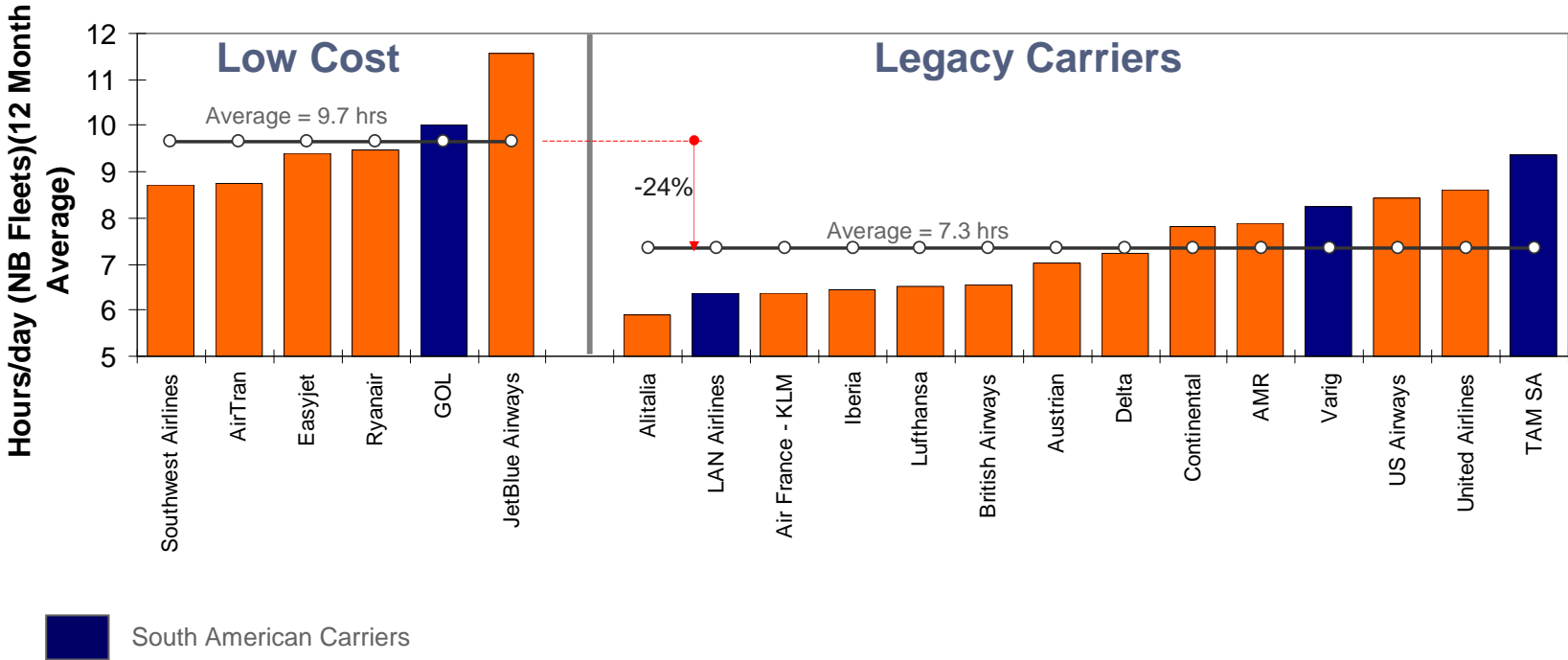
1. All Low Cost Results reported for FYR 2005
2. Legacy carriers AF-KLM, AMR, BA, Continental, LAN, and US Airways all FYR 2005.
3. The remainder are FYR 04.

Source: Thomson Financial, Annual Reports, ACAS, RATI, IATA. EBIT according to Thomson Financial – similar to USGAAP.

The LCC's average 24% more hours aircraft utilisation than the legacy carriers (narrowbody comparison only)



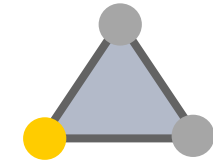
Average asset utilization of the narrow body fleets (B737, A320, MD80, MD90)



Source: ACAS 2006

South America has the second oldest fleet in operation (behind Africa) and has aged the most since 2001.

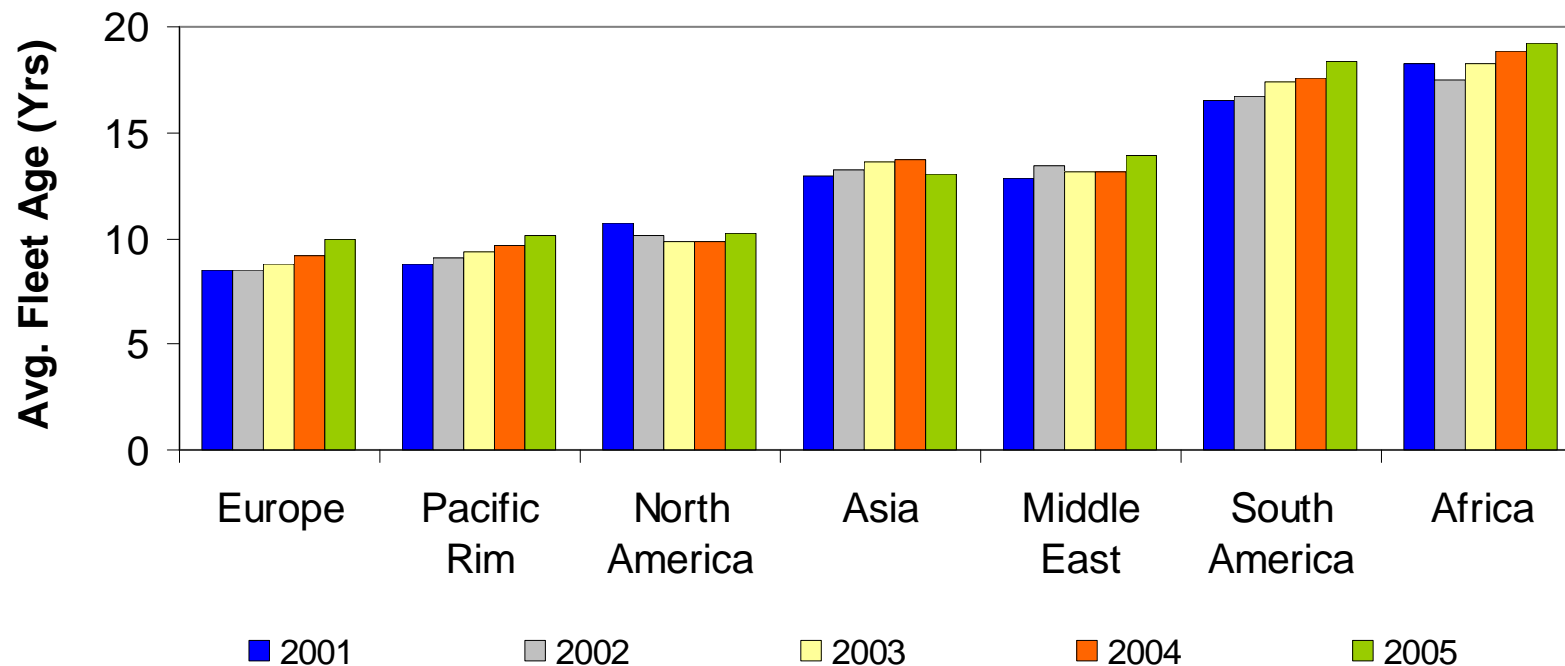
2



Fleet Age Development – World Regions (2001-2005)

Delta avg. age since 2001

+1.5 +1.4 -0.4 +0.1 +1.1 +1.8 +0.9



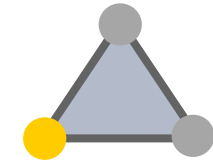
Note:

1. The fleets addressed include aircraft that are used for passenger transport, regional jets, narrow body above 100 seats, and wide body aircraft. TP's, smaller aircraft, and aircraft for other roles (e.g. Cargo) are excluded.

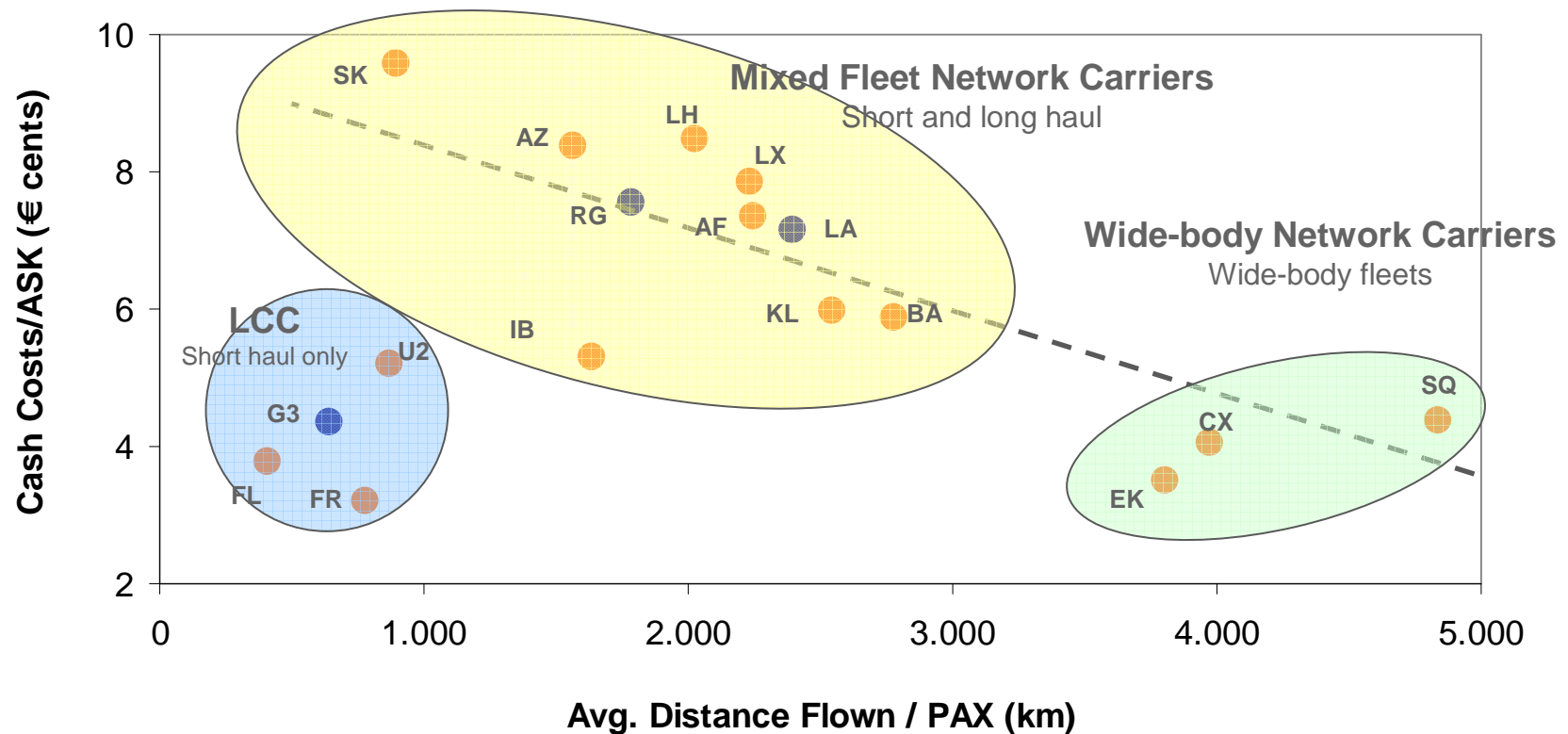
Source: ACAS. Lufthansa Consulting Research.

Costs matter in a fragmented market – the traditional network carriers are being squeezed from both sides.

2



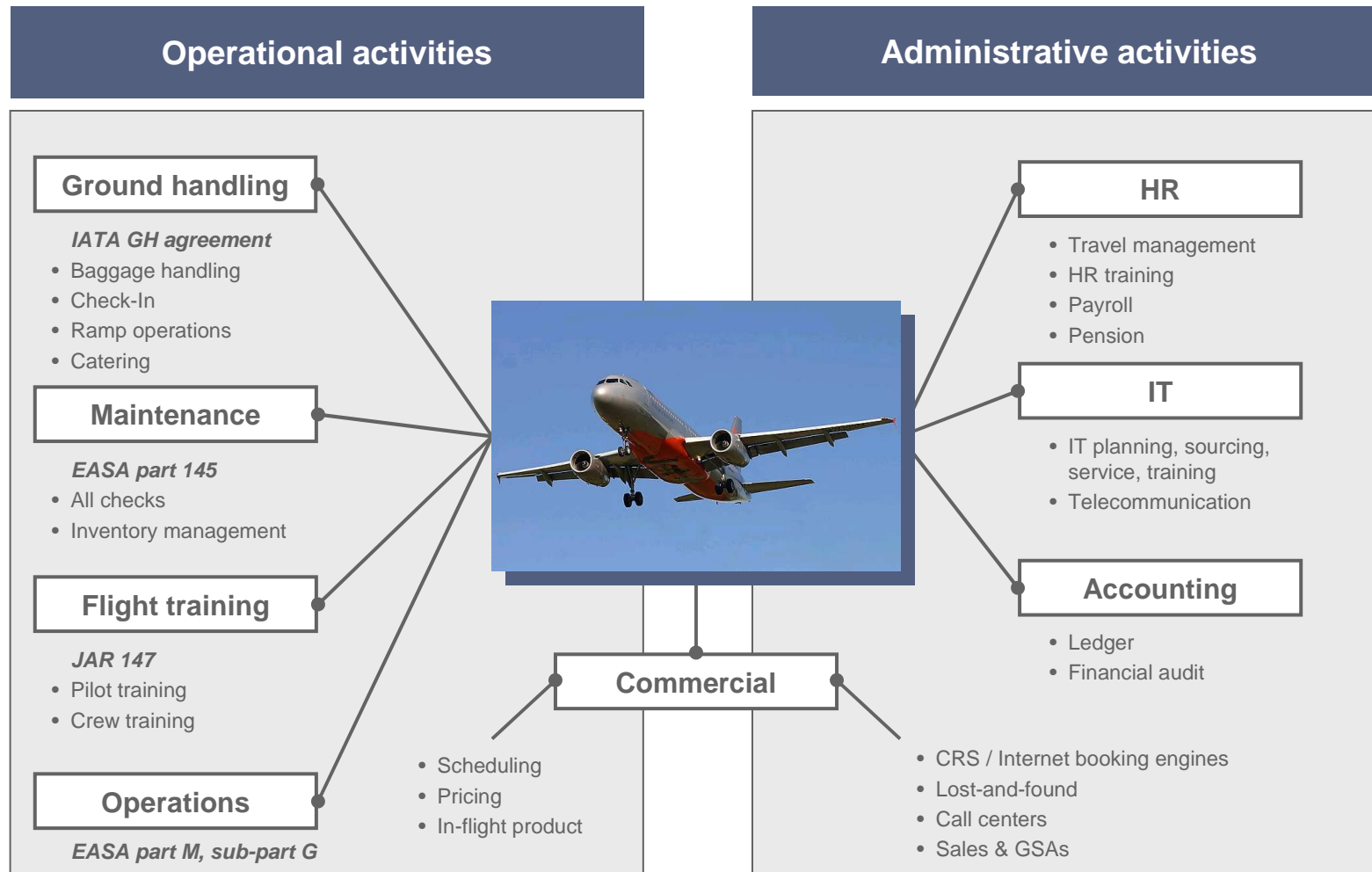
Cash Costs/ASK vs. Stage length for selected carriers, 2004



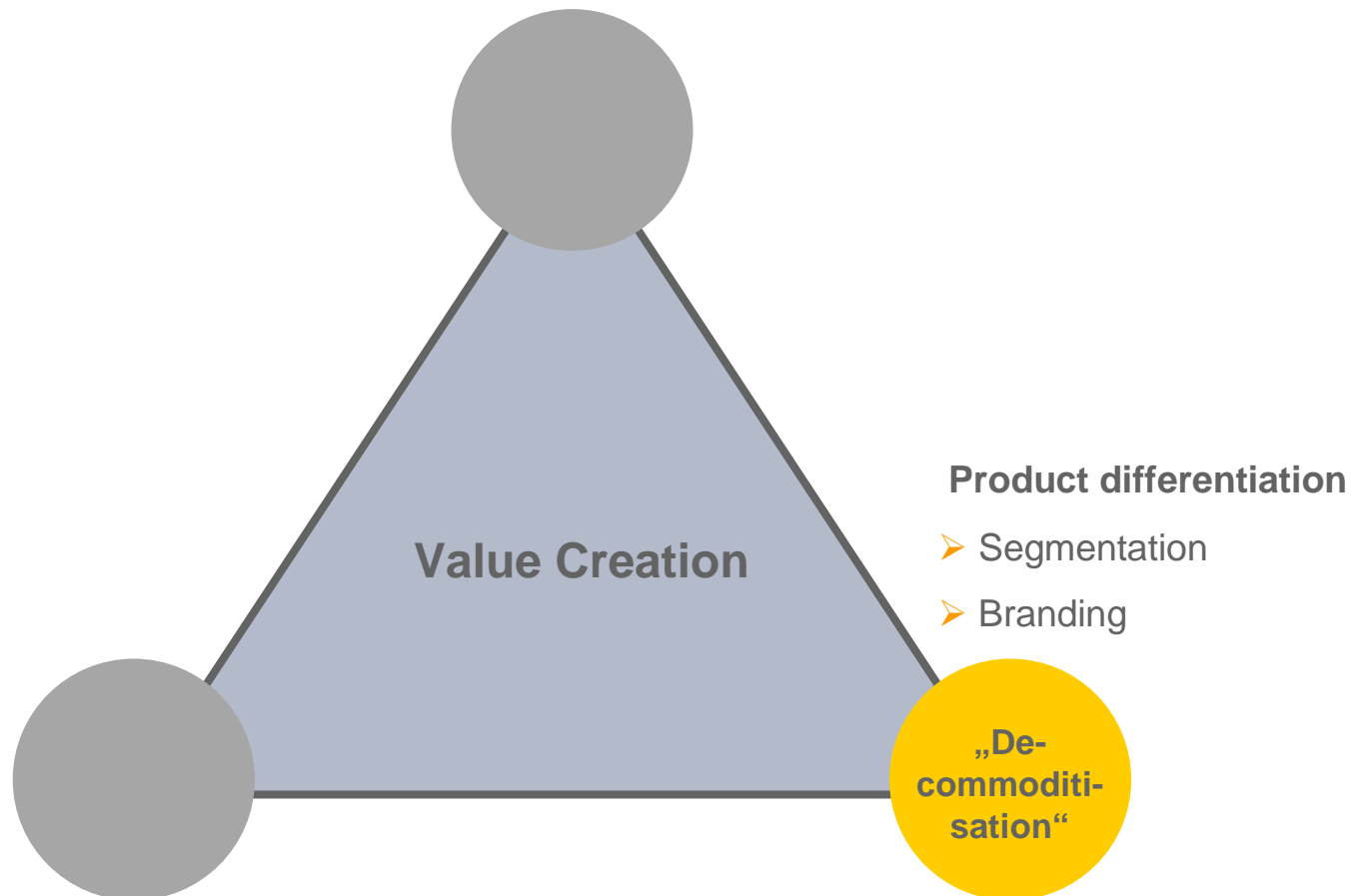
Source: Goldman Sachs Global Investment Research (July 2005)

In the airline business considerable operational and administrative activities can be outsourced

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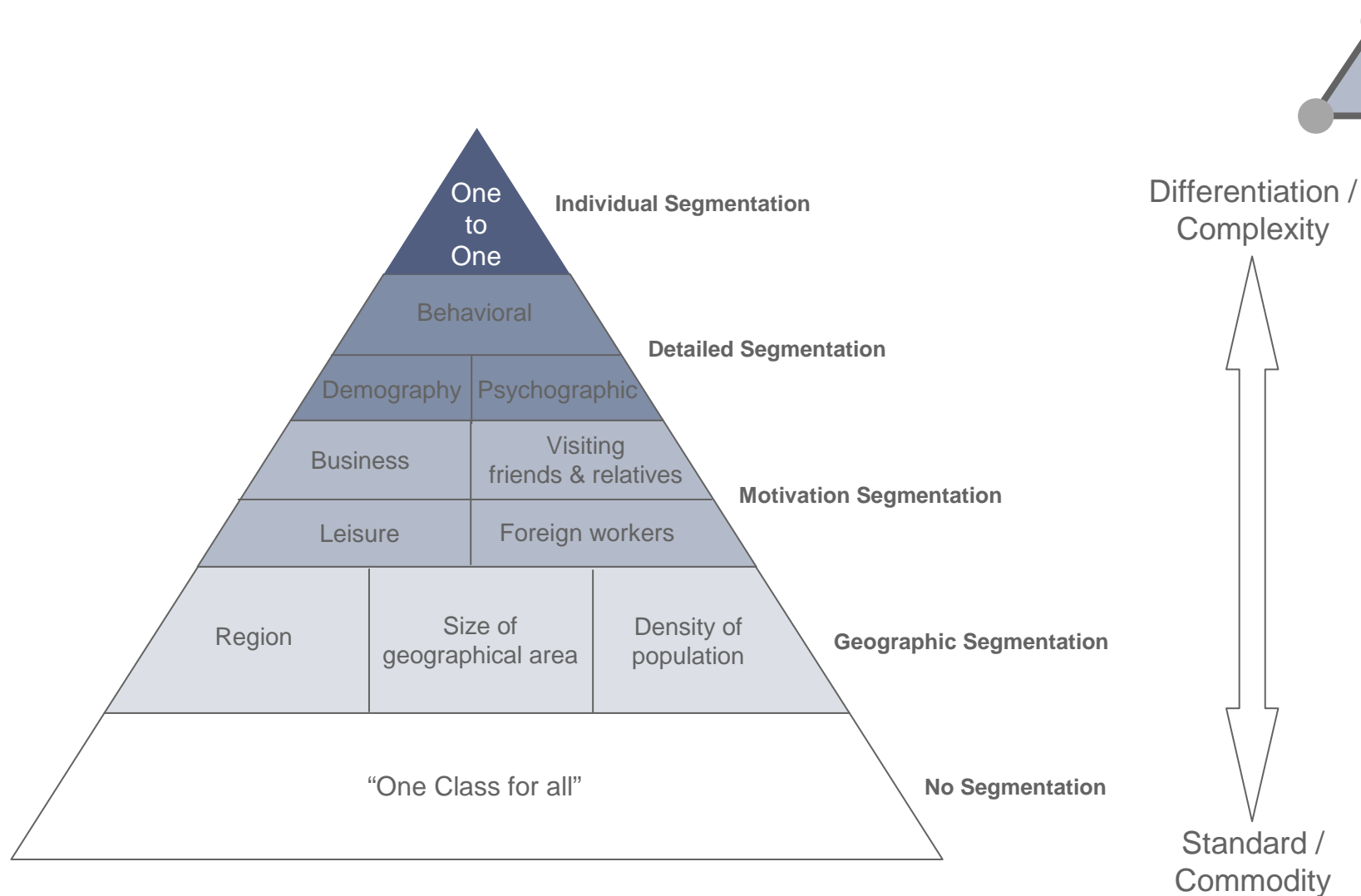


Source: Lufthansa Consulting 2005



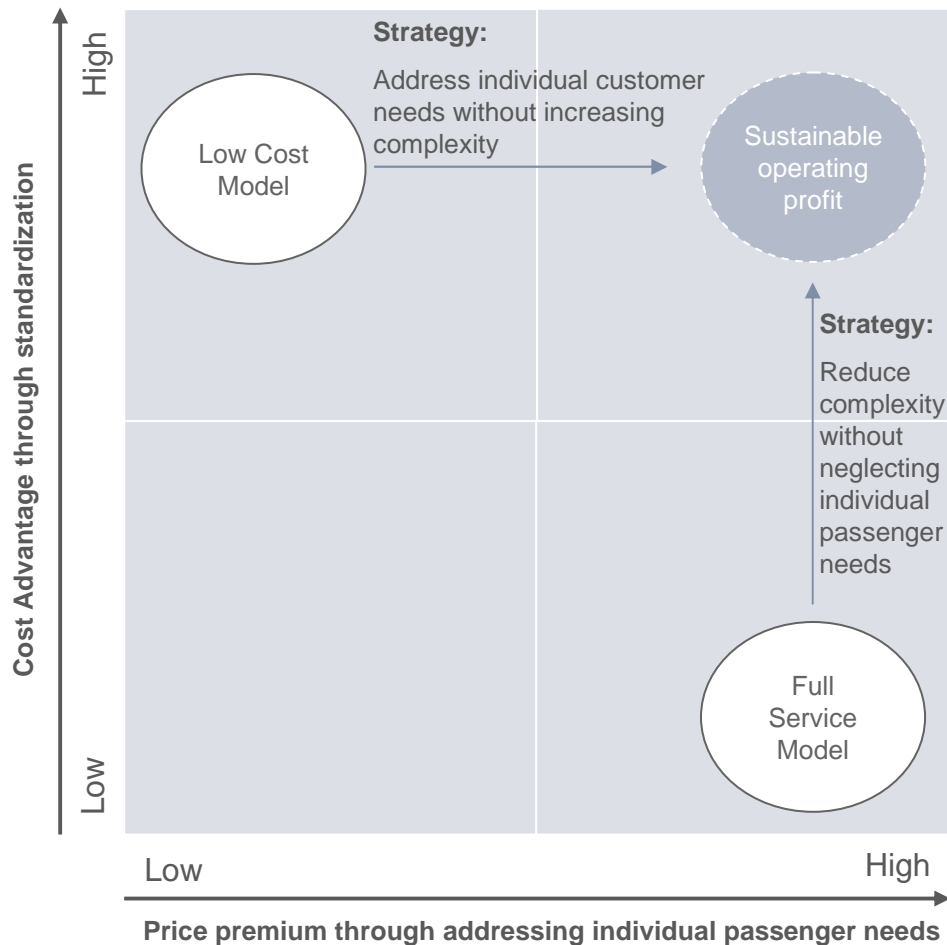
With increasing segmentation levels differentiation will drive revenue potential but complexity will drive cost

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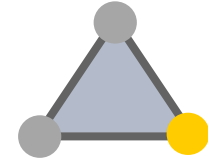


The target is to address individual customer needs without increasing complexity and drive cost

2



Success Factors for both strategies:

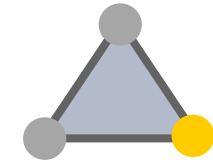


- **Apply information technology**
Data Mining and Data Warehouse
- **Address individual desires**
Personalization and mass customization
- **Create customer-oriented processes**
BPR adding value for the customer
- **Establish long term perspective**
Customer life time value
- **Adapt controlling**
Customer-oriented cost and revenues

Airline Global Brand (and name) recognition is low compared to other industries & institutions (Interbrand 2005-ranking)

2

1 Google	21 Toyota	41 CNN	61 Café de Colombia/Juan Valdez
2 Apple	22 Mini	42 Disney	62 Bacardi
3 Skype	23 Microsoft	43 Pepsi	63 G8
4 Starbucks	24 Red Cross	44 Dell	64 Ford
5 Ikea	25 al Jazeera	45 Philips	65 AOL
6 Nokia	26 BMW	46 Mercedes	66 Mandarin Oriental Group
7 Yahoo!	27 Bono	47 FedEx	67 Mitsubishi
8 Firefox	28 Red Bull	48 Fairtrade	68 Peninsula Hotels
9 eBay	29 BBC	49 Volvo	69 NTT DCoMo
10 Sony	30 Motorola	50 Nestlé	70 Daewoo
11 Zara	31 McDonald's	51 Canon	
12 Bluetooth	32 Cirque du S	52 UN	
13 H&M	33 Honda	53 Hello Kitty	
14 Coca-Cola	34 Volkswagen	54 Burger King	
15 Amazon.com	35 MTV	55 UBS	
16 Puma	36 HSBC	56 Medecins..	
17 Samsung	37 LG	57 Gucci	
18 Nike	38 Guinness	58 Mazda	
19 Virgin	39 ING Direct	59 Nissan	
20 adidas	40 Vodafone	60 GE	



In 2003 Singapore Airlines was placed No. 62...

Source: Interbrand/Brandchannel 2005 Internet polling. Population 2500 from 99 countries – brands are judged on their Impact (positive or negative).

..although regional Top-20 gives a different result..

2

Latin America

- 1 Corona
- 2 Bacardi
- 3 movistar
- 4 Havaianas
- 5 Cemex
- 6 Café de Colombia
- 7 Bimbo
- 8 Natura
- 9 Lan Airlines
- 10 Concha y Toro
- 11 Petrobras
- 12 Brahma
- 13 Aeromexico
- 14 Falabella
- 15 Telcel
- 16 Lala
- 17 Itaú
- 18 Arcor
- 19 AmBev
- 20 Bancolombia

Europe & Africa

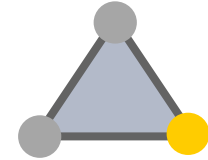
- 1 Nokia
- 2 Ikea
- 3 Skype
- 4 Zara
- 5 BMW
- 6 BBC
- 7 adidas
- 8 al Jazeera
- 9 H&M
- 10 Aramex
- 11 Mini
- 12 Virgin
- 13 Audi
- 14 Puma
- 15 Nestlé
- 16 Emirates Airline
- 17 Vodafone
- 18 Dove
- 19 Mercedes
- 20 Orange

USA & Canada

- 1 Apple
- 2 Google
- 3 Starbucks
- 4 Target
- 5 Lance Armstrong
- 6 craigslist
- 7 Whole Foods
- 8 Coca-Cola
- 9 Oprah Winfrey
- 10 Amazon.com
- 11 Trader Joe's
- 12 Yahoo!
- 13 eBay
- 14 Wal-Mart
- 15 Firefox
- 16 BlackBerry
- 17 Pixar
- 18 JetBlue
- 19 Bluetooth
- 20 AMEX

Asia-Pacific

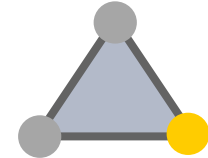
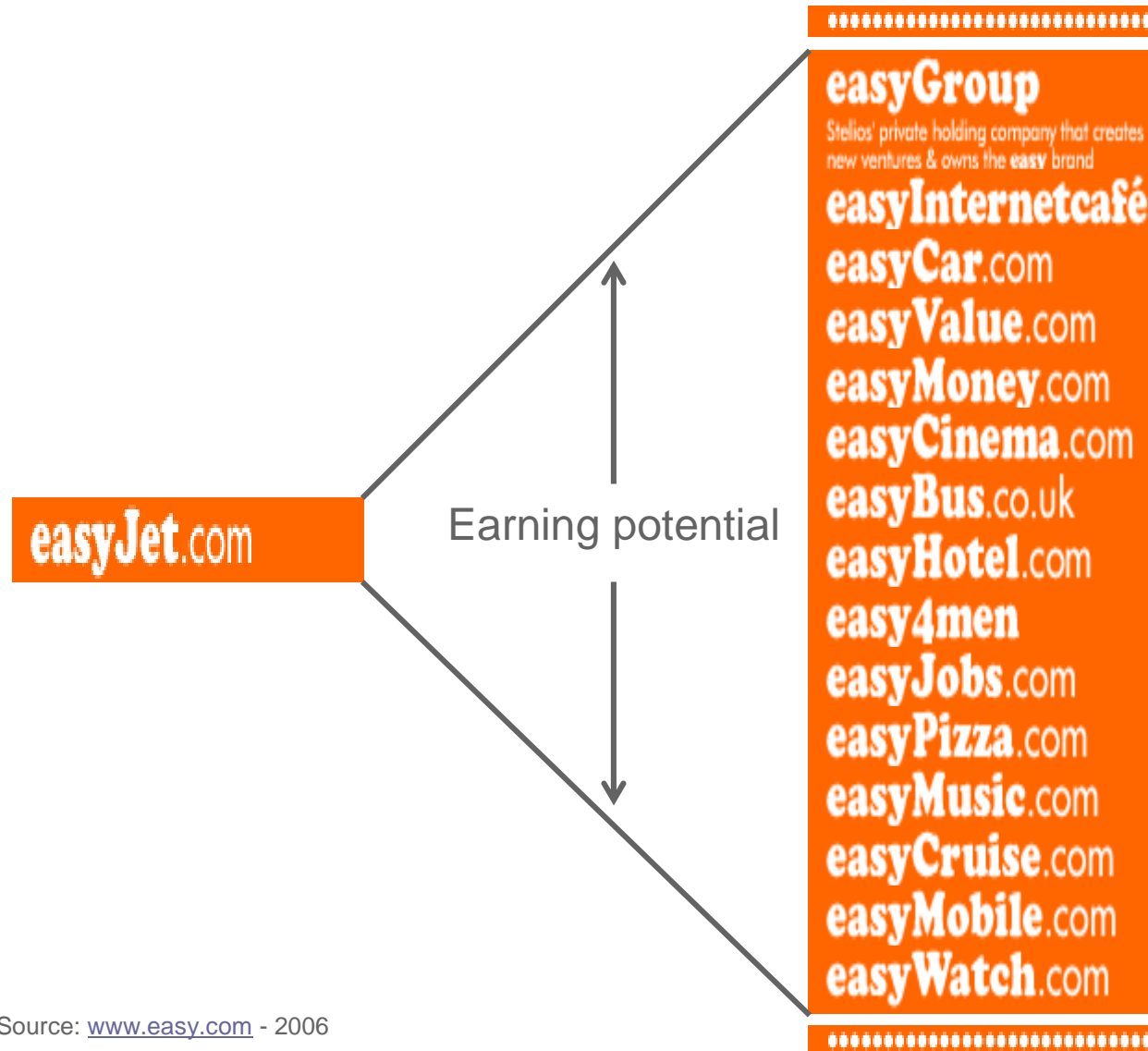
- 1 Sony
- 2 Toyota
- 3 Samsung
- 4 LG Electronics
- 5 HSBC
- 6 Singapore Airlines
- 7 Honda
- 8 Lonely Planet
- 9 Tiger Beer
- 10 Hello Kitty
- 11 Cathay Pacific
- 12 Star TV
- 13 Qantas
- 14 Lenovo
- 15 Jet Airways
- 16 Tata
- 17 Nissan
- 18 Mazda
- 19 Acer
- 20 Muji



Source: Interbrand/Brandchannel 2005 Internet polling. Population 2500 from 99 countries – brands are judged on Impact (positive or negative). Survey carried out in Nov-Dec. 2005

The creation of the easyJet brand has enabled easyGroup to develop its franchise to other industries

2



Source: www.easy.com - 2006

