

Earnings Reports and Airlines, October 2009

Airsavings' CEO Raphael Bejar Outlines What to Expect from Airlines' Third Quarter Earnings Reports (Hint: It's Not All Bad)

Paris, France—October 2009 - It's that time again; quarterly earnings reports are due out this month from airlines around the world. Most likely, these will reflect the fragile state of the industry - and the economy as a whole - with stories about losses dominating headlines.

But losses aren't the whole story. At a time when many of the world's industries are battered beyond recognition, the airline industry has showed remarkable resilience and the ability to rebound, time and again. And without bailouts. So the modest quarterly losses we anticipate being reported by both legacy airlines and low cost carriers could, in fact, be much worse.

After all, the decline in demand for air travel that accompanied the Great Recession was one of the most severe ever encountered by the industry, and the respite airlines enjoyed from sky-high fuel prices was relatively short lived (as of this writing, crude oil was trading at \$70/barrel, still below the July 2008 highs but nearly double the February/March '09 lows of around \$35).

Instead, we are seeing the results of two industry-wide strategies coming to fruition. The first is the dramatic reduction in capacity carried out by most airlines in the last two quarters of 2008. The second, and perhaps greatest seismic shift in airline operations in the last three decades, is the emphasis on ancillary revenue development as a core operating strategy. While the first is clearly responsible for the mitigation of fixed costs (fuller flights=more efficient flights, from a P&L standpoint), the second provides a platform for economic viability far, far into the future.

Based on these developments, the following represents what we at Airsavings forecast for this quarter's earnings season, and beyond.

Fuel Related Losses

The fact that fuel prices have nearly doubled over the second and third quarters of this year will almost certainly affect many airlines. Look for those carriers with established fuel hedging programs (or those that were brave enough to engage in hedging contracts when fuel prices were at their first quarter lows) to fare best, but overall look for increased costs to dampen profitability.

Going forward, analysts are split as to where they expect fuel prices to go in the near future. We have seen at least one report that projects crude oil to break the \$100 barrier in as little as 18 months, while many others anticipate price growth commensurate with the global economic recovery. We- and history - fall on the latter side of this argument.

Capacity Constrained

Especially in light of the rise in fixed costs, expect most carriers to continue managing their capacity in a highly disciplined way. It may seem common sensical to state, but those airlines flying the fullest planes are likely to have the best margins- and most likely to post the smallest losses.

For consumers, this may mean fewer options for flights or routes with any given carrier (or with carriers within a code sharing group or alliance), but this also presents an opportunity for low cost carriers or regional airlines to meet whatever excess demand is left over from capacity-conscious legacies.





Ancillary Revenues Rule

An area that will truly separate the winners from the losers this quarter. We believe that a strong correlation will emerge between those airlines that execute robust, effective ancillary revenue development strategies and third quarter profitability. In fact, we expect that correlation to extend well into the next three years, as core product sales begin to represent a smaller and smaller portion of airlines' top line.

Look for those airlines that do ancillary revenues the best- including those LCCs that rely less on unbundled-airfare ancillaries (like baggage fees, etc.) and emphasize commission-based ancillary revenue streams- to outperform their competitors. These are the airlines that understand the future of the industry the best (as well as their passengers), and have been early adopters of the ancillary revenue development strategies that represent the future of the industry at large.

In short, don't focus too much on the negative earnings sure to surface this week or next. Depressed demand is a fact of life for just about every industry, for the foreseeable future. Airlines, which have always skated on the edge of profitability anyway, may not post substantial earnings gains until the demand for their core product returns -which will likely be on pace with the general economic recovery.

But for those airlines that have strong ancillary revenue program already in place, manage their capacity well, and engage in effective cost mitigation tactics will consistently outperform industry expectations.

There may just be more of those airlines out there that you think.

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About Raphael Bejar and Airsavings

Raphael Bejar is CEO of Airsavings, a Paris-based company that specializes in facilitating the two fundamental operational imperatives of the airline industry: cost reduction and revenue generation. By assisting airlines in unbundling their core services and providing a speedy, cost effective platform on which to offer ancillary services, Airsavings helps carriers to swiftly and easily develop alternative revenue streams. And by employing one of Europe's most successful group buying systems, Airsavings helps member airlines obtain competitive pricing on critical goods and services. As founder and chief executive of a company that focuses on the critical operational aspects of low cost and mid-sized carriers around the globe, and with his 15 years of experience in airline finance with European giants Credit Foncier and Jet Finance, Mr. Bejar is uniquely positioned to comment on issues affecting the airline industry.

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