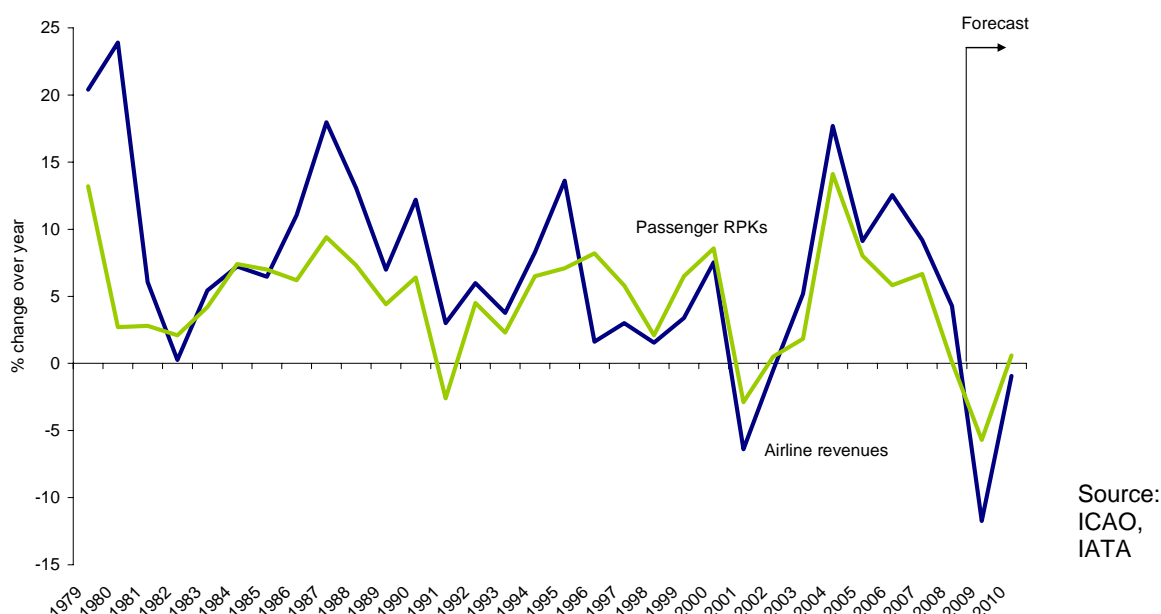


FINANCIAL FORECAST

March 2009

DEEP RECESSION LEADS TO BIG REVENUE LOSS

- Since our previous forecast in December economic conditions took a further dramatic turn for the worse. Companies were left with excessive inventories and so abruptly cut shipments; freight was down by a quarter by the end of the year as a result. Passenger travel has fallen less precipitously overall but premium travel is down sharply. Economists were expecting world GDP in 2009 to grow by 0.9% at the time of our December forecast. Now they forecast world GDP to shrink by 1.9% in 2009 in the deepest recession since the 1930s.



- As a result the outlook for demand for passenger or cargo services and airline revenues has deteriorated very sharply from our previous forecast. In 2009 we now expect cargo traffic to fall 13%, passenger traffic down 5.7% and airline revenues to decline by 12% or \$63 billion.
- The industry is shrinking in response to this slump in demand, with a 6% cut in capacity forecast, and lower fuel prices should cut this year's fuel bill by \$52 billion. Evenso, net losses in 2009 are now expected to be higher than previously forecast at \$4.7 billion.
- Airlines in the US are the only region to have been able to shrink capacity in line with the fall in demand, and are forecast to turn large 2008 losses into a small 2009 profit. However, we expect that airlines in all other regions will find that the deep recession causes significant net losses.

Industry profits, US\$ billion	2006	2007	2008E	2009F	2006	2007	2008E	2009F
	Operating profits				Net profits			
Global	15.0	19.7	2.2	3.0	-0.1	12.9	-8.5	-4.7
excluding restructuring costs					3.6	12.9	-8.5	-4.7
Regions								
North America	7.3	9.3	-0.3	3.6	-2.6	5.3	-5.0	0.1
excluding restructuring costs					1.0	5.3	-5.0	0.1
Europe	5.2	6.4	3.9	1.1	1.8	5.4	1.4	-1.0
Asia-Pacific	1.8	3.5	-1.2	-0.6	0.9	2.1	-3.6	-1.7
Middle East	0.0	0.0	-0.5	-0.8	-0.1	-0.1	-0.8	-0.9
Latin America	0.5	0.4	0.3	-0.1	0.1	0.1	-0.4	-0.6
Africa	0.1	0.1	0.0	-0.3	-0.2	0.1	-0.1	-0.6

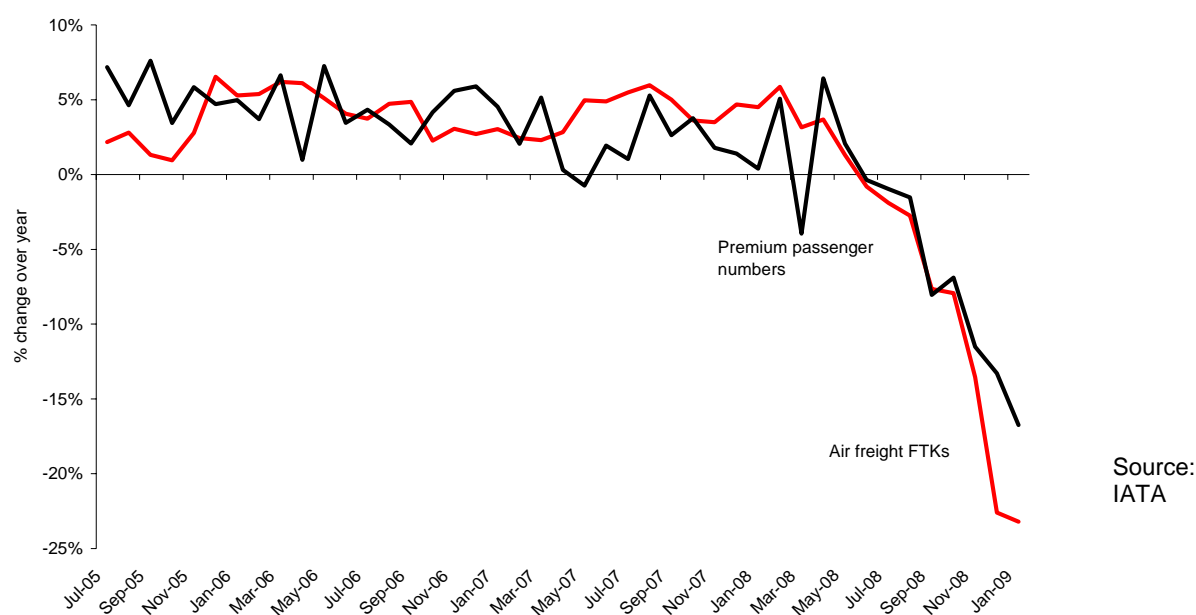
Source: ICAO data to 2007. IATA 2008-09 forecasts. Excludes exceptional items and 'mark-to-market' fuel hedging losses.

2008Q4 LOSSES MUCH LARGER THAN EXPECTED

- The fourth quarter of 2008 was always expected to produce an industry loss because traffic is always seasonally weak at the end of the year. The recession was reducing revenues further but oil prices had halved from third quarter levels which, in principle, should have lowered fuel costs. In the event net losses in Q4 were much higher, at over \$4 billion, than the \$1 billion loss we had expected.
- The very severe deterioration in the economy and air transport demand, as the chart below shows, was one major reason for these bigger losses. However, fuel hedging contracts taken out earlier in the year when prices were much higher led to some unexpectedly high losses for airlines in Q4 (see box). There was also an issue with refinery margins that rose from 25% over crude oil prices in Q3 to over 40% in Q4, causing spot prices for jet fuel to fall by less than oil prices.

Fuel hedging together with recent changes to accounting rules has produced a complex and potentially confusing impact on reported net profits in 2008. There are three main ways in which fuel hedges have affected airline financial results. First, hedges like forward contracts produced cash losses in Q4 where the forward price paid was much higher than spot. Second, other hedging instruments that were 'out of the money' in the sense that if exercised would produce a cash loss were 'marked-to-market' and that paper loss was written off reserves in the airline's balance sheet – if the hedging instrument was considered 'effective'. Third, recent changes to international accounting rules have meant that if the hedging instrument is considered 'ineffective' the paper loss needs to be registered as a loss in the P&L, despite there being no immediate adverse impact on cash flow. We already strip out non-cash P&L items like the \$6.9 billion goodwill writeoff associated with the Delta/Northwest merger. If all the non-cash P&L items are included the US industry registered a net loss of around \$21 billion in 2008, compared to the underlying \$5 billion net loss we have used here. In addition to these items **we have sought to strip out 'mark-to-market' fuel hedging losses from net losses, since they do not represent a realised cash loss.** In Asia alone these totalled \$5 billion in 2008 and, we estimate, a total of at least \$8 billion across the industry. If these 'mark-to-market' fuel hedging losses are included then our estimate of industry net losses in 2008 of \$8.5 billion rises to \$16-17 billion. As more airlines report 2008 results further information on this issue and underlying performance may lead to revisions to our first estimate of 2008 net losses reported in this briefing at \$8.5 billion.

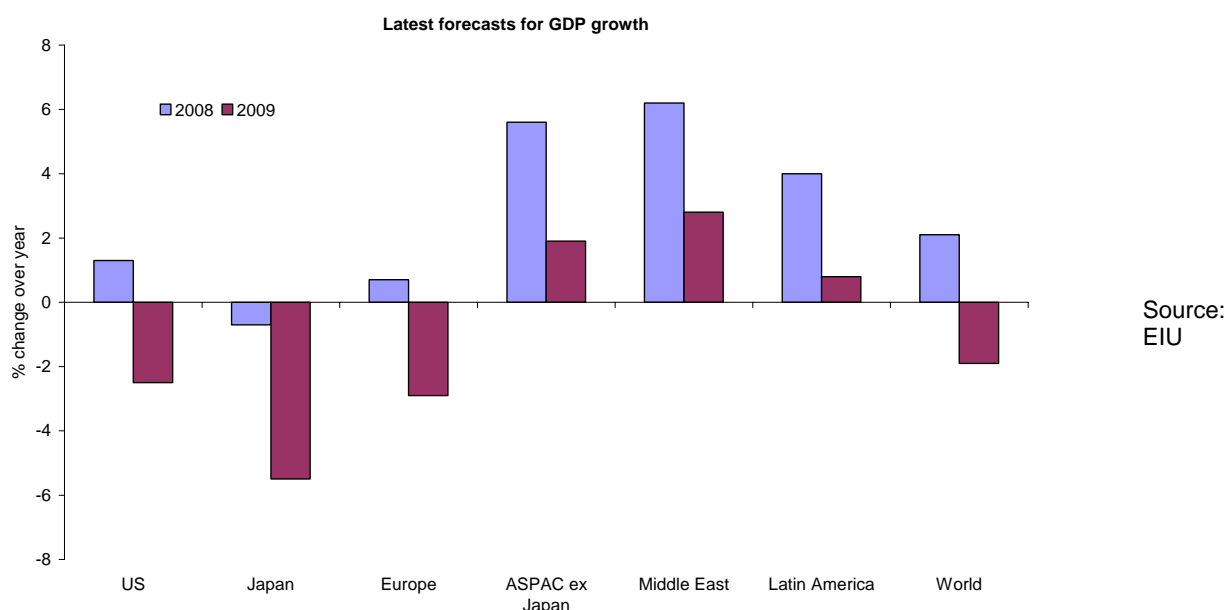
PREMIUM TRAVEL AND FREIGHT FALL SHARPLY



- The big shock at the turn of the year was the collapse of freight demand, which was down an unprecedented 23%. Premium passenger numbers also slumped by almost 17% by January but that was a more normal cyclical slump – falls of more than 20% have been experienced in past downturns. Both of these together represent a major challenge to network airline profitability since, in normal times, revenues from both make a disproportionate contribution to profitability. Larger than expected Q4 losses were partly due to this.

- The shrinkage of air freight by almost a quarter has never been experienced before in post-war years typified by expanding globalisation and reducing trade barriers. Partly this reflects the depth of the recession and extreme weakness in business demand for capital goods and lack of consumer demand for electronics and other high value/low weight products normally shipped by air. However, there was also a huge stock overhang that developed at the end of last year that caused manufacturers and retailers to reduce inventories and so abruptly cut shipments of components and products by air. Freight slumped as a result.
- These developments made for an extremely weak start to 2009 and simple arithmetic shows that our December forecasts for a 5% and 3% decline in cargo and passenger demand respectively now look highly optimistic.

WORST RECESSION SINCE 1930s FORECAST



- The airline industry was not the only sector to suffer at the end of last year. Overall GDP fell at an annualised rate of around 6% in the US, 12% in Japan and 20% for South Korea. What began with the credit crunch and a financial sector crisis have become a manufacturing crisis and the exporting economies of Asia and Europe are now suffering severely, as world trade contracts.
- Governments are responding with bank bailout packages that seem to be stabilising the situation in the face of banking losses estimated by some at \$3.6 trillion. Fiscal stimulus is also being supplied in the form of government spending to replace shrunken private spending as both households and business conserve cash and try to pay down some of the debt built up during the credit boom years. The US package represents an addition of 5.5% to US GDP. As yet it is not clear whether this is enough to generate an economic recovery.

CAPACITY SHRINKS BUT LAGS FALL IN DEMAND

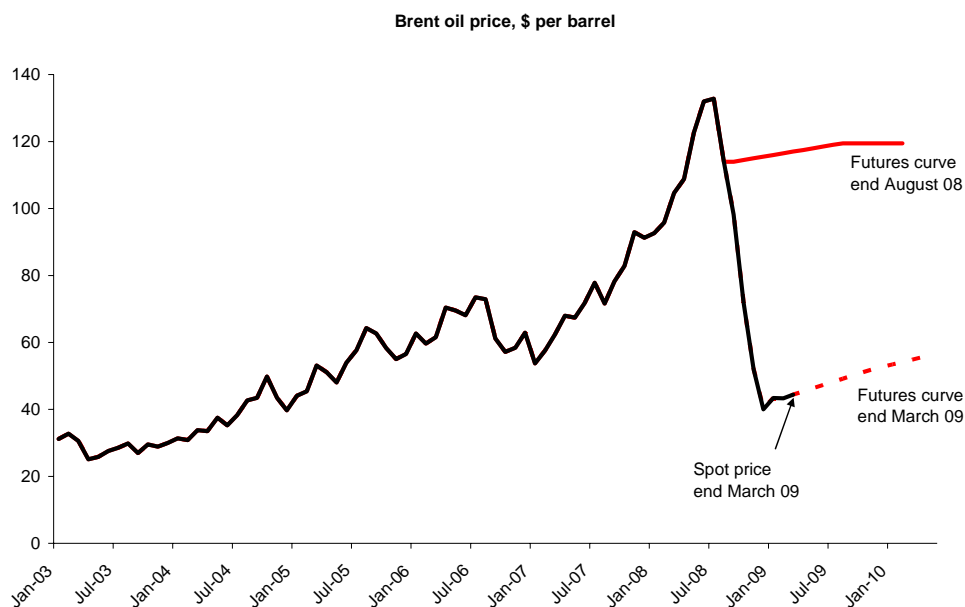
Annual average growth rates, %	2006	2007	2008E	2009F	2006	2007	2008E	2009F
	Traffic volumes (tkp)				Capacity (atk)			
Global	5.3	5.3	-1.2	-7.8	4.1	5.0	2.0	-6.0
Regions								
North America	2.7	3.5	-2.5	-7.5	0.5	3.2	-1.7	-7.5
Europe	4.9	2.1	1.3	-6.5	3.9	3.5	2.6	-5.3
Asia-Pacific	7.5	7.8	-1.6	-6.8	6.7	6.9	2.3	-4.0
Middle East	11.8	16.4	6.1	1.2	12.6	14.5	8.3	3.8
Latin America	-3.4	9.9	0.0	-7.8	1.6	6.9	3.4	-3.8
Africa	7.0	4.5	-4.1	-7.8	1.8	5.8	-3.4	-6.0

Source: ICAO data to 2007. IATA 2008-09 forecasts. Domestic and international traffic. Includes passenger and cargo by weight.

- Our forecast is based on the view that the economy and demand for air transport will hit bottom by the middle of the year. If correct much (but not all) of the decline in traffic volumes had already occurred by January, when international RPKs were down 5.6% and international FTKs were down 23.2%.

- Economic forecasts, now showing a 1.9% decline in world GDP this year, essentially describe economies moving sideways after the extremely weak start to this year. Most expect only very weak recovery during 2010 with only later in that year signs of today's bank and fiscal packages starting to produce a significant economic recovery. Overall air traffic demand is forecast to shrink 7.8% during 2009 as a consequence.
- US airlines are expected to cut capacity in line with lower demand, which allows an improvement in their financial performance. However, elsewhere capacity cuts are unable to keep up with the demand slump.

LOWER OIL PRICES REDUCE COSTS IN 2009



Source:
RBS,
Bloomberg

- Lower oil prices should bring about substantial fuel cost savings in 2009. We estimate airlines' fuel bill will fall \$52 billion this year to 25% of operating costs. Futures markets and the consensus of oil market 'experts' both point to a moderate rise in oil prices this year from current levels to average \$50/b. Recession has also narrowed the 'crack spread' implying average jet fuel prices of \$58/b this year.

System-wide global commercial aviation	2000	2001	2002	2003	2004	2005	2006	2007	2008E	2009F
REVENUES, \$ billion	329	307	306	322	379	413	465	508	530	467
Passenger	256	239	238	249	294	323	365	401	417	370
Cargo	40	39	38	40	47	48	53	58	57	46
Traffic volumes										
Passenger growth, tkp, %	8.6	-2.7	1.0	2.3	14.9	7.0	5.9	5.9	0.1	-5.7
Passenger numbers, millions	1672	1640	1639	1691	1888	2022	2124	2260	2247	2118
Cargo growth, tkp, %	9.1	-6.0	8.7	3.9	7.9	0.4	3.9	4.0	-4.5	-13.0
Freight tonnes, millions	30.4	28.8	31.4	33.5	36.7	37.6	39.8	41.6	39.7	34.6
World economic growth, %	4.5	2.2	2.7	2.8	4.2	3.4	4.0	3.8	2.1	-1.9
Yield growth, %	-1.1	-2.8	-3.7	2.3	4.5	4.0	6.9	3.6	5.6	-4.3
Yield growth, inflation/ex rate adjusted %	-2.3	-2.9	-5.9	-5.3	-2.0	0.1	3.3	-1.3	0.2	-1.5
EXPENSES, \$ billion	318	319	311	323	376	409	450	488	527	464
Fuel	46	43	40	44	65	91	107	136	168	116
% of expenses	14	13	13	14	17	22	24	28	32	25
Crude oil price, Brent, \$/b	28.8	24.7	25.1	28.8	38.3	54.5	65.1	73.0	99.0	50.0
Non-Fuel	272	276	270	279	311	318	343	353	360	348
cents per atk (non-fuel unit cost)	39.2	39.7	38.8	38.9	39.5	38.7	40.1	39.2	39.2	40.4
% change	-2.3	1.4	-2.3	0.3	1.4	-2.1	3.6	-2.1	0.0	3.0
% change, adjusted for ex rate	-0.2	4.1	-3.0	-5.0	-2.4	-2.7	3.3	-4.1	-1.5	4.7
Break-even weight load factor, %	60.8	61.5	63.2	62.3	63.4	63.3	63.4	61.9	62.5	61.0
Weight load factor achieved, %	61.5	59.0	60.9	60.8	62.5	62.6	63.3	63.6	61.5	60.4
OPERATING PROFIT, \$ billion	10.7	-11.8	-4.8	-1.4	3.3	4.3	15.0	19.7	2.2	3.0
% margin	3.3	-3.8	-1.6	-0.4	0.9	1.0	3.2	3.9	0.4	0.6
NET PROFIT, \$ billion	3.7	-13.0	-11.3	-7.5	-5.6	-4.1	-0.1	12.9	-8.5	-4.7
% margin	1.1	-4.2	-3.7	-2.3	-1.5	-1.0	0.0	2.5	-1.6	-1.0

Source: ICAO data to 2007. IATA 2008-9 forecasts. Excludes exceptional accounting items and mark-to-market fuel hedging losses.