



Turbulence Ahead for Airlines in '09

The principal founder of Delta Airlines, C.E. Woolman once said, "Running an airline is like having a baby: fun to conceive, but hell to deliver." Indeed, delivering good earnings results during the current economic crisis is likely to pose a serious challenge to most firms. Airline companies are no exception and are in for some turbulent times in 2009. Overall, global industry revenue is expected to decline to US\$501 billion, a US\$35 billion decline from revenues forecasted for 2008. This is significant as it represents the first fall in airline industry revenue since registering two consecutive years of decline in 2001 and 2002.

There are several major factors to be examined in order to project airline industry performance in 2009. Demand destruction for air transport, fuel prices, credit availability to finance operations and management of capacity and costs would all play a part in determining the industry's outlook.

In terms of demand for air travel, following growth of 2% in 2008, passenger traffic is forecasted to fall by 3%, representing the first decline in passenger traffic since the 2001 drop of 2.7%. Global cargo traffic is also expected to decrease by 5%, following a drop of 1.5% in 2008. Prior to 2008, the last time that cargo transport demand declined was also in 2001, when a 6% drop was recorded. Asian-Pacific (including Japan) airlines cover 45% of the global cargo market, therefore these carriers in particular will be adversely affected. Asia-Pacific airlines may thus sustain losses amounting to more than twice that seen in 2008 to about US\$1.1 billion in 2009. Air cargo comprises 35% of the value of goods traded internationally, and for this reason the forecasted decline in demand serves as a stark reminder that the global economic slowdown may persist well into 2009.

Fuel prices, which are driven by oil prices, play an important role in airline profitability. US airlines were caught relatively off guard when prices skyrocketed. Those hardest hit by the fuel price increases posted the largest losses for 2008. We expect oil however, to average US\$45 per barrel in 2009 after averaging over \$100 a barrel in 2008. Airline operating margins may thus begin to recover somewhat next year, driven mainly by more favourable fuel costs. Cash balances at many companies may remain constrained though, due to substantial debt maturities at most airlines which will be difficult to re-finance if tight credit conditions continue.

In terms of credit availability, estimates place the 2009 debt and capital lease maturities of the seven largest U.S. airlines at \$4.4 billion, with approximately \$6 billion more becoming due in 2010. Traditional sources of financing such as bank debt and sale-leasebacks have become largely inaccessible, so airlines need to focus on improving their liquidity positions to ensure survival in what will be a tough year.

In an attempt to mitigate the negative cost effects of oil's historic rise in 2008, some US airlines had reduced domestic capacity. These airlines have thus given themselves a head start in staving off the effects of current declining demand due to

the depressed economy. Consequently, some US airlines are likely to register small profits in 2009.

Over in Europe, airline companies' losses are forecasted to increase phenomenally by almost ten times to US\$1 billion. Demand for air transport is likely to remain muted as Europe's major economies are already facing recessionary conditions. Unfortunately for many of Europe's carriers, prior attempted hedging strategies have locked in fuel contracts at high prices in US dollar terms, and the weakened Euro is exacerbating the situation. Losses incurred by Middle Eastern airlines will most likely double to US\$200 million over 2009 as the region struggles to match capacity to demand as fleets expand and air traffic slows especially in the case of long-distance connections. Across Latin America, demand for the region's commodities has fallen off substantially due to tougher economic times and with this decline, falling incomes has led to a decline in demand for air transport. Latin American airlines are thus forecasting that 2009 losses will stand at US\$200 million, twice that of 2008.

Following the finalization of the Delta-Northwest merger in October 2008, no additional consolidation within the industry is expected in the near term with liquidity remaining tight amidst difficult credit conditions. U.S. airlines though, are expected to actively seek expansion of international alliance relationships with emphasis on code-share revenue benefits that incur relatively mild incremental costs for far less integration risk versus full-fledged mergers. Among the initiatives toward increased international cooperation are the announced entry of Continental into the Star Alliance next year, American Airlines' renewed efforts to complete its trans-Atlantic partnership with British Airways and the achievement of broad antitrust immunity within a more closely integrated SkyTeam Alliance.

The Revenue per Available Seat Mile (RASM) is the amount of revenue that an airline generates divided by all the potential seats that are available for purchase at any given point in time. RASM across the industry is likely to be the best leading indicator of free cash flow trends in 2009. Since fuel costs are beyond the control of the airlines, the industry's ability to maintain adequate liquidity levels amidst a deep recession will hinge on efforts to keep yields and unit revenue from dropping drastically by effectively managing scheduled capacity, non-fuel operating expenses and capital spending. American industrialist Henry Ford once said "When everything seems to be going against you, remember that the airplane takes off against the wind, not with it." Many airlines are hoping that the recessionary headwinds of 2009 do not prove to be insurmountable.

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Table 1: Regional Market Performance (as at 22 January 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	845.59	1.11	0.52	0.32	-13.84
All Trinidad	1,135.68	0.86	-1.82	-1.65	-4.88
JSE Index	86,285.03	0.03	9.48	7.65	-21.33
JSE Select	2,007.26	-0.38	5.36	1.13	-35.17
All Jamaica	74,041.24	-0.96	3.93	0.06	-34.12
BSE Composite	921.65	0.38	0.03	0.19	-10.08

Table 2: International Market Performance (as at 22 January 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	827.50	-1.92	-5.06	-8.39	-36.86
Nasdaq Composite	1,465.49	-3.07	-4.36	-7.07	-36.07
Dow Jones Industrial	8,122.80	-1.09	-4.66	-7.45	-32.15
German Dax	4,219.42	-2.71	-9.05	-12.28	-37.67
FTSE 100	4,052.23	-1.67	-4.64	-8.61	-29.40
Nikkei 225	8,051.74	0.35	-7.70	-7.95	-35.96
Hang Seng	12,657.99	-4.42	-13.43	-12.02	-41.82
DJ Eurostoxx	2,160.07	-4.32	-9.91	-11.89	-42.45

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