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Fear of flying: "All we have to fear is fear itself"

MANY airline passengers are terrified of flying. It takes very little to upset confidence to the point that the passenger decides that flying is just *too* much hassle. In 2003 the SARS epidemic originating in China had a significant impact in Asia and North America. Now, in 2014, we have an outbreak of an horrendous haemorrhagic disease from the Ebola virus.

In 2003 the impact from SARS on the aviation industry was dramatic. It was a viral respiratory disease that was highly infectious and transmitted easily through airborne droplets. The confined spaces of an aircraft fuselage seemed to provide limited or no protection against the spluttering sneezes of fellow passengers in the early stages of the disease and air transport's very nature helped to disseminate it round the world. A large part of the outbreak involved the source in China and related travel through Hong Kong and throughout SE Asia — and people stopped travelling out of fear. At the depths of the crisis passenger demand among Asian airlines had fallen 50% year on year in RPK terms (see chart on next page). The total number of confirmed SARS cases according to the World Health Organisation (WHO) was just over 8,000 with a mortality rate of just under 10%. According to some estimates this had an impact of reducing global GDP growth in 2003 by ten basis points.

This time round we have an outbreak of a particularly nasty haemorrhagic virus in West Africa — Ebola. In this case the disease is highly contagious, but not particularly infectious, transmitted through contact with bodily fluids of those infected or deceased as a result of the infection. The likelihood of contagion on board an aircraft in these circumstances is highly unlikely — the contagious body is likely to be so ill as to make it exceedingly unlikely that he or she would be able physically to board the aircraft. So far there have been just over 13,000 confirmed or suspected infections and just under 5,000 deaths.

This issue includes

SARS Epidemiology 2003

			Impact on 2003 GDP	
	Cases	**Deaths**	**%**	**US$ bn**
Asia				
China	5,327	349	-1.05	-14.8
Hong Kong	1,755	299	-2.63	-4.1
Taiwan	346	37	-0.49	-1.4
Singapore	238	33	-0.47	-0.4
Others	109	11		
North America				
Canada	252	44	-0.60	-4.7
US	27	0	-0.07	-7.6
Europe	33	1		
Others	10	1		
World total	**8,097**	**775**	**-0.10**	**-33**

Source: WHO, IATA

Ebola — so far

	Cases	**Deaths**
Africa		
Guinea	1,906	997
Liberia	6,535	2,413
Sierra Leone	5,235	1,500
Mali	1	1
Nigeria	20	8
Senegal	1	0
Other		
Spain	1	0
USA	4	1
Total	**13,703**	**4,919**

Source: WHO 29 Oct 2014

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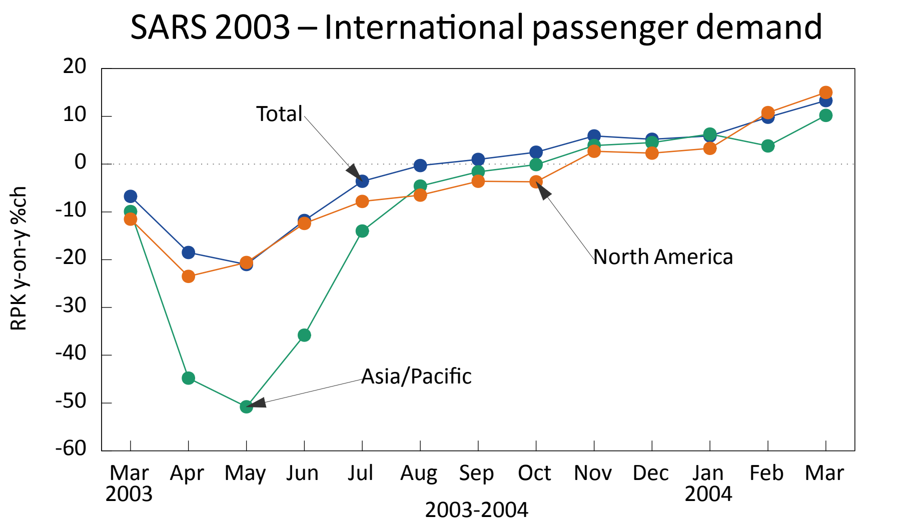


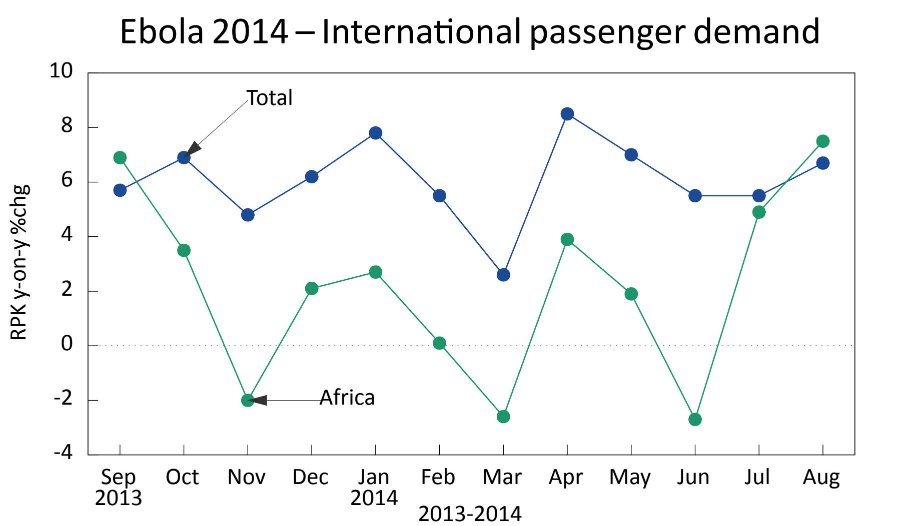
Source: IATA

So far there has been little real reaction from the travelling masses. International passenger demand according to IATA figures may have been modestly affected (see chart below) on a localised basis — but then African aviation only accounts for 4% of total air traffic demand.

Certainly some carriers have cancelled operations, particularly to the most affected areas of Sierra Leone, Liberia and Guinea, while some countries have imposed travel restrictions and passenger screening at border controls.

However, when an Ebola case was confirmed in the USA at the end of September — and then two further cases of local infection — there has been a bit of a panic, particularly in the US. The typical knee-jerk reaction of the stock markets was to extrapolate an effect on global aviation and to knock airline share prices by 5%.

Meanwhile, a recent survey in the US suggested that 40% of respondents now believed that there would be a major outbreak of Ebola in the US and that a quarter of respondents worry that someone in their immediate families will be infected within the next year.



Source: IATA

FedEx and the future of e-commerce

Back in the late 90s FedEx briefly branded itself as the "Official Airline of the Internet". It seemed plausible — transactions would be increasingly be conducted online and, for example, Amazon, the new electronic bookstore might carve out a small niche for itself in the publishing market, while FedEx was perfectly positioned to provide rapid physical transport for goods ordered through websites.

It hasn't quite worked out like that. FedEx is still the world's largest air express operator, with a current fleet of 300 jets and 356 turboprops, but its traffic volumes have been stagnant or in decline for some time. Its relationship with the internet and e-commerce has been complicated.

FedEx reported a pre-tax profit of $2.1bn on revenues of $27.1bn in its last financial year (to May 2014), a respectable overall 7.6% margin. FedEx's strategic aim is for an operating margin of 10% and an additional $1.6bn in pre-tax profits by 2016. But FedEx's strategy is not based on traffic growth but on cutting costs, rationalisation and yield increases.

At the operating level FedEx breaks down its performance by segment. It is perhaps surprising to note how modest the profitability of the air operation, FedEx Express, is compared to that of the boring Ground segment. Even the traditional Freight segment produces a higher margin. In the first quarter of FY 2015 FedEx's margin improved to 8.5%, with Express at 5.4%, Ground 18.6% and Freight 10.6%.

Indeed, a key element of FedEx's strategy in recent years has been to "work with customers to shift deferred Express volumes to FedEx Ground" and to "transition international deferred shipments out of the FedEx Express air network on certain lanes". This has enabled FedEx to reduce its jet fleet by 35 units over the past four years, and its plans are for a continuous contraction in aircraft over the next six years. As the table below shows, the jet fleet is to be reduced by 9% between this year and 2020, and payload capacity by 11%. There will be no further aircraft capex in the foreseeable future, a contrast to ten years ago when FedEx placed a launch order for 25 A380Fs, which was subsequently cancelled.

FedEx: FY 2014 Results ($bn)

	Revenue	Op. Profit	Margin
Express	27.12	1.30	4.8%
Ground	11.62	2.01	17.3%
Freight	5.75	0.35	6.1%
Services	1.54		
Total	**45.56**	**3.45**	**7.6%**

FY to end May. Totals are adjusted for "Segment Eliminations"

However, the new 767s will provide a significant improvement in operating costs, lowering trip costs by 30% compared to the MD10.

FedEx management are quite optimistic about the near term for two basic reasons. First, they see improved economic conditions — FedEx's own forecast for US GDP growth is 2.2% for this year and 3.1% for next, with e-commerce growing at three times this rate. Second, they hope to consolidate recent gains in yields, specifically by intruding a new charging system for Ground service based on weight rather than volume. Rival UPS is following FedEx's lead in this pricing initiative.

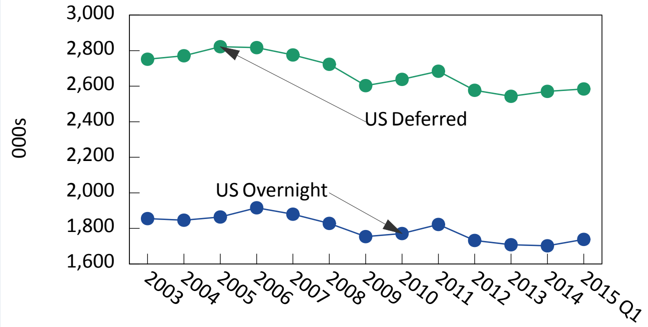
However, e-commerce has developed in ways that not necessarily benefited FedEx and the other inte-

FedEx Jet Fleet Plan

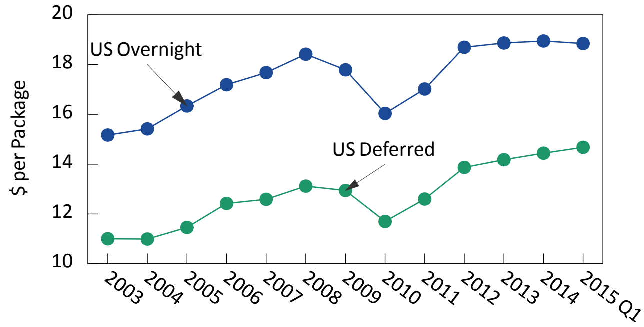
Type	757-200	767F	MD10-10	MD10-30	MD11F	777F†	A300	A310	TOTAL
Payload (Lbs per unit)	*63,000*	*127,100*	*137,500*	*175,900*	*192,600*	*233,300*	*106,600*	*83,170*	
2014 August	**112**	**4**	**45**	**16**	**64**	**25**	**71**	**29**	**366**
2015	7	12	-11	-6	-1	–	–	-4	-3
2016	–	11	-11	-5	-1	2	–	-11	-15
2017	–	11	-1	–	-8	–	–	–	2
2018	–	10	-5	-1	-4	2	-1	–	1
2019	–	4	-4		-2	2	-5	–	-5
2020	–	–	-5		-2	3	-8	–	-12
Delivered/Retired Total	7	48	-37	-12	-18	9	-14	-15	-32
End 2020	**119**	**52**	**8**	**4**	**46**	**34**	**57**	**14**	**334**

Source: FedEx. Note: †Another 9 777Fs on firm order unallocated

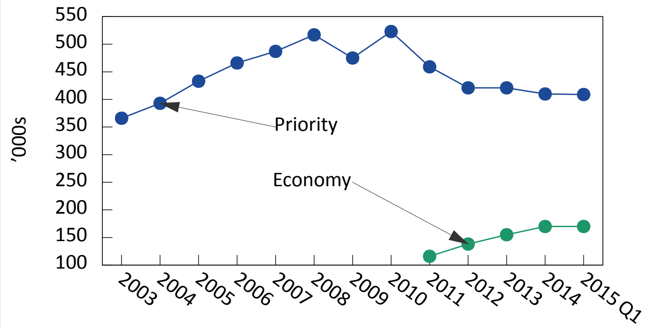
FedEx Express: US Domestic Daily Packages



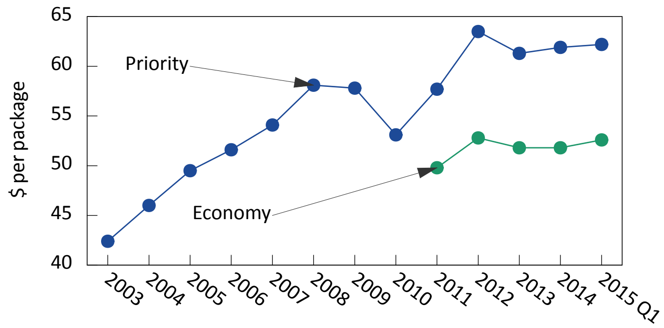
FedEx Express: US Domestic Yields



FedEx Express: International Daily Packages



FedEx Express: International Yields



grators. Most obviously the volume of documents and contracts that formerly was air-expressed has greatly diminished with email. Just in Time inventory control is not as dominant as previously, partly because hardware has become much more reliable and much less expensive, reducing the cost of inventory held by retailers. Software is now universally downloaded over the internet rather than dispatched as discs in a polystyrene-filled package.

In FY2014 the volume of FedEx packages transported by air in the US domestic market was about 7% below that of ten years ago. In 2004 FedEx had just stated a major international expansion but the volume of International Priority packages was roughly the same last year as it was then.

A worrying development for the integrators is a change in distribution strategy by the big e-commerce retailers in order to reduce their own shipping costs. Amazon is decentralising its warehouse network away from its Seattle base, building new facilities in, initially, San Francisco, New York, Boston and Chicago and ultimately targeting the top 50 urban markets. Wall-Mart is doing something similar. The additional cost of the new facilities will, Amazon expects, be outweighed by savings generated by cutting FedEx and UPS out of the distribution chain and using its own, franchised local delivery companies under the Amazon brand. Fulfilment costs, which are mostly transport-related, have risen to 15% of Amazon's revenues, up from 11% in 2009.

Amazon's ultimate aim for Amazon is to guarantee one day, or even one hour, delivery to customers — as close to physical shopping as possible. Google is moving inexorably into this market with a slightly different concept — here the customer orders online and a local courier company, branded Google Express, picks up the good from the shop and delivers it to the customer's home.

The e-commerce giants are not, however, guaranteed success. FedEx and UPS point out that logistics is a complicated business in which they have decades of experience. Their customers are not going to leave them for the new e-commerce upstarts.

Then, there is a further technological break-through on the near horizon — commercial drones delivering air cargo (after all, wars are now been fought using drones). Amazon's Prime Air, using an octopus-looking unmanned aircraft, is according to Amazon, ready for service from a technological point of view, and only requires FAA approval. In the UK Balpa, the pilots union, has recently been lobbying for strict regulation of drones on safety grounds. Balpa expects drones "the same size as small passenger aircraft" to be operating commercially within ten years. Amazon thinks within two years.

Boeing and Airbus: Two paths to globalisation

Boeing's big push on globalisation came with the 787 when substantial chunks of development and manufacture were spun out to Europe and Japan. But poor coordination meant that the manufacturer either had to take over subcontractors or re-work finished fuselages back in the US. The upshot was years of delay and a horrendous cost overrun that will mean that the model does not make a real profit until after 2020. So Boeing's first big push to be global fell at the first fence and the company now places more emphasis on seeking cheaper facilities in the US but far from its unionised base in and around Seattle.

Airbus, meanwhile, has always had more distributed manufacturing thanks to the national work-sharing inherent in the original European consortium structure. Unlike Boeing which deals with many suppliers across the board Airbus tends to work with Tier One suppliers who are in turn responsible for dealing with their own network of parts providers. Now Airbus is to increase its offshore final assembly activity in two places: the US and China.

When the Mobile plant in Alabama starts work in a few months it will assemble the largest of Airbus's narrowbodies — the A321, probably the long-range version, recently named the A321neoL. It consists of a re-engined A321 that can cover nearly all the missions of the venerable 757. The fact that it will be made in Mobile makes it a much more acceptable option for Big Three US airlines, which are the biggest users of the 757 and so likely to be the biggest customers for any replacement. Should the A321neoL prove acceptable it piles pressure on Boeing to bring forward an all-new single-aisle as the design of the 737 family makes it less adaptable for moving up into 757 territory.

Airbus is still hoping to open a second factory in China to consolidate its recently acquired half-share of that market. John Leahy, the CCO of Airbus, thinks that China will overtake the US as the biggest airline market within a decade. Since Airbus decided in 2005 to open its assembly plant in Tianjin for A320s it has delivered about 200 airliners made in China. Since that first agreement with the Chinese for local production the Airbus fleet in China has risen from 240 to over 1,000.

The next plant in China will be used to fit and finish the interiors of A330s. Over a year ago Airbus unveiled a de-rated "lite" version of its best-selling A330 widebody aimed to providing a cheap, roomy aircraft for intercity hops around China. China suffers from air traffic constraints imposed among other things by military aviation, which puts a premium on bigger jets even for shorter flights. So far no Chinese carrier has signed up for the A330neo, but the plans for the finishing plant are expected to prompt an order in coming months.

Boeing, by contrast, has taken a strategic decision not to locate a final assembly plant in China (or seemingly any other country outside the US, for that matter), preferring to rely on its extensive use of its global network of sub-contractors to earn it favour with countries seeking manufacturing offsets against their big purchases of American aircraft. Given that final assembly accounts for less than 10% of the total cost of an aircraft, that might be a convincing argument. But the sheer visibility of a big assembly line and the sight of hundreds of workers finishing off the manufacture of impressive aircraft might work in favour of Airbus.

Given that the two follow each other in other ways — such as the move to super-twins in widebodies and new-engine options in single aisles — it is interesting to see a clear divergence in how to play the globalisation game.

Buoyant leasing industry heading to cycle peak?

It has been a bumper year for the global aircraft leasing industry and — while not at the peak of the leasing cycle — the industry is significantly past the cyclical low point and is reaping the benefits of relatively bullish airlines, many of whom are expanding largely via leasing rather than through buying equipment themselves.

As a result the proportion of leased aircraft in the global fleet is still rising, and is now around the 41% to 43% level according to many analysts; this compares with a 25% slice in 2000 and 11% in 1990. Many forecasts say the proportion will rise above 50% sometime in the next decade — though there may be a couple of warning signs that a frothy leasing cycle peak may not be too far away.

First, there is a glut of orders from some of the smaller lessors (see below), and second — and probably most significant — some significant deals have been made or are in the process of being made: AIG has finally offloaded ILFC, Avolon's private equity and sovereign wealth fund owners are trying to sell the lessor, and Terra Firma has hired financial advisers to "explore its options" for AWAS. Clearly the best time to sell is as close to the cyclical peak as you can — but before everyone else recognises that a peak is coming.

In addition there is an unanswered question. Three LCCs — norwegian, AirAsia and Lion Air — who between them have orders for over 1,000 narrowbodies (representing 12% of the current backlog of narrowbodies at Boeing and Airbus) have signalled their intention to lease out aircraft. Each has suggested that one of the thoughts behind the move is that leasing companies make a higher margin than airlines, however erroneous the logic behind the thought. Some of the intention may be for inter-group leasing; some may be for efficient use of ordered equipment that is surplus to requirement when delivery approaches. However, none of them have publicly addressed the logic of the disparity between the airline model and aircraft leasing model: is it commercial suicide for an airline to pursue a business of leasing aircraft that are surplus to its own requirements to another airline? There are a handful of other carriers who may have appeared to have over-ordered.

In *Aviation Strategy's* annual survey of the leasing industry (see table on the facing page), the overall fleet for lessors with more than 100 owned or managed aircraft totals 6,347 — compared with a total of 6,287 for comparative lessors as of 12 months ago (see *Aviation Strategy,* October 2013) and 5,879 as of two years ago.

There has been a significant change to the traditional Big Two (GECAS and ILFC), with AerCap acquiring ILFC in May this year and finally putting an end to the long-running attempts of AIG to sell its lessor. With the combination of AerCap's existing fleet to that of the now-gone ILFC's, the new Big Two (GECAS and AerCap) together account for 45.6% of the 100+ lessor fleet.

Both these companies are still

Single aisle order backlog — the top customers

Customer	Airbus	Boeing	Total	share of backlog	multiple of airline fleet
Lion Air	234	285	519	6.0%	3.5
American	171	165	336	3.9%	0.7
AirAsia	319		319	3.7%	2.0
Southwest		283	283	3.2%	0.4
ALC	122	154	276	3.2%	
norwegian	100	146	246	2.8%	2.6
AerCap/ILFC	205	26	231	2.7%	
GECAS	82	140	222	2.5%	
BOC Aviation	108	82	190	2.2%	
Indigo	182		182	2.1%	2.2
THY	89	90	179	2.1%	0.9
Ryanair		178	178	2.0%	0.6
easyJet	170		170	2.0%	0.8
Top 13 customers	1,782	1,549	3,331	38.2%	
Unidentified customers	368	930	1,298	14.9%	
Other (141)	2,593	1,489	4,082	46.8%	
Total backlog	**4,743**	**3,968**	**8,711**		

Source: Boeing, Airbus.

Major Lessors

Company	Total portfolio	Change†	Orders: Boeing	Orders: Airbus	Orders: Total	Change†
GECAS	**1,600**	-80	161	83	**244**	**5**
AerCap (inc. ILFC)	**1,296**	-16	85	229	**314**	**21**
BBAM	**450**					**-6**
SMBC Aviation Capital	**374**	31	15	128	**143**	**84**
CIT	**350**	21	57	71	**128**	**-27**
AWAS	**300**	37	1	19	**20**	**-36**
ACG	**250**		80	38	**118**	**-29**
BOC Aviation	**248**	19	84	109	**193**	**125**
BCC	**230**	-20				
Air Lease Corporation	**189**	27	215	148	**363**	**86**
ORIX Aviation	**170**					
ICBC Leasing	**168**	56		61	**61**	**-16**
Aircastle	**148**	-10				
Macquarie AirFinance	**136**	-6				
Avolon	**133**	30	36	20	**56**	**4**
Pembroke Group	**105**	3				
SkyWorks Leasing	**100**	-32				
MCAP	**100**					
Total	**6,347**	**60**	**734**	**906**	**1,640**	**211**

Note: This table includes jet lessors with at least 100 owned or managed aircraft; we exclude entities set up solely to manage the leasing activities of a specific airline.
†change from 12 months ago

comfortably ahead of the chasing pack of lessors, although in terms of outstanding firm orders (from lessors with 100+ aircraft), their dominance is less pronounced, as they account for 34% of orders. Aggressive ordering over the last 12 months has seen Air Lease Corporation now command the largest single lessor order book (with 363 aircraft), while BOC Aviation and SMBC Aviation Capital have also been bullish over the last year, adding 125 and 84 net orders respectively.

Interestingly, there has also been a raft of new orders from lessors with less than 100 aircraft in their current portfolio (pushing the share of orders from 100+ fleet lessors from 88.3% of all lessor orders a year ago to 83.4% today) — see table on the next page.

Over the next few pages *Aviation Strategy* profiles the leading lessors (defined as having more than 100 jet aircraft) in descending order of portfolio size.

General Electric Capital Aviation Services (GECAS)

It has been yet another year of trimming the portfolio at GECAS, with the owned and managed fleet now standing at around 1,600 aircraft, compared with 1,680 a year ago (and 1,830 three years ago).

However, a reduction in the average aircraft age that had been occurring over the last couple of years appears to have stopped — as at June 30 2014, by value 44% of GECAS's owned portfolio is five years old or less (compared with 45% a year ago and 41% 24 months previously), while 28% is aged between six and 10 years (29% a year ago), 24% is between 11 and 15 years (20%) and 5% is aged 16 years or more (6%).

More interestingly, there has been yet another shift in the relative importance of narrowbodies to widebodies over the 12 month period. As at mid-year 2014, narrowbodies accounted for 59% of the total fleet by value (compared with 45% a year ago, and more than the 57% proportion they accounted for 24 months ago), with 19% being widebodies (up from 29% a year ago and 20% two years ago), 11% RJs and 5% cargo variants (the rest of the "fleet value" is in engines).

Part of the giant conglomerate GE, GECAS's portfolio is placed with more than 230 customers in around 75 countries, but while the US remains the largest market for GECAS, it is being caught by Europe. As at June 30 2014, 26.6% of the fleet by value is placed in the US — down from 29% a year ago and 47% in 2009. The European share is now 25% of the overall fleet value, followed by the

Other lessors with orders

	Orders		
	Boeing	Airbus	Total
Alafco	28	97	**125**
HKAC		70	**70**
CALC		32	**32**
Aerospace International Group		27	**27**
Amedeo		20	**20**
Alphastream		15	**15**
Intrepid Aviation	6	8	**14**
Sberbank Leasing	12		**12**
Z/C Aviation Partners		4	**4**
Jackson Square Aviation	2		**2**
Meridian Aviation Partners		2	**2**
DAE Capital	2		**2**
Inception Aviation		2	**2**
Total	**50**	**277**	**327**

Asia/Pacific region (20%), the Americas (12%) and all other markets (17%).

GECAS still lags behind ILFC (now AerCap) in terms of outstanding orders, and its order book increased only slightly over the last 12 months, to stand at 244 aircraft today. In total GECAS's order book comprises 161 Boeing aircraft (45 737-800s, 95 737 MAXs, 11 777-300ERs and 10 787-10s) and 83 Airbus models (three A320ceos, 60 A320neos, 19 A321ceos and one A330-300s).

Based in Stamford, Connecticut, GECAS has more than 500 employees and 23 other offices around the world. In the first six months of 2014 GECAS's segment profit increased to $695m (compared with a profit of $652m in January to June 2013). That's welcome news given that in calendar 2013 GECAS had to take $732m worth of pre-tax impairments, much of which was due to write-downs of ageing freighter aircraft.

AerCap (inc. ILFC)

At long last — and after several failed attempts — insurance giant AIG (which received a $182bn US government bailout in 2008) has managed to offload its "non-core asset" — International Lease Finance Corporation (ILFC). The deal was done in May of this year, with the troubled lessor going to AerCap for $2.4bn in cash and 97.6m AerCap shares. Those shares were worth $4.5bn as at the closure date and represent around 46% of AerCap's total ordinary share capital, although AIG is subject to a lockup period before it can sell them, which expires in stages from February to August 2015. In addition ILFC paid a "special distribution" of $600m to AIG prior to the closure of the deal., while Robert Benmosche, president and CEO of AIG, and David Herzog, EVP and CFO of AIG, joined the AerCap board.

The acquisition of ILFC boosts the AerCap fleet by almost 1,000 to 1,296 aircraft (of which 1,134 are owned and 162 managed) with an asset value of around $45bn. 59% of that portfolio is narrowbody aircraft and 41% is widebody, and of the owned fleet the highest proportion of total net book value is provided by 737NGs, accounting for 26%, ahead of A330s (18%), A320s (17%) and 777s (15%).

Clearly there needs to be some rearrangement of the newly-enlarged portfolio; AerCap says it has "sold, disposed or parted-out" more than 100 aircraft valued at around $2bn since the announcement of the ILFC deal (in December 2013) which is double its targeted annual asset sales. This is aimed at reducing the average age of the portfolio into its targeted sweet spot, which is between five and eight years; the average age of the owned fleet as of June 30, 2014 was 7.6 years.

The enlarged AerCap now has more than 200 customers in over 90 countries, and while ILFC was based in Los Angeles and had offices across the globe, NYSE-listed AerCap will continue to be headquartered in Amsterdam, and to its existing offices in Ireland, the US, China, Singapore and the United Arab Emirates, AerCap has incorporated certain ILFC offices, such as Shanghai and Toulouse.

Along with a massive injection of aircraft to its portfolio, AerCap has taken on the large debt pile that ILFC was carrying. At the end of the second quarter of 2014 AerCap's balance sheet now contains $31.3bn of debt, compared with debt of $6bn as at June 30 2013. In the first six months of 2014 AerCap's revenue was $1.1bn, with net income coming in at $191m (with comparisons to the previous half-year meaningless given the ILFC acquisition in May).

In July AerCap exercised options to buy 50 A320neos, and including ILFC's pre-existing order book AerCap's total outstanding firm orders stands at 229 Airbus aircraft (three A320ceos, 175 A320neos, five A321ceos, 25 A321neos, one A330-300 and 20 A350-900s) and 85 Boeing models (26 737-800s, 10 787-8s and 49 787-9s). As of June 30th, 90% of deliveries through to the end of 2016 had already been placed with customers, and 50% of all deliveries arriving by the end of 2022.

BBAM

BBAM's managed fleet has remained stable year-on-year at around 450 aircraft, with an asset value of $14bn. Its most important model is the 737NGs, of which the portfolio contains 177 aircraft, followed by A320s, of which it has 135. There are also 25 A321s and 23 777s.

Based in San Francisco, BBAM has eight other offices around the world, in Nevada, New York, London, Zurich, Santiago, Singapore, Dublin and Tokyo. BBAM has around 80 airline customers, including Air France/KLM, British Airways and easyJet in Europe; China Southern, China Eastern and Air China in the APAC region; Delta and United in the US; and Emirates and flyDubai in the Middle East.

BBAM has no outstanding orders, again making it the only Top 10 lessor (excluding BCC) not to have any firm orders.

SMBC Aviation Capital

SMBC Aviation Capital continues to grow following its acquisition from RBS by Sumitomo Mitsui Banking Corporation in 2012. Its portfolio increased by 31 aircraft over the last 12 months to 374 (with an average age of five years), of which 277 are owned and 97 are managed, and which is valued at more than $10bn. The lessor is a narrowbody specialist, with all but 12 aircraft in its owned fleet being A320 family or 737NG models.

SMBC Aviation Capital employs more than 110 people and is headquartered in Dublin, with other offices in New York, Seattle, Toulouse, Amsterdam, Tokyo, Hong Kong, Beijing, Shanghai and Singapore.

The portfolio is currently leased to 95 customers, including Aeroflot, Norwegian and Air Berlin in Europe; Qantas, Air China and MAS in the Asia/Pacific region; and Etihad and Air Arabia in the Middle East.

SMBC Aviation Capital's ambitions were shown by the order it placed in July, at Farnborough, for 110 A320neo aircraft (although they can be converted into A321 models) worth around $11.8bn at list prices. This brings the total order book to 143 aircraft, comprising 15 737-800s, 18 A320ceos and 110 A320neos.

CIT Aerospace

CIT Aerospace's portfolio has risen from 329 to 350 owned and managed aircraft over the last 12 months. The portfolio has an average age of six years, and mostly comprises A320s and 737s, with A330s on the widebody side. Altogether narrowbodies account for 85% of the portfolio by value.

They are placed with around 100 airlines in 50 countries, though CIT says that the "Far East/Asia is driving our growth", where 37% of the portfolio by value is placed. In terms of importance that's followed by Europe (25%), the US and Canada (19%), Latin America (12%) and Africa/Middle East (7%).

Owned by US bank holding company CIT Group, CIT Aerospace is based in Dublin and has offices in New York, Fort Lauderdale, Los Angeles, Washington, Toulouse and Singapore.

CIT Aerospace has 128 assorted aircraft on order, including four 737-800s, 30 737-MAXs, three 737-900ERs, four 787-8s, 16 787-9s, 47 A320neos, three A321neos, one A330-200, five A330-300s and 15 A350-900s

AWAS

AWAS's portfolio continues to rise, now breaking through the 300 aircraft level (compared with 263 of 12 months ago). Narrowbodies dominate the portfolio, which is placed with more than 110 airlines in 50 countries, including Aeroflot and Vueling in Europe and Thai Airways and Philippine Airlines in the Asia/Pacific region.

Based in Dublin and with offices in New York, Miami and Singapore, AWAS is owned by private equity house Terra Firma and the Canada Pension Plan Investment Board. Both are looking to cash out with a profit now that the leasing upturn appears robust (and some eight years after Terra Firma acquired the company, prior to merging it with another lessor it bought a year later — Pegasus) by hiring financial advisors to look at options for an IPO, sale or piecemeal portfolio break-up.

AWAS has a small order book compared with most of its rivals — just 20 aircraft, comprising a single 737-800, 16 A320ceos, one A321ceo and two A350-900s.

Aviation Capital Group

Aviation Capital Group (ACG) has kept its portfolio of owned or managed aircraft stable at around the 250 level over the last 12 months. It has a mixed fleet of narrowbodies and widebodies, including the A320 family, 737s (classics and NGs), 757s, 767s, 787s and A330s, that are placed with around 90 customers in 40 countries.

Owned by US insurance group Pacific Life, ACG has a headquarters in Newport Beach, California and other offices in Beijing, Dublin, Santiago, Seattle, Shanghai and Singapore. In calendar 2013 ACG reported a 12%

rise in lease revenue, to $736m, with net income reaching $76m.

Its outstanding orders total 118 aircraft, comprising 10 737-700s, five 737-800s, 60 737 MAXs, five 787s, four A320ceos, 30 A320neos, four A321ceos.

BOC Aviation

It has been another year of growth for BOC Aviation, with its owned and managed fleet rising by 19 to 248 aircraft, which have an average age of less than four years and a total asset value (as the end of June 2014) of US$10.8bn. Almost 80% of the portfolio is comprised of A320 family aircraft and 737NGs, with the next most important model being the 777, of which it owns 17.

The portfolio is placed with 58 airlines globally, including THY, Vueling and Air France in Europe, and Southwest and Air Canada in North America.

Owned by the Bank of China, BOC Aviation has a headquarters in Singapore and other offices in Dublin, London and Seattle. For the first six months of 2014, BOC Aviation recorded a net profit of US$163m (which allowed it to pay a US$139m dividend to the Bank of China) — exactly the same as it reported for the same period in 2013.

BOC Aviation's ambitious growth plans have been boosted by a raft of new orders this year, giving it the largest increase in orders among all lessors (even beating ALC). In July the lessor ordered 42 A320 family aircraft, comprising seven NEOs and 36 CEOs, and scheduled for delivery from now until 2019. And in August BOC Aviation also placed a firm order for 80 737s (50 737 MAX 8s and 30 737-800NGs) — to be delivered over 2016 to 2021 — as well as two 777-300ERs.

In total, BOC Aviation's order book stands at 193 aircraft, including 32 737-800s, 50 737 MAXs, two 777-300ERs, 35 A320ceos, 18 A320neos, 30 A321ceos and 26 A321neos — which now gives it the fourth largest order total of all lessors.

Boeing Capital Corporation (BCC)

Based at Renton, Washington, Boeing Capital Corporation is a provider of "last resort" finance for a wide range of Boeing products, from aircraft to space and defence. It has gradually been reducing its exposure and today owns, has partial ownership of, or interest in 230 aircraft — 20 less than 12 months ago and 41 fewer than two years ago.

BCC has around 160 employees in Renton and other offices in Los Angeles, Beijing, London, Hong Kong and Moscow. In the first six months of 2014 BCC reported an 18% decrease in revenue to $172m, although earnings from operations was up 22% to $77m. The revenue fall was due both to the reduction in its portfolio and "non-recurring adjustments to estimated residual values". As at the end of June 2014, BCC's portfolio's value totalled $3.4bn, compared with $4.1bn a year ago and $6.4bn five years ago.

As BCC has stopped releasing a standalone 10Q (instead reporting within the overall Boeing results), there is no longer any information available as to the age profile of the BCC portfolio, nor to how exposed that portfolio is to a handful of airlines.

Air Lease Corporation

Air Lease Corporation maintained its steady progression through the ranks of the lessors by entering the Top 10 after adding 27 aircraft over the last 12 months and bringing its total jet portfolio to 189. Launchedin 2010 by ILFC founder Steven Udvar-Hazy, the Los Angeles-based lessor now has a fleet with an average age of less than four years and with a net book value of $8.3bn.

The portfolio includes 60 737NGs, 55 A320 family, 31 E175/190s and 21 A330s, and they are placed with airlines in 47 countries. The Asia/Pacific region is now firmly established as Air Lease Corporation's most important market, accounting for 46% of the portfolio by net book value, with Europe in second place with 35%, and then Central America with 9%, the US and Canada with 5% and the rest of the world with 4%.

In the first six months of 2014 Air Lease Corporation reported a 25.7% rise in revenue leap to $502m, with net profit increasing by almost 50%, to $123m.

Air Lease Corporation is maintaining its momentum with even more new orders. In July, at Farnborough, the lessor ordered 60 A321neos and six 777-300ERs, while also confirming the purchase of 10 737-8/9 MAXs that had previously been MoUs. All these are due to be delivered between 2016 and 2023.

This brings the lessor's total order book up to an impressive 363 new aircraft — 50 737-800s, 104 737 MAXs, 16 777-300ERs, 15 787-9s, 30 787-10s, 31 A320neos, 12 A321ceos, 79 A321neos, one A330-300, 20 A350-900s and five A350-1000s. As they arrive through the rest of the decade Air Lease Corporation will almost certainly become a Top 5 lessor at some point.

ORIX Aviation

Part of the Orix Corporation (a Japanese financial services group), ORIX Aviation has maintained its portfolio at around 170 aircraft over the last 12 months. Based in Dublin and with an office in Singapore, ORIX Aviation has a wide mix of aircraft in its portfolio, although the majority are narrowbodies.

These are placed with 70 customers in 35 countries, including BA, United, Lufthansa and South African Airways. ORIX does not have any aircraft on outstanding order.

ICBC Leasing

Part of the Industrial and Commercial Bank of China, ICBC Leasing deals in aviation, shipping and other "large-ticket" equipment. With headquarters in Beijing and other offices in Tianjin, Bangkok and Dublin, the Chinese lessor has increased its jet portfolio by 56 to 168 aircraft over the last 12 months.

They are placed with 40 airlines, with one-third of clients being Chinese and the rest from around the world, including Emirates, BA, Air Berlin, and Aeroflot. The lessor has outstanding orders for 29 A320ceos, 20 A320neos and 12 A321ceos.

Aircastle

Aircastle's fleet was trimmed by 10 aircraft over the last 12 months and now stands at 148 owned aircraft, comprising 90 narrowbodies, 42 widebodies and 16 freighters. The fleet is relatively old, and much of Aircastle's focus is on reducing the fleet age; in the first six months of 2014 the lessor sold 17 aircraft, most of which were classic models. As a result the average age has come down from approximately 11 years as of 12 months ago to 8.6 years as of mid-2014.

The portfolio is currently placed with 63 customers in 37 countries that include Delta and United in the US, Iberia and Monarch in Europe, and SIA and Korean Air in the Asia/Pacific region. The most important market for Aircastle is Europe, where 62 aircraft are placed, followed by the Asia/Pacific region, with 46 aircraft, with the remainder in North America (21), South America (13) and the Middle East and Africa (six). In terms of individual airlines, the greatest exposure is to Chile's LATAM, to which Aircastle is leasing four aircraft that account for more than 6% of the lessor's total net book value.

Aircastle is headquartered in Connecticut and has offices in Dublin and Singapore, and in the first six months of 2014 reported a 16% rise in revenue to $402m, although net profit fell by 17% to $60.5m. It has no orders.

Macquarie AirFinance

The gradual contraction of Macquarie AirFinance's owned and managed portfolio has continued over the past 12 months, and it's now down to 136 aircraft (compared with 142 a year ago and 155 24 months ago). Largely a narrowbody specialist, of the 128-strong owned portfolio 63 are A320 family aircraft and 57 are 737NGs.

They are placed with 73 airlines in 43 countries around the globe, with the most important market being Europe, where 52 aircraft are on lease, followed by the Asia/Pacific region (34) and Latin America (20).

Part of the finance giant Macquarie Group, Macquarie AirFinance has its headquarters in Dublin and other offices in Singapore and San Francisco. The lessor doesn't have any Airbus or Boeing aircraft on outstanding order.

Avolon

Avolon has increased its portfolio significantly over the last year, with 30 extra units resulting in the portfolio reaching 133 aircraft. Within the owned fleet of 123 aircraft (and which has an average age of less than three years), the overwhelming majority of models are narrowbodies, including 48 737-800s and 48 A320s.

These are leased to 49 airlines in 27 countries, with its most important market being the Asia/Pacific region, where Avolon has placed 37% of its portfolio (at clients such as AirAsia and China Eastern), followed by Europe with 22% (with clients that include Ryanair and Virgin Atlantic) and Latin America with 20% (including Avianca and volaris).

Avolon's 63 staff are employed at a headquarters are in Dublin and other offices in Connecticut, Dubai, Shanghai and Singapore. The lessor is owned by three private equity funds — Cinven, CVC Capital Partners and Oak Hill Capital Partners — plus the Singaporean sovereign wealth fund GIC. Avolon filed an application for an IPO in New York in June this year, but is reportedly in talks with banks and other investors in China and Japan over a potential deal that could be worth around $7bn.

In July Avolon ordered six 787-9s — which had a list price of $1.5bn — and bringing its total order book to 56, which also includes 20 A320neos, 10 737-800s and 20 737 MAXs. In July Avolon also announced it was a launch customer for the A330neo by making a commitment to buy 15 of the type, with a total list price of S$4.1bn and due for delivery from 2018 onwards — though this has yet to be turned into a firm order.

Pembroke Group

The Pembroke Group's fleet has risen by three aircraft over the last 12 months, bringing its portfolio to 105 (of which all but four are owned).

Though the owned fleet is primarily A320 family aircraft (of which it has 45) and 737s (38 aircraft), the rest of the fleet is quite varied, including A330s, five different 777 models (10 aircraft in total), 767s and three 717s.

The portfolio is leased to more than 20 airlines, including Air Arabia, Cathay Pacific, TUI and Ethiopian Airlines. The lessor is owned by London-based bank group Standard Chartered and operates from offices in Dublin and Limerick. No aircraft are on order.

SkyWorks Leasing

SkyWorks Leasing manages a portfolio of 100, some 32 aircraft down from 12 months previously. The portfolio includes a variety of models, including A319/320s, 737NGs, 757s and 767s.

Based in Greenwich, Connecticut, SkyWorks Leasing's clients include Air China, Southwest and Virgin America. It has no aircraft on order.

MC Aviation Partners (MCAP)

MC Aviation Partners (MCAP) has maintained its fleet at around 100 owned and managed aircraft over the last 12 months. A subsidiary of Japanese conglomerate the Mitsubishi Corporation, MCAP is based in Tokyo and maintains other offices in Los Angeles and Dublin.

It is largely a narrowbody specialist, with more than 75 A320 family aircraft and 737-800s, and unsurprisingly almost half of its portfolio is placed with airlines in the Asia/Pacific region. The lessor has no outstanding orders.

Other lessor orders

During the first nine months of 2014 there has been a substantial addition to outstanding firm orders from lessors with less than 100 aircraft. They include:

- ✈ 40 A320neo and 30 A321neo aircraft for **Hong Kong Aviation Capital (HKAC)**
- ✈ 20 A380s for Dublin-based **Amedeo**, part of an ambitious plan to establish the lessor "as the primary leasing specialist" for A380s.
- ✈ 13 Airbuses for New York's **Aerospace International Group,** bringing its total order book to 16 A320s and 11 A321s
- ✈ Eight A319ceos for New York-based **Z/C Aviation Partners** (of which four have been delivered).
- ✈ Six 777-300ERs for Connecticut-based **Intrepid Aviation** (also with offices in Dublin and Singapore) — a widebody specialist, that has a total order book of 14 (including one A330-200 and seven A330-300s).
- ✈ Four A321ceos for **China Aircraft Leasing Company (CALC),** which has a total of 32 Airbuses on order.
- ✈ Three 737-800s (of which one has already been delivered) for San Francisco's **Jackson Square Aviation**.

Other lessors with outstanding orders are:

Alafco — a lessor that is majority owned by the Kuwait Finance House — has 125 aircraft on order, comprising eight 787-8s, 20 737 MAXs, 85 A320neos and 12 A350-900s.

AlphaStream Capital Management is a Swiss lessor with outstanding orders for 13 A320ceos and two A321ceos, while Moscow-based **Sberbank Leasing** has 12 737-800s on order.

Meridian Aviation Partners is a Dublin lessor owned by Canadian private equity company Onex that has two A330-300s on order, while the leasing arm of the state's Dubai Aerospace Enterprise — **DAE Capital** — has two 777Fs on order, and Monaco-registered **Inception Aviation** has two A330-300s on order.

US Airlines: Now solidly profitable across the cycles?

US AIRLINES reported strong results for the third quarter and expect more of the same in Q4. How are Delta, American and United using the significant cash generated? And how are the airlines preparing for what could be a choppy 2015 in international markets?

The third-quarter results of the nine largest US carriers were uniformly excellent. Operating margins were all in the double-digits, ranging from JetBlue's 10.7% to Alaska's 21.6%. The three largest carriers also achieved double-digit pre-tax margins (excluding special items) and ROIC.

Delta — the margin leader in recent years because it was the first to complete a Chapter 11 restructuring and a merger in 2008 — earned an ex-item pretax profit of $1.6bn (14.3% of revenues) in the third quarter. ROIC for the last 12 months was 19.3%. The management noted that the results were consistent with those of high-quality S&P 500 industrials.

United has staged a spectacular financial recovery this year after the serious IT/technology integration issues it experienced in 2012 in the wake of the 2010 merger with Continental. In the third quarter, United's ex-item pretax profit doubled to $1.1bn (10.4% of revenues). ROIC in the 12 months to September 30 was 12.3%.

American, which began earning healthy profits even before its late-2013 Chapter 11 exit and completion of the merger with US Airways, has seen progressively stronger results in the past three quarters. For the latest period, AAL posted an ex-item pretax profit of $1.2bn, accounting for 10.8% of revenues. AAL is expecting a similar 10-12% pretax margin in the current quarter, which is typically the seasonally weakest for the industry.

Net profits in some cases were diluted by huge extraordinary charges brought about by continued restructuring. Delta recorded $657m in special charges, mainly related to the accelerated retirement of its 747s. American had $281m in net special charges, including $168m of merger integration expenses.

The combination of strong earnings and relatively modest capex has meant significant free cash flow (FCF) for many US carriers. Delta generated $910m of FCF in the third quarter and is on track to produce nearly $3.5bn in 2014.

US airlines' efforts to pay down debt are increasingly being recognised by the rating agencies. In early October S&P raised Delta's corporate credit rating from 'BB-minus' to 'BB', which is just two notches below investment grade.

In June Alaska became the second airline in the US (after Southwest) to gain an investment-grade credit rating (from Fitch). Alaska has led the industry in terms of profit growth and deleveraging, achieving a 21.8% adjusted pretax margin in the third quarter and a 17.2% after-tax ROIC in the 12 months to September 30. The Seattle-based niche carrier has lowered its adjusted debt-to-capital ratio to 31%.

But Alaska's extraordinary margins and financial ratios have not gone unnoticed by competitors. Delta has started to grow aggressively in Seattle — something that has kept the lid on Alaska's share price.

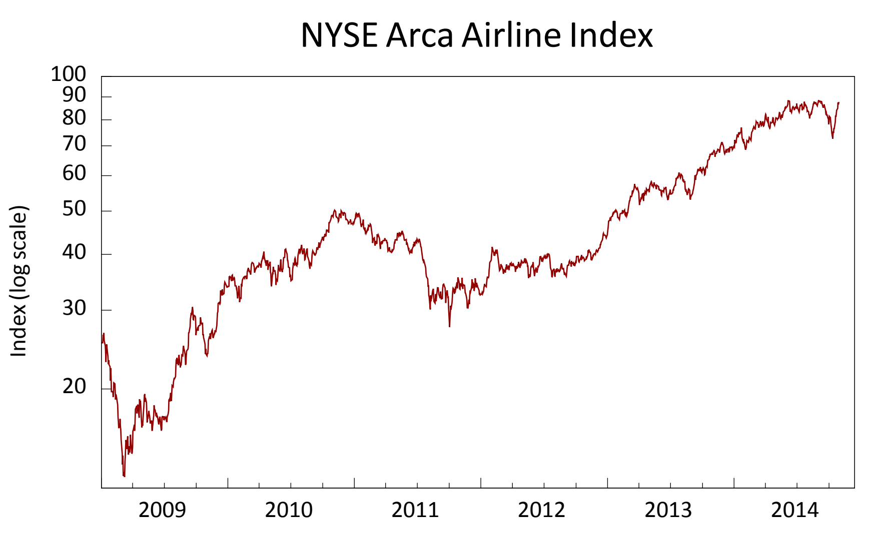
Why the strong profits?

2014 will be the fifth consecutive year of healthy profitability for the US airline industry. The reasons for

US Airlines' Third Quarter 2014 Financial Results

	Operating revenue $ (m)	Operating revenue % chg	Operating margin %	Pretax profit† $ (m)	Reported Net Profit $ (m)
Delta	11,178	6.6	15.8	1,600	357
American	11,139	4.4	13.3	1,200	942
United	10,563	3.3	11.7	1,100	924
Southwest	4,800	5.6	13.5	525	329
JetBlue	1,529	5.9	10.7	132	79
Alaska	1,465	6.3	21.6	316	198
Hawaiian	639	6.7	16.6	58	36
Spirit	520	13.8	19.3	111	67
Allegiant	265	15.8	10.9	22	14

Source: Company reports. †Excl items.



the legacy sector's profit run are well documented: a decade of restructuring, many Chapter 11 visits, an intensive new consolidation phase, years of tight capacity discipline, repeated domestic fare increases, lucrative new ancillary revenue streams and smarter managements that are more profit and return oriented.

In this year's third quarter, US carriers benefited from two additional factors: the decline in fuel prices and continued strong domestic air travel demand.

The spot price of WTI crude oil has fallen from the $100-per-barrel level in early August to the low-80s in late October. The decline has benefited especially American, which does not have any fuel hedges in place.

The combination of healthy air travel demand and tight capacity in the US has continued to facilitate fare increases and solid unit revenue growth. Most recently, in mid-October the industry successfully implemented a Delta-led modest system-wide fare increase.

A strong domestic environment benefits Delta, American and United enormously because they still earn half or more of their total revenues domestically. In the third quarter, domestic operations accounted for 63% of American's, 56% of Delta's and 48% of United's mainline passenger revenues.

The domestic entities cushioned the carriers against the volatility now seen in international markets — something that was clearly evident in the regional breakdowns of passenger revenues, PRASM and yields released in the third-quarter reports.

At Delta, domestic passenger revenues surged by 11.6% and unit revenues by 7.2%. Internationally, transatlantic revenues and PRASM rose by 3.9% and 0.2%; Pacific revenues and PRASM fell by 2.8% and 2.2%; and Latin revenues rose by 10.3% but PRASM declined by 5.1%.

At United, domestic passenger revenues rose by 6.5%, PRASM by 7.9% and yield by 7.6%. Internationally, revenues rose by 4.7%, PRASM by 1.9% and yield by 2.8%.

At American, PRASM was up 5.7% domestically and down 6.1% internationally. The latter consisted of 5% growth on the Pacific, a 2.3% decline on the Atlantic and an 11.7% decline on Latin America routes (despite a mere 1% capacity increase).

The performance of the international entities can be summarised as follows. The transatlantic was the best-performing international region for US carriers, even though there was excess capacity in the summer. Delta and United saw very difficult conditions on the Pacific, because industry capacity was up substantially. United has continued to see 20% capacity growth from foreign competitors especially on the China routes, while the weakening yen has put pressure on Narita flying. Latin America has been a tough market this year, with both supply and demand issues (the region's economic slowdown, World Cup-related woes, Venezuela, etc).

New challenges

Except for the nice surprise with fuel, 2014 has been a challenging year in terms of negative external factors for global airlines: the disappearance of MH370, the shooting down of MH17, the Ukrainian conflict and the resulting US, EU and Russian economic sanctions, monies trapped in Venezuela, the rise of ISIS, Western military action in Syria and Iraq, and the Ebola crisis.

Other negatives affecting US airlines now also include currency headwinds (resulting from the dollar's 5-10% appreciation in recent months), a modest slowing of domestic bookings this autumn, and tough fourth-quarter RASM comparisons at some carriers (especially United). American has trimmed its fourth-quarter PRASM growth estimate by as much as two points to 0-2% because of the Venezuelan situation.

Concerns about Ebola, the RASM outlook and the global economy have led to mighty stock market gyrations. Between September 2 and October 13, the NYSE Arca Airline Index (XAL) declined by 18%. However, by late October XAL had recovered much of the earlier fall as a result of the worst Ebola fears subsiding, stock upgrades from analysts, the excellent third-quarter results and reassuring commentary from airline managements.

Although travel demand to and from West Africa has declined and airlines have reduced capacity in those markets (including Delta pulling out of Liberia), US airlines claim not to have seen any measurable negative effects from Ebola so far. Bookings, unit revenue and profit outlooks for the current quarter remain strong.

Analysts theorise that, as long as Ebola is not an airborne disease and thus remains extremely difficult to catch, and given that US carriers' exposure to Africa is low (only 1% of system capacity), the effects could never be as bad as with the 2003 SARS epidemic, which many US investors have been busy studying. The SARS impact was sharp but short, reducing US airlines' transpacific revenues by 40% for a few months, but after that traffic quickly returned to normal.

A global economic downturn in 2015 is potentially more serious. Then again, as JP Morgan analysts have argued, the worst that could conceivably happen for US airlines would be something like a 5% RASM decline. Any recession scenario in 2015 would probably mean lower oil prices, and the net effect would be that "industry profits would barely budge from the 2014 levels".

Near-term capacity discipline

US airlines' continued domestic capacity discipline is virtually a given by now, but the good news is that, in light of the weakening global environment, the top three carriers are exercising much restraint also in international markets this winter.

American has trimmed its transatlantic capacity plan for the winter from 5% growth to a 2% decline. American is also cutting Latin America capacity this winter, contrasting with its earlier plan to grow by 4% in that market.

At this point American is looking to grow system capacity by 2-3% in 2015, but more than half of that would come through increased aircraft seat density — something that the airline hopes will be "highly earnings accretive".

Delta is keeping system capacity growth at about the rate of GDP growth and currently envisages 2% ASM growth in 2015. The strategy is to grow modestly through seat density increases and up-gauging. Delta has become a master of the strategy of growing modestly with fewer aircraft; since 2009 it has reduced its fleet by 200 aircraft.

Delta plans to keep its international capacity flat in 2015. Together with its JV partners it has reduced transatlantic growth to 1-3% this winter, with a similar rate expected in 2015. The primary growth focus will be on London, where combined capacity with Virgin Atlantic will be up by 2.6% this winter. Delta calls Heathrow a "bright spot", having seen the JV margins improve by 270 basis points this year. The rest of Europe will see just 1% ASM growth, while markets with high volatility (Moscow, Tel Aviv and West Africa) are seeing a 20% capacity reduction.

Delta is in the middle of an extensive Pacific restructuring, which involves reducing capacity, "getting the gauge right" and adding more non-stop services from the US. Delta is building Seattle into a new transpacific gateway. The transatlantic capacity cuts have freed up smaller widebody aircraft that Delta can now redeploy on the Pacific, allowing it to accelerate plans to retire its 16 remaining 747-400s (by 2017).

United expects its JV with Lufthansa and Air Canada to reduce transatlantic capacity by 0.5% this winter. United's own ASMs to Europe will actually decline by 3%.

Having restructured extensively on the Pacific in recent years, and despite the China challenges, United says that its Pacific network is solidly profitable. It expects to grow seasonal capacity by a double-digit percentage in the Pacific beach markets. In addition to new routes linking Guam with Seoul and Shanghai, United is launching SFO-Tokyo Haneda and LAX-Melbourne routes (the latter with 787-9s).

United is also committed to keeping system capacity growth below GDP growth; the current ASM growth projection for 2015 is 1.5-2.5%. About half of it will come through additional seats and upgauging; the rest will come from increased aircraft utilisation. Like its peers, United believes that this strategy provides the "best opportunity for margin expansion".

While Delta is clearly the most conservative of the three about growth in the near-term, it has indicated that its focus could soon shift to growing the global network. The management stated: "Looking further ahead, our international network provides the largest opportunity for additional margin improvement, as we accelerate our Pacific network restructuring, recalibrate our transatlantic capacity levels, and reap the benefits of our investment in our Latin network." (The latter refers to Delta's equity stakes in Gol and Aeromexico.)

All of the US carriers have indicated that they will increasingly be relying on their JV and other airline partners in the global arena.

Rewarding shareholders

Delta's initial $350m shareholder reward programme, launched in May 2013, marked the start of a new era for capital deployment at US airlines. Delta has far exceeded the original target, returning more than $1bn to shareholders this year through dividends and share repurchases. In May 2014 the carrier increased its dividend by 50% and authorised another $2bn of share repurchases by the end of 2016.

Shareholder rewards were the obvious next step for Delta after three years of solid profits, significant FCF generation and reaching its debt reduction goal. Delta's net debt has fallen by almost $10bn since 2009 (to $7.4bn), saving the carrier $500m in annual interest expenses.

Delta has also continued to pay down debt, address pension obligations and buy aircraft. It hopes to reduce net debt to $5bn by 2016. The plan is to invest roughly 50% of operating cash flow back into the business, keeping annual capex in the $2-3bn range.

Delta buys both new and used aircraft. It is currently evaluating proposals from Airbus and Boeing for a new widebody order, but the management has also noted a "huge glut of airplanes in the global market", indicating good opportunities for used aircraft purchases. The carrier says that the current lower fuel prices are not influencing those decisions, because aircraft are long-term investments.

But Delta's shareholder rewards put pressure on United and American to jump on the bandwagon — probably a little sooner than they would have liked, given their lower cash generation, higher aircraft capital spending and other priorities.

United has returned $220m to shareholders as part of a $1bn share buyback programme introduced last year. It has also modestly reduced debt. United's priorities are to execute a $2bn cost-cutting plan, improve its balance sheet and continue to make "return-driven investments" in its product. Its long-term goals include reducing non-aircraft debt and bringing lease-adjusted gross debt down to $15bn.

United also has higher aircraft capex than Delta. It is taking 787-8s, 787-9s, 737-900ERs and E175s. But United is trying to rein in the spending. For example, it is retaining 11 767-300ERs that had been slated for retirement; the aircraft will get new interiors, winglets and reliability modifications to extend their useful life into the next decade. United also continues to explore the used aircraft market.

American announced a capital deployment programme in July, just seven months after exiting Chapter 11. The programme includes $2.8bn of debt and lease prepayments, $1bn share repurchases by year-end 2015, quarterly cash dividends (for the first time since 1980) and $600m of additional pension contributions. The amount returned to shareholders in the third quarter was $185m, made up of $72m of dividends and $113m in stock repurchases.

It is amazing that American is doing all that while still funding a major fleet renewal programme, significant product improvements and integration costs. As a glimpse into the fleet renewal, in the third quarter American received 22 new mainline aircraft and retired 28 older aircraft. Capex is about $3bn this year. In recent months the company has taken on $3.3bn of additional debt or credit facilities.

American: the rising star

While Delta has been the profit margin leader among the US "Big Three", American is the rising star. Analysts are already getting excited about the prospect of AAL overtaking Delta in the margin league, possibly by the end of 2015.

But there is a need for caution here, because American is still far from completing the merger integration. Some of the toughest hurdles lie ahead in 2015, including a move to single IT/technology platform. Also, the incremental costs from labour integration are not yet known, because flights attendants have not yet ratified their joint contract, and talks with the pilots have not yet even begun.

American is already seeing greater cost inflation than its peers. Its ex-fuel CASM is projected to increase by 2-4% in 2014. BofA Merrill Lynch analysts estimate new labour contracts could add two percentage points to the CASM hike in 2015 and 2016.

On the positive side, AAL has had much success in attracting corporate contracts, especially in key markets such as New York. The management predicts that the original $1bn-plus merger synergy estimate will be met or exceeded. But analysts note that the synergies will not be meaningful until 2016.

United has also been narrowing the margin gap with Delta. United does not have potential tailwinds as powerful as American's, but its substantial and promising "Project Quality" revenue initiative is still in the early stages. It is only a matter of time before American and United catch up with Delta.

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e-mail ________
Telephone ________
VAT No ________

Invoice Address

Name ________
Position ________
Company ________
Address ________
____
____
Country ________
Postcode ________

DATA PROTECTION ACT

The information you provide wil be held on our database and may be used to keep you informed of ourpproducts and services or for selected third party mailings

PLEASE RETURN THIS FORM TO:

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London EC1V 7ET, UK
e-mail:info@aviationstrategy.aero
Tel: +44(0)207-490-4453, Fax: +44(0)207-504-8298
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