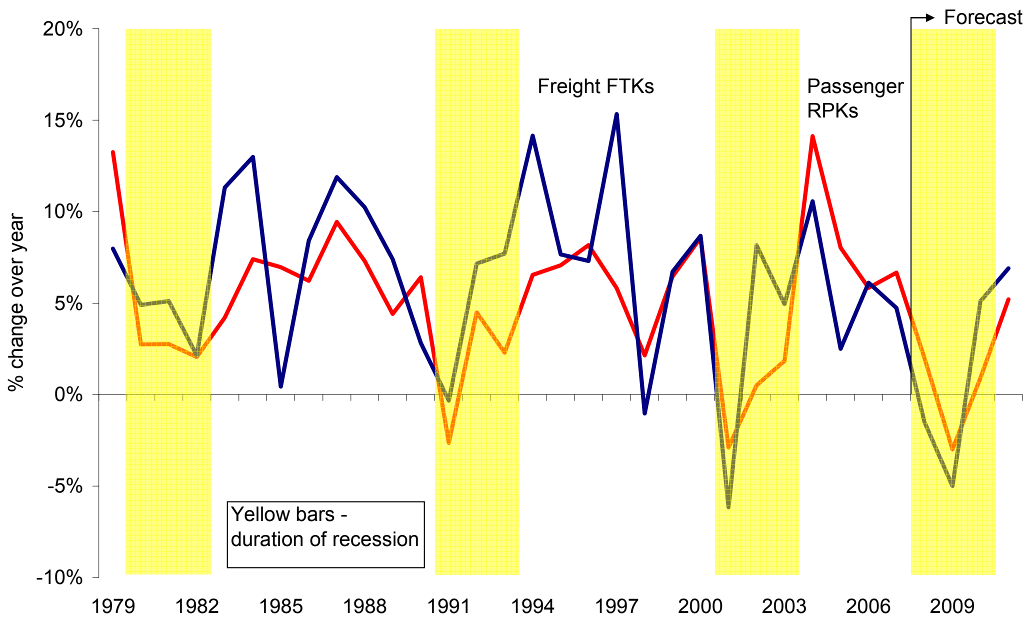
FINANCIAL FORECAST

December 2008

LENGTHY RECESSION IS NOW MAIN CHALLENGE

- The outlook for the airline industry has changed dramatically since the last forecast was put together three months ago. Spot oil prices have more than halved to around $50 a barrel but, following the near collapse of the banking system, the deepest recession since the early-1980s is now expected in 2009.
- We had expected modest economic growth in 2009 to generate modest growth in both air traffic and revenues. Recession now means that passenger traffic is forecast to fall 3%, cargo to fall 5% and revenues to fall by over 6% in 2009 producing an extremely challenging revenue environment for the industry.



Source: ICAO, IATA

- The first half spike in oil and jet fuel prices was the principle cause of the $5 billion industry net losses we forecast for 2008, with the bulk of these occuring in the US where hedging protection was least. However, that fuel price spike caused airlines, particularly in the US, to drastically cut their future capacity plans. In addition the recession has led us to slash our previous forecast for oil prices in 2009 from $110/b to $60/b.
- Deep recession and the most challenging revenue environment for fifty years will lead to larger losses during 2009 in all regions except the US. In both Europe and Asia we expect losses of $1 billion or more. The exception is the US where low hedging, leading to the full benefits of low fuel prices, and early substantial capacity cuts will lead to a counter-cyclical return to profit, albeit small.

Industry profits, US$ billion	2006	2007	2008F	2009F	2006	2007	2008F	2009F
	Operating profits				Net profits			
Global	**15.0**	**19.7**	**1.1**	**3.9**	**-0.1**	**12.9**	**-5.0**	**-2.5**
excluding restructuring costs					3.6	12.9	-5.0	-2.5
Regions								
North America	7.3	9.3	-0.3	3.6	-2.6	5.3	-3.9	0.3
excluding restructuring costs					1.0	5.3	-3.9	0.3
Europe	5.2	6.4	1.5	0.7	1.8	5.4	-0.1	-1.0
Asia-Pacific	1.8	3.5	-0.1	-0.6	0.9	2.1	-0.5	-1.1
Middle East	0.0	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.2
Latin America	0.5	0.4	0.1	0.1	0.1	0.1	-0.1	-0.2
Africa	0.1	0.1	0.0	0.0	-0.2	0.1	-0.3	-0.3

Source: ICAO data to 2007. IATA 2008-09 forecasts. Excludes 'fresh-start' items.

Data revisions: ICAO has revised its estimate of 2007 net profits for the commercial airline industry from a provisional estimate of $4.7 billion to $12.9 billion. A revision to this data is common and we had made an allowance for this in the $5.6 billion we used previously as the historic 2007 data on which to base our forecast of 2008-09 profits. However, the scale of the revision is larger than usual, albeit still only 1.6% of revenues. ICAO reported that the revision was due to late delivery of data on 'below the line' asset sales and profits from affiliate companies, cash flows from which were much larger than in previous years. 'Above the line' data have been subject to the usual minor revisions.

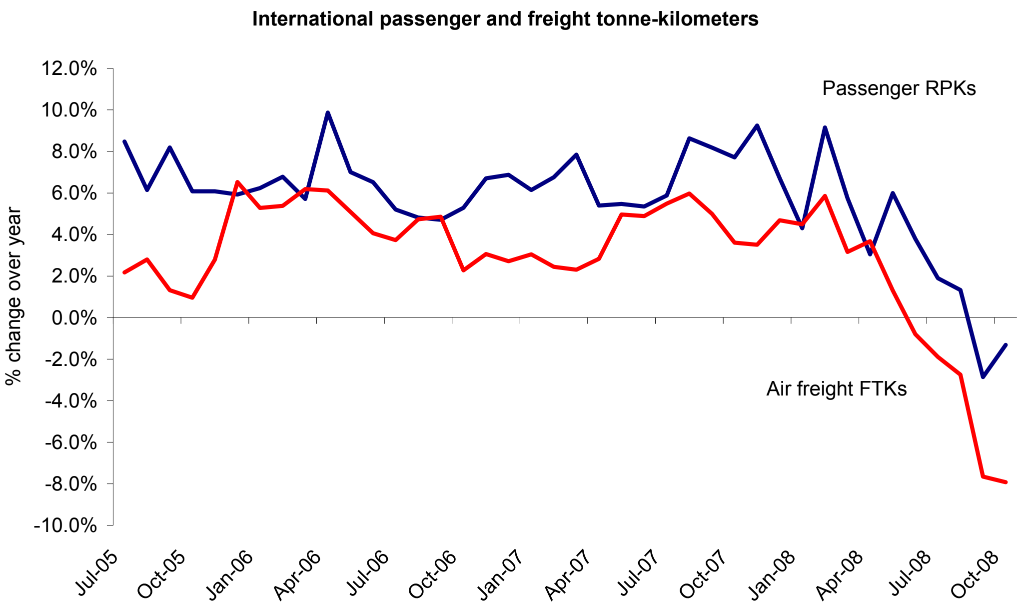
2008Q1-Q3 NET LOSSES HAVE EXCEEDED $4 BN

		2007 Q1-Q3		2008Q1-Q3	
		US $ million			
	Nb Airlines	**Op. profits**	**Net profits**	**Op. profits**	**Net profits**
US	13	7452	7029	-600	-3589
Europe*	13	6002	6016	3008	-34
Asia - Pacific**	8	3678	3504	1871	-592
Other	2	356	246	436	183
TOTAL	36	17,487	16,795	4,715	-4,033

Source: company reports

- Profitability has deteriorated very sharply during 2008 as the spot price of jet fuel rose from $90 barrel in January to peak at $180 a barrel in July, leading to a $38 billion rise in the industry's fuel bill for the year as a whole. Hedging limited, or rather delayed, the damage from the surge in energy costs in many regions. However, US airlines were almost fully exposed to the rise in spot prices. Moreover, the end-2007 collapse in the US housing market and the resulting credit crunch had caused the confidence of US consumers and travellers to slump early this year.
- As a result the bulk of losses at the operating and net post-tax levels have occurred in the US industry. Nevertheless, airlines in other regions have not escaped the spike in fuel prices nor the onset of recession from the second quarter. Both Japan and Europe were in recession during both Q2 and Q3 this year. Both of these regions saw previously robust airline profits slip into loss during the first three months of this year.

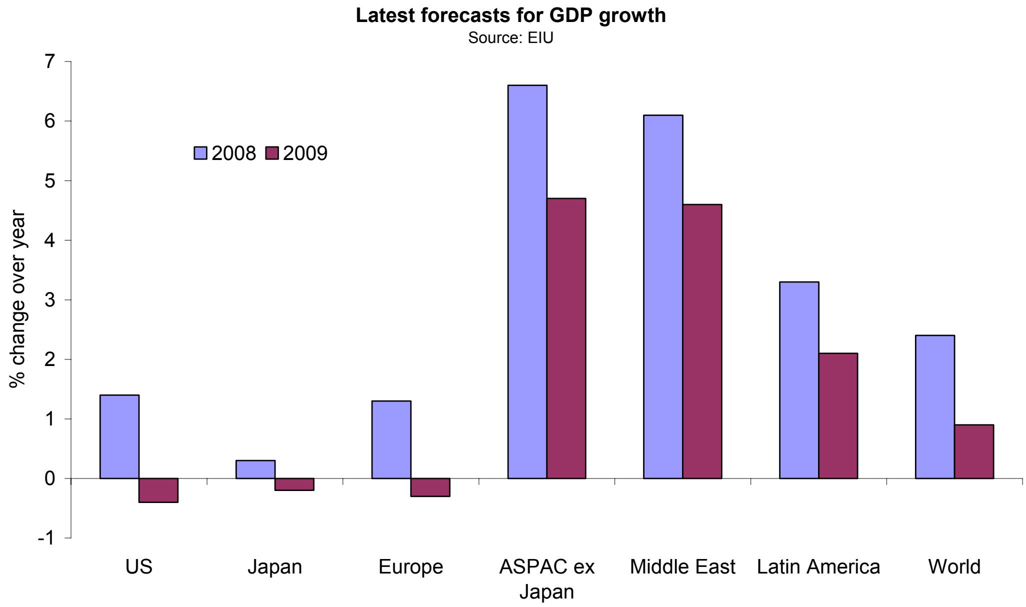
PRECIPITOUS FALL IN AIR TRAFFIC VOLUMES



Source: IATA

- Both passenger and air freight markets were growing at reasonably robust rates during the first half of this year. However, since recession hit, the fall in both markets has been precipitous. Air freight in particular suffered early losses as world trade contracted and was down almost 8% in October. The deterioration in passenger markets was a little later, as is usually the case, when jobs started to be lost. By September and October passenger volumes were shrinking at an average rate of over 2%.
- Since business and consumer confidence slumped in October and November, following the near-collapse of the banking system, further absolute falls in both passenger and freight markets are expected.

DEEP RECESSION IS NOW FORECAST



Source: EIU

- Economic growth is the principle driver of the industry's passenger and freight markets. Price is also important but just a casual look at the closeness with which traffic volumes follow GDP up and down confirms statistical evidence that price elasticity/sensitivity is low (at an industry-wide level, not airline or city-pair level) and GDP or income elasticity is high. As a result recession is particularly bad news for market prospects.
- Just three months ago mainstream economists were forecasting that the US economy would be growing by about 0.5% and both Europe and Japan by 1.5% in 2009. All three major economies are now expected to shrink in their worst recession since the early 1980s. Moreover, a much more substantial slowdown is expected in the previously robust emerging markets, including China and India. Overall, the forecast for global economic growth has been cut from 2.6% to 0.9% which is the lowest growth rate since the 1981 recession. In the 1991 recession global growth was 1.5% and during the 2001 downturn it was 2.2%.

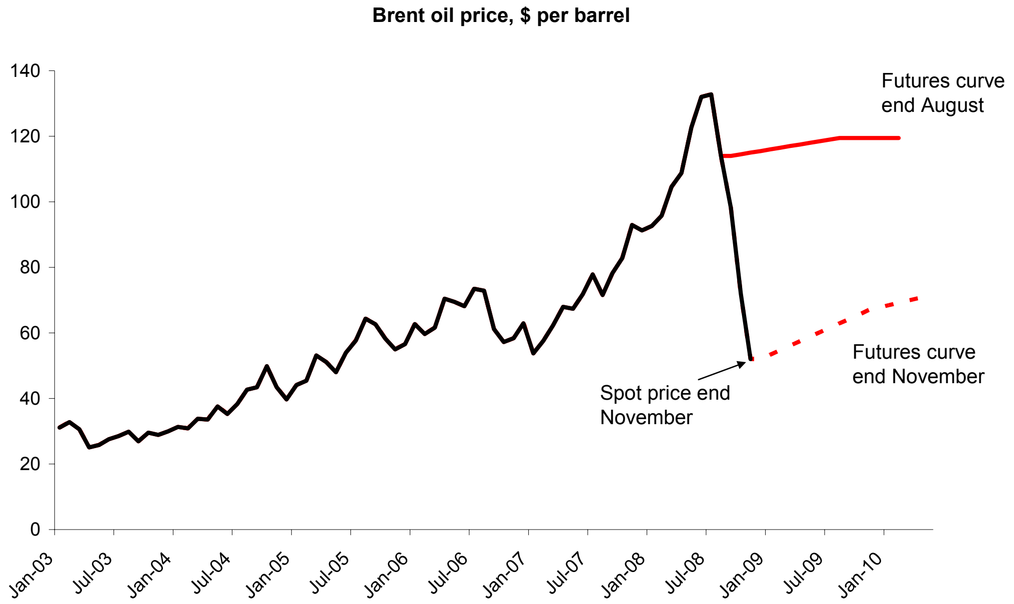
CAPACITY IS BEING CUT FASTER THAN NORMAL

Annual average growth rates, %	2006	2007	2008F	2009F	2006	2007	2008F	2009F
	Traffic volumes (tkp)				Capacity (atk)			
Global	5.3	5.3	0.9	-3.6	4.1	5.0	2.0	-2.5
Regions								
North America	2.7	3.5	-1.3	-4.8	0.5	3.2	-0.1	-5.7
Europe	4.9	2.1	1.1	-3.6	3.9	3.5	1.7	-2.5
Asia-Pacific	7.5	7.8	0.6	-2.5	6.7	6.9	2.3	-0.5
Middle East	11.8	16.4	7.6	1.2	12.6	14.5	7.4	4.9
Latin America	-3.4	9.9	1.5	-4.1	1.6	6.9	3.4	-0.2
Africa	7.0	4.5	-1.9	-3.6	1.8	5.8	-3.4	-2.5

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

- We had been forecasting growth in traffic of 2.8% in 2008 and 2.9% in 2009. Now, as a result of the recession we forecast a sharp fall in traffic, with passenger RPKs down 3% and freight FTKs down 5% in 2009. Overall that means a global traffic decline of 3.6% in 2009, following growth of only 0.9% in 2008 as growth in the early part of this year was offset by the sharp decline from mid-year.
- There are also significant changes in capacity. US airlines had earlier announced plans to cut domestic capacity by around 10% in 2009, but published plans now show cuts on international markets too. This is expected to allow US airlines to actually raise load factors through the recession, since traffic is not expected to fall as far as capacity despite the recession. This is key to US airlines eliminating losses next year.
- In other regions capacity has proved harder to cut quickly. In Europe there is a danger of losing slots at congested airports if they are not used, while in Asia and the Middle East there are substantial numbers of new aircraft being delivered. As a result traffic is forecast to fall faster than capacity in all regions outside the US, leading to a fall in load factors and downward pressure on yields and profitability.

OIL PRICE EXPECTATIONS HAVE FALLEN $50/B



Source: RBS, Bloomberg

- The bursting of the oil and, more generally, the commodities price bubble was more dramatic than virtually all analysts expected. Spot oil prices are now $60 a barrel lower, and futures prices $50 a barrel lower, than when we put our last forecast together at the end of August. At that time futures markets were predicting oil prices at $120 a barrel in 2009. We, and the 'analyst consensus', took the view that softer economic growth would lead to oil prices averaging $110 a barrel. We have now cut that forecast to $60 a barrel for 2009, following an average $100 a barrel this year.
- Without hedging a $40 a barrel fall in the price of oil and jet fuel would reduce fuel costs by over $60 billion. However, while hedging reduced the price paid for fuel below the spot price during the first half of this year it is working against the industry during the rest of the year and into 2009. As a result the effective fuel price only falls by an estimated $17 a barrel which, with lower capacity, should cut the fuel bill by $32 billion in 2009. This and a $35 billion fall in revenues is why we forecast the industry will remain in loss next year.

System-wide global commercial aviation	2000	2001	2002	2003	2004	2005	2006	2007	2008F	2009F
REVENUES, $ billion	329	307	306	322	379	413	465	508	536	501
Passenger	256	239	238	249	294	323	365	401	425	394
Cargo	40	39	38	40	47	48	53	58	59	54
Traffic volumes										
Passenger growth, tkp, %	8.6	-2.7	1.0	2.3	14.9	7.0	5.9	5.9	2.0	-3.0
Passenger numbers, millions	1672	1640	1639	1691	1888	2022	2124	2260	2304	2236
Cargo growth, tkp, %	9.1	-6.0	8.7	3.9	7.9	0.4	3.9	4.0	-1.5	-5.0
Freight tonnes, millions	30.4	28.8	31.4	33.5	36.7	37.6	39.8	41.6	41.0	38.9
World economic growth, %	4.5	2.2	2.7	2.8	4.2	3.4	4.0	3.8	2.6	0.9
Yield growth, %	-1.1	-2.8	-3.7	2.3	4.5	4.0	6.9	3.6	4.6	-3.0
Yield growth, inflation/ex rate adjusted %	-2.3	-2.9	-5.9	-5.3	-2.0	0.1	3.3	-1.3	0.2	-5.3
EXPENSES, $ billion	318	319	311	323	376	409	450	488	535	497
Fuel	46	43	40	44	65	91	107	136	174	142
% of expenses	14	13	13	14	17	22	24	28	32	29
Crude oil price, Brent, $/b	28.8	24.7	25.1	28.8	38.3	54.5	65.1	73.0	100.0	60.0
Non-Fuel	272	276	270	279	311	318	343	353	361	356
cents per atk (non-fuel unit cost)	39.2	39.7	38.8	38.9	39.5	38.7	40.1	39.2	39.4	39.7
% change	-2.3	1.4	-2.3	0.3	1.4	-2.1	3.6	-2.1	0.4	1.0
% change, adjusted for ex rate	-0.2	4.1	-3.0	-5.0	-2.4	-2.7	3.3	-4.1	0.6	1.0
Break-even weight load factor, %	60.8	61.5	63.2	62.3	63.4	63.3	63.4	62.8	63.5	62.5
Weight load factor achieved, %	61.5	59.0	60.9	60.8	62.5	62.6	63.3	63.6	62.9	62.2
OPERATING PROFIT, $ billion	10.7	-11.8	-4.8	-1.4	3.3	4.3	15.0	19.7	1.1	3.9
% margin	3.3	-3.8	-1.6	-0.4	0.9	1.0	3.2	3.9	0.2	0.8
NET PROFIT, $ billion	3.7	-13.0	-11.3	-7.5	-5.6	-4.1	-0.1	12.9	-5.0	-2.5
% margin	1.1	-4.2	-3.7	-2.3	-1.5	-1.0	0.0	2.5	-0.9	-0.5

Source: ICAO data to 2007. IATA 2008-9 forecasts. Excludes 'fresh-start' accounting items.

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