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Brighter Skies: Challenges and Opportunities for Asia Pacific Aviation

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Malaysia
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Presentation outline

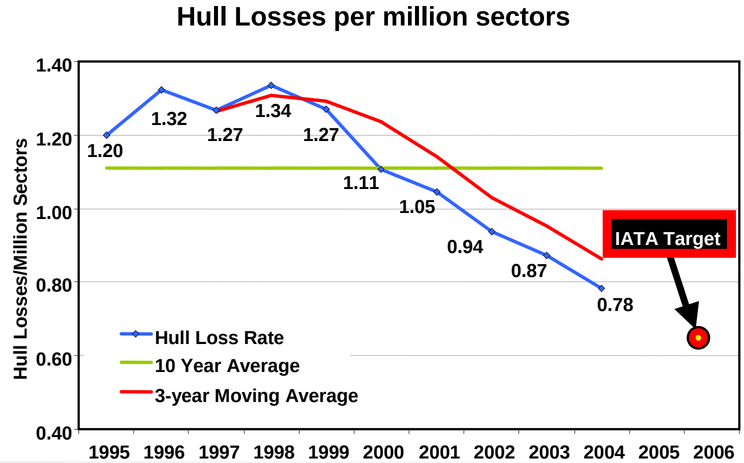
- Global aviation
- AAPA role
- Combined strength
- Management challenges
- Competition and new entrants
- Our competitive edge
- Future outlook

Global aviation: this is a great industry!

- 100 years ago the Wright brothers made their first flight
- 50 years ago: 9 million passengers
- Today: 1,800 million people flew safely last year
- Modern jet aircraft are as fuel efficient as compact cars
- Air cargo delivers 35% of global trade by value

Aviation has delivered incalculable benefits to society

Safe flying: global hull loss rate 1995-2004



Source: IATA Western-built jets

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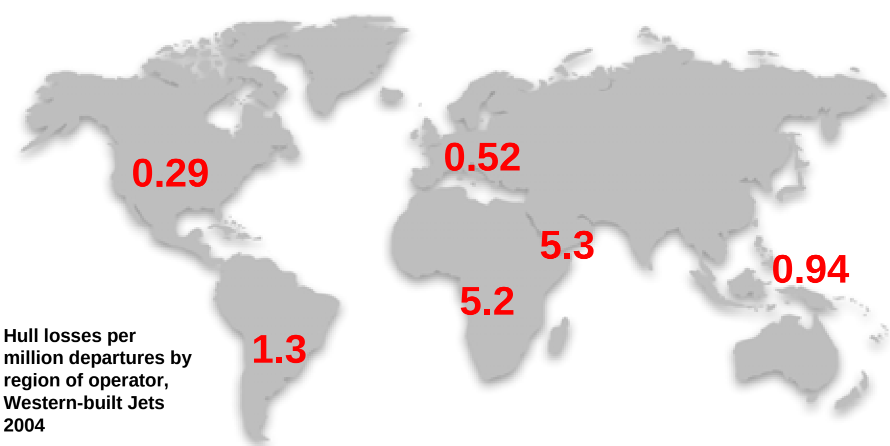
Safe and safer: 2004 hull loss rates by region



Hull losses per million departures by region of operator, Western-built Jets 2004

World average 0.78 per million sectors

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Aviation and the Environment

- Aircraft fuel consumption improved by 38% in the last 20 years
- Modern aircraft fuel consumption matches that of a small car
  - 3 litres of fuel per 100 pax-km
- Modern aircraft are 20 decibels quieter than 30 years ago
  - 75% reduction in noise impact
- Despite rapid growth, aviation accounts for only 3.5% of overall global emissions

These achievements deserve to be more widely understood

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Global industry structure

- Aviation is a mass transport business, and a key element of the modern global economy
- Highly regulated, both technically and commercially
- Outdated international bilateral regulatory framework
- Progressive liberalisation, but at a measured pace
- National ownership and control restrictions hold back global consolidation and competition
- Structural inefficiencies persist, notably uncompetitive labour costs and lack of competition amongst key service providers

Some of the many challenges for airlines and AAPA

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- Regional trade association representing 17 major international airlines based in Asia Pacific
- Committed to promoting sustainable growth of the aviation industry serving both passenger and freight needs
- Work with member airlines, governments, regulators and industry partners on issues of common concern
- Permanent secretariat headquartered in Kuala Lumpur, Malaysia
- Representation in Washington and Brussels

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Global regulatory policy issues

- Airlines facing continuing onslaught of new regulations
  - Safety
  - Security
  - Environment
  - Consumer rights
  - Taxes and charges
- These initiatives are driven by individual governments and regulatory bodies
- As a result, international airlines are confronted by conflicting and overlapping regulations
- Complexity also compounds the cost impact on the industry and its customers

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U.S. & EU : regulatory perspectives

- Mainly driven by US domestic political concerns
  - Safety, led by FAA
  - Security, led by DHS/TSA
  - Open (your) Skies
- Mainly driven by EU Domestic political concerns
  - Safety: EASA, Eurocontrol
  - Consumer rights
  - Environment
  - EC assuming lead role in aero-political process
- Insensitivity about extra-territorial impacts: unilateral actions
- Where international issues are taken into account, the focus tends to be on US-EU differences
- Insufficient recognition of Asia-Pacific role and views

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Asia Pacific: regulatory perspective

- Highly diverse: multiple governments and regulators
- Need for regional co-operation on multilateral basis
- Positive bias towards consensus, but sometimes slows the process
- Harmonisation is more about sharing best practices before legislating, not about resolving differences after unilaterally imposed regulations

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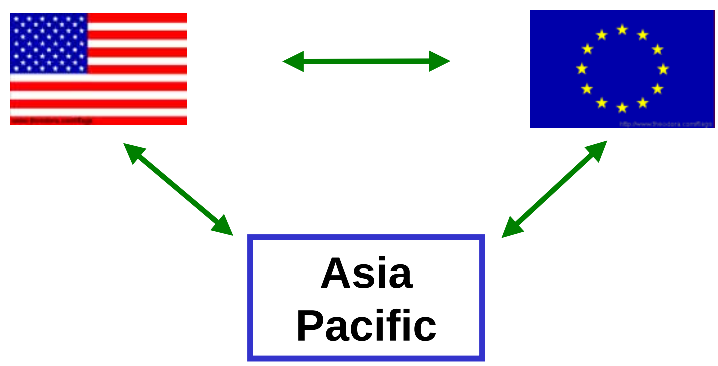
U.S. and EU: the wider impact



Need for better global harmonization
and regulatory framework

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AIR NEW ZEALAND	SINGAPORE AIRLINES	Philippine Airlines
CATHAY PACIFIC	JAL	KOREAN AIR
Asiana Airlines	DRAGONAIR 港龍航空	THAI
QANTAS		Vietnam Airlines
EVA AIR 長榮航空	Garuda Indonesia	CHINA AIRLINES
malaysia AIRLINES	ANA A STAR ALLIANCE MEMBER	ROYAL BRUNEI Giving the world Asia's best

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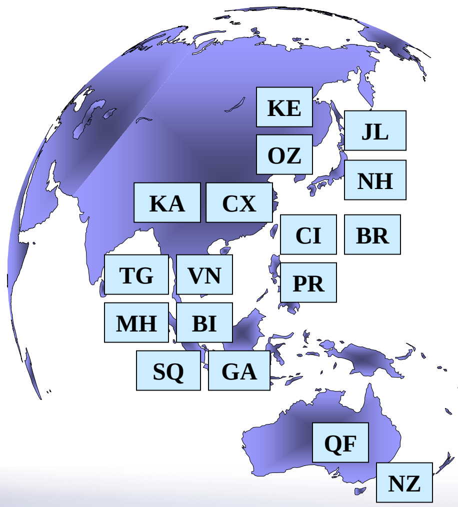
AAPA's combined strength



- 17 airlines
- US$ 65 billion revenue
- US$ 4 billion profit
- 255 million passengers
- 10 million tonnes of cargo
- 190,000 employees
- 1,300 aircraft

Global Market Share :
- **~ 19% of global pax traffic**
- **~ 33% of global cargo traffic**

Data: 2004

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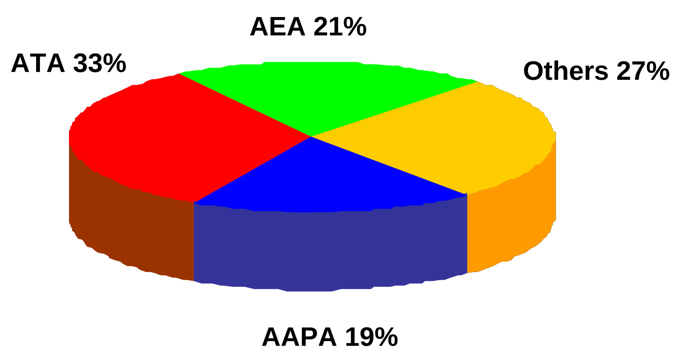
AAPA global passenger traffic share

Scheduled Systemwide
Revenue Passenger Kilometres 2003



Source: IATA AAPA: Association of Asia Pacific Airlines, ATA: Air Transport Association of America, AEA: Association of European Airlines

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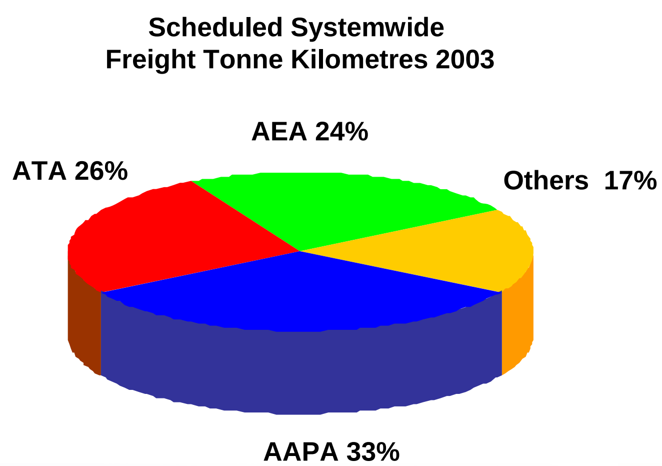
AAPA global freight traffic share



Source: IATA AAPA: Association of Asia Pacific Airlines, ATA: Air Transport Association of America, AEA: Association of European Airlines

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AAPA: fleet development

- 1,300 aircraft
- 73% of the fleet is widebody
  - Operating 25% of world's widebody passenger fleet
  - Operating 34% of world's B747F
- 46% of all new widebody orders for 2004
- 359 aircraft on order for delivery over the next 5 years
- Major customers for new types including A380 and B787

Source: AAPA and Airclaims' world air fleet (as at 10 May 2005)

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AAPA: 49 A380 orders



Emirates	43
Lufthansa	15
Qantas Airways	12
Air France	10
Federal Express	10
ILFC	10
Singapore Airlines	10
UPS	10
Malaysia Airlines	6
Thai Airways Int'l	6
Virgin Atlantic	6
China Southern Airlines	5
Kingfisher Airlines	5
Korean Air	5
Etihad Airways	4
Qatar Airways	2
Total	159


Source: Airbus

25% of world's A380 orders

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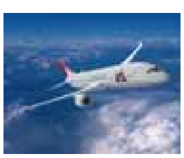
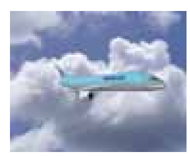
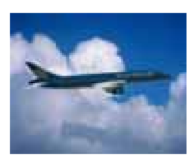
AAPA: 96 B787 orders

Mainland Chinese Carriers	60
All Nippon Airways	50
Japan Airlines	30
Primaris Airlines	20
Air Canada	14
Continental Airlines	10
Ethiopian Airlines	10
Korean Air	10
First Choice	6
Blue Panorama	4
Vietnam Airlines	4
Air New Zealand	2
Icelandair	2
Total	222

AIR NEW ZEALAND

Source: Boeing

43% of world's B787 orders

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Mainland China's aviation market

120 million passengers

Domestic 100 million

&

International 20 million

AAPA carriers are key players in serving the rapidly growing Chinese market

Source: CAAC

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AAPA: Mainland China's destinations

AAPA members serve a total of 28 Mainland Chinese cities

		Flights/Week
1.	Shanghai	280
2.	Beijing	168
3.	Xiamen	50
4.	Guangzhou	44
5.	Qingdao	39
6.	Hangzhou	36
7.	Kunming	24
8.	Dalian	23
9.	Chengdu	22
10.	Tianjin	17

Over 800 flights per week

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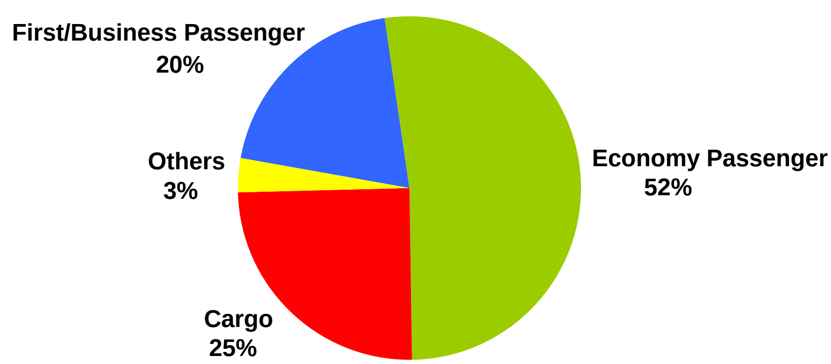
Airline management: past lessons

- Benefits of diverse revenue mix
- Passenger demand
  - Business
  - Leisure
- Network strength
  - Short haul
  - Long haul
- Cargo demand
- Critical importance of cost management

AAPA: international revenue mix

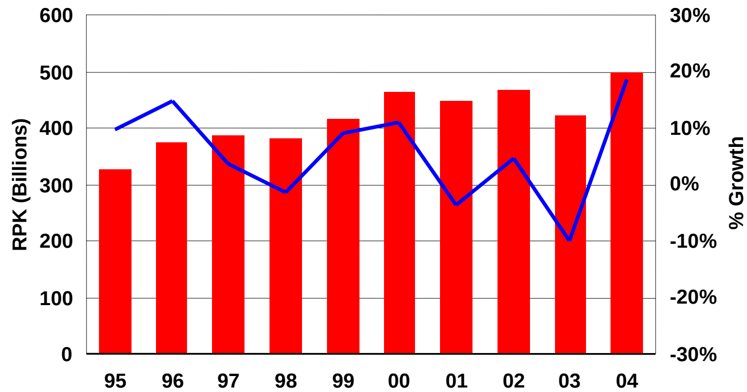
AAPA Operating Revenue FY2004
International Operations



Source: AAPA FY2004 = April 2003 to March 2004

AAPA’s international passenger traffic 1995-2004

Scheduled International Revenue Passenger Kilometres 1995-2004



Strong recovery in passenger demand

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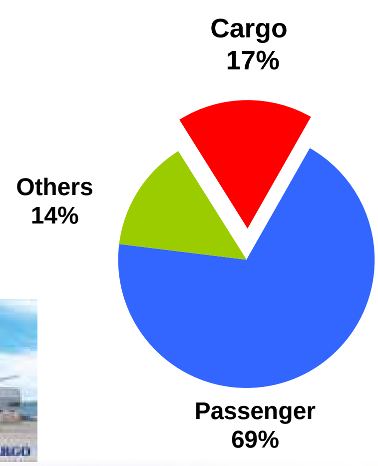
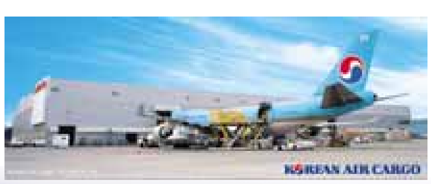
Cargo operations: key revenue contributor

- AAPA ~ 33% of global cargo traffic
- US$ 11 billion revenue
- Belly space complemented by 112 freighters





Source: AAPA, IATA

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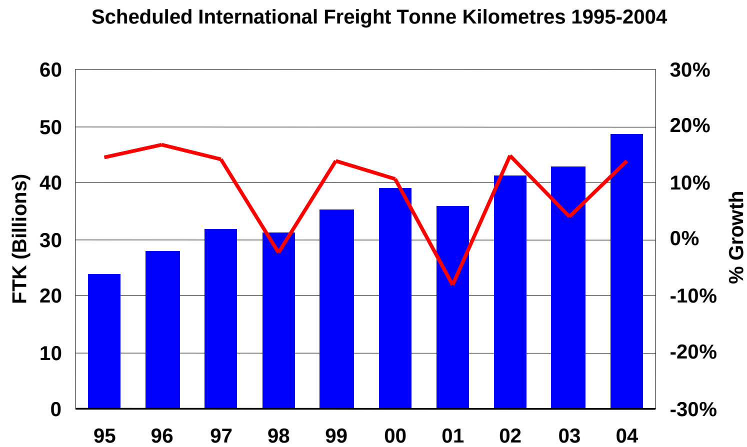
AAPA's international freight traffic 1995-2004



Continued growth in cargo demand

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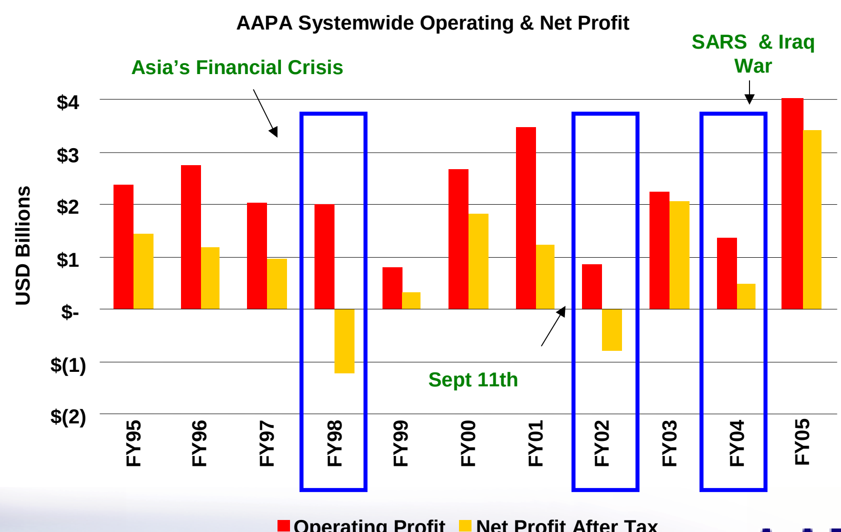
Summary: lessons from 2004

- Good global economic growth
- Strong recovery in passenger demand
- Continued growth in cargo demand
- High oil prices
- Keen competition
- Cost management more critical than ever

Airline profitability
Some global comparisons

- How does airline performance vary in different regions of the world?
- What are the contributory factors which could explain some observed variations?

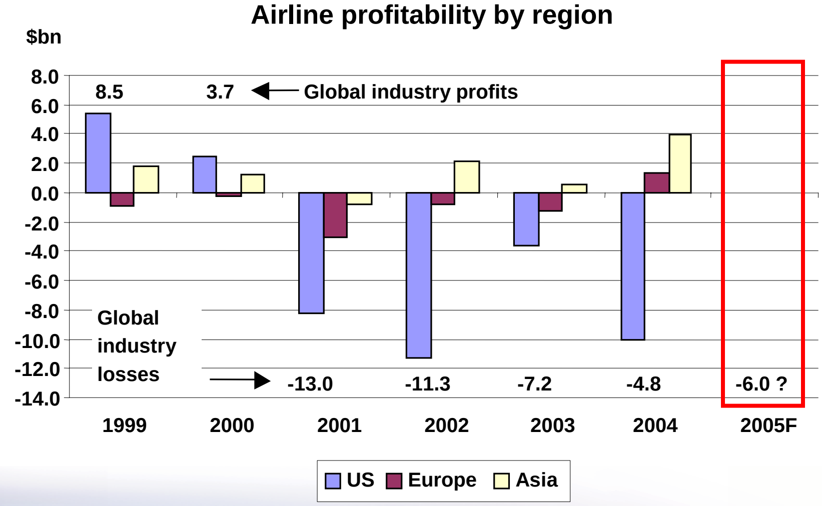
AAPA's profitability trends: strong FY2004/5



Source: AAPA (FY 2004: April 2003 to March 2004)

Airline profitability: mixed picture

Airline profitability by region



Source: IATA

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Rising fuel costs

Source: Credit Suisse First Boston

AAPA 2004 fuel costs ~ US$12 bn
or ~20% of total operating costs
Further sharp increase in 2005

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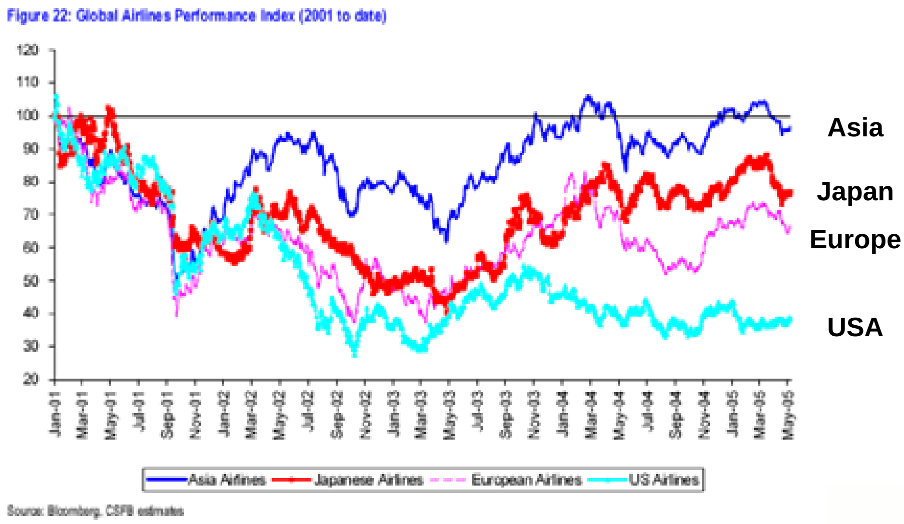
Airline valuations 2001-2005



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Airlines: market capitalisation

Region	Carriers	Market capitalisation US$ billion	Revenues US$ billion
USA	ATA (9)	5	85
	Southwest	*11*	*7*
	JetBlue	*2*	*1*
Europe	AEA (10)	24	69
	easyJet	*2*	*2*
	Ryanair	*6*	*2*
Asia Pacific	AAPA (12)	42	65
	Virgin Blue	*2*	*1*
	AirAsia	*1*	*0.1*

Source: Airclaims, Bloomberg, company data and AAPA estimates   Data: December 2004

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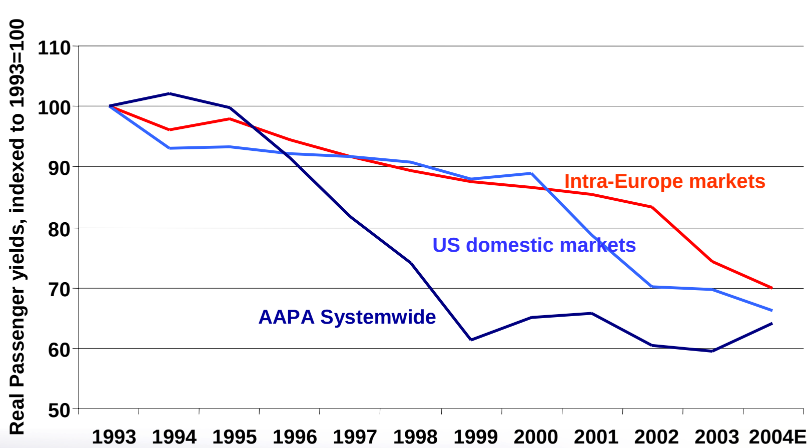
Competition

- Highly competitive markets
- Impact of new entrants
- Regional variations

Airfares do not keep pace with inflation

Real Passenger Yields have fallen by a third in the past decade



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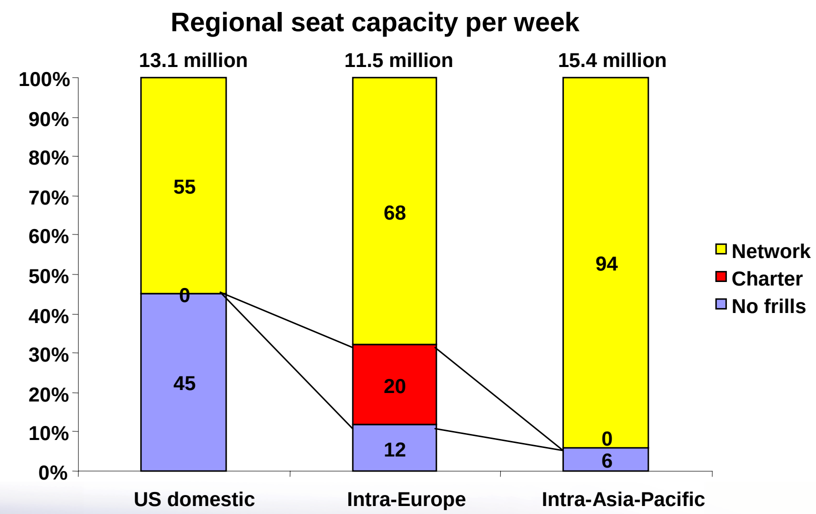
Impact of new entrants



Source: McKinsey & Co, BACK; IATA   Data: Summer 2004

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Proliferation of new entrants in Asia

AirAsia · Virgin blue · tiger airways.com

CEBU PACIFIC · KINGFISHER AIRLINES · SNA Skynet Asia Airways · FREEDOM AIR INTERNATIONAL

One-Two-GO · Jeju 제주에어 Jeju Air · Valuair SMILES AHEAD · Jet★Asia

pacific blue · Lion Airlines · AIR DECCAN · Jet★

SKY SKYMARK AIRLINES · Hokkaido International Airlines AIR DO · spicejet

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Proliferation of new entrants in Asia

- Some already well established e.g.
  - Virgin Blue (50 B737)
  - AirAsia (28 B737, ordered 60 A320)
  - Lion Air (25 MD80/90, 6 B737, ordered 30 B737-900ER)
  - Cebu Pacific (12 DC-9, 3 B757, ordered 14 A319/320)
- 20+ new carriers
- Serving more than 30 short-haul regional destinations
- Market penetration remains low
- Easy access to capital, but profitability remains elusive for many

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Challenges for new entrants

- Established airlines and new entrants competing directly in overlapping market segments
- Face keen competition on established routes
- Relative cost advantages being squeezed by:
  - Higher aircraft leasing costs
  - Higher costs for skilled labour
  - High fuel prices
- Liberalisation and relaxation of ownership rules encourage new entrants, but could eventually lead to industry consolidation

Established Asia carriers are well placed to compete and continue to grow

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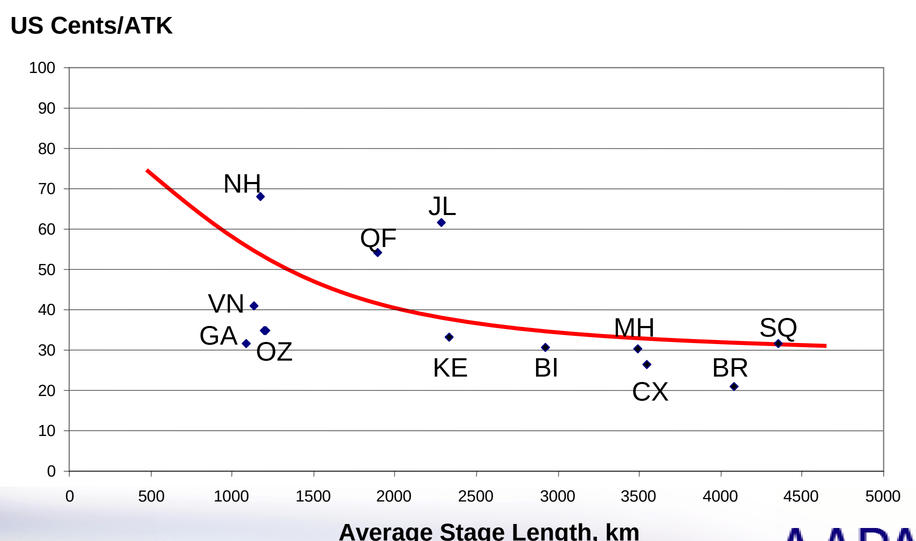
AAPA carriers: competitive fares

Average yields: US cents/RPK	
easyJet	8.1
Virgin Blue	8.0
Southwest	7.4
Ryanair	6.8
JetBlue	5.2
AAPA *	4.8
AirAsia	3.7

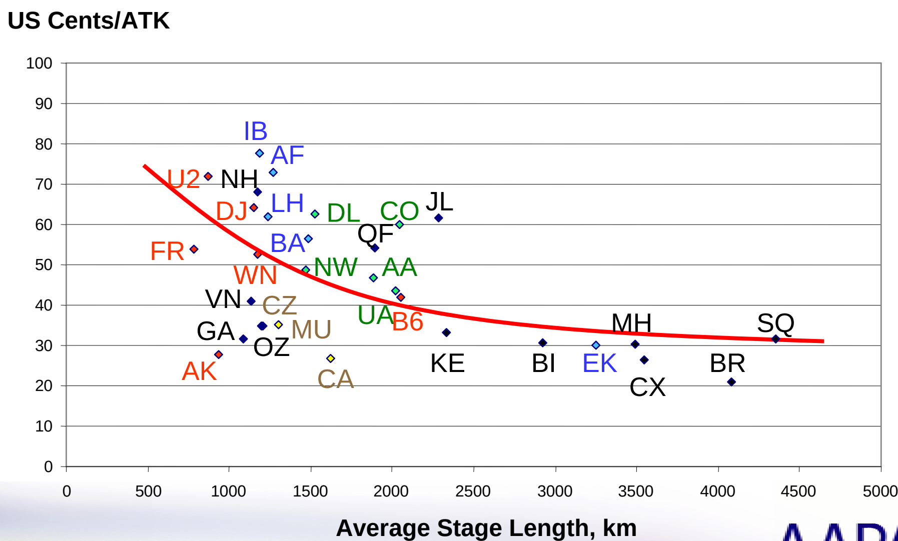
* AAPA Economy class yields

Keeping costs down: operating costs per ATK



Source: Company reports, IATA, AAPA estimates

Keeping costs down: operating costs per ATK



Source: Company reports, IATA, AAPA estimates

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Future outlook

- Slowing global economy
- Asia Pacific should still lead, boosted by dynamic growth of China
- Persistently high oil prices may dampen demand
- Keen competition and more new entrants

Future growth – next 20 years

	Passenger			Freight		
	Boeing	Airbus	IATA	Boeing	Airbus	IATA
	20-Year Forecast	20-Year Forecast	AAGR 2004-08	20-Year Forecast	20-Year Forecast	AAGR 2004-08
World	5.2	5.3	6.0	6.2	5.9	6.0
Asia-North America	6.1	6.3	5.9	7.2	6.1	4.6
Asia-Europe	6.0	5.9	7.1	6.7	6.3	7.0
Intra-Asia	6.1	6.9	8.3	8.5	6.4	6.1
Domestic China	8.1	8.7	-	10.6	10.1	-

The challenge is turning growth into profitability

Airbus and Boeing 20-year forecast = 2004-2023
Source: Airbus, Boeing, IATA forecasts

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Future of Asia Pacific Aviation

- **A key element of a modern economy**
- **Good prospects for continued growth**
- **Progressive liberalisation will widen competition but also open up new global opportunities**

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