

AIR JAMAICA

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LONDON ROUTE - POSITION PAPERSummary

- The Company's Transition Business Plan, approved by Cabinet on Jan. 29th, reflected an exit from the London Route as of July 1, 2007.
- The basis of this decision was a profound reversal of fortunes on the Route, primarily due to increased competition and escalating fuel prices:

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
RASM cents	6.77	8.19	7.00	5.96	5.98
Fuel per ASM cents	3.59	3.17	2.19	1.56	1.27
“ as % of RASM	53.0%	38.7%	31.30%	26.12%	21.22%
“ cost per pax \$	256.00	192.006	143.00	103.00	80.00
ASM per pax	7,132	6,042	6,535	6,623	6,292
Lease Costs (\$millions)	15,040	14,750	13,180	13,600	12,480
“ “ per pax \$	119.00	98.00	78.00	75.00	71.00
“ “ per ASM cents	1.67	1.62	1.19	1.13	1.12

- As can be seen from the table above, the cost of fuel has increased nearly 3x per ASM and from 21% to 53% of revenue per ASM. In addition, due to the increased average cost of the A340 leases and reduction in the PLF due to increased competition from both scheduled and chartered flights, the lease cost per passenger has increased by \$48.00 compared to 2002.
- The actual loss for 2006 was \$27 M; the goal is to save half in 2007 and the full amount in 2008. With the code share agreement there will also be the opportunity to earn revenue from sales on the selected carrier.
- For a variety of operational and competitive reasons (addressed later herein), there are virtually no prospects for any meaningful improvement to the current trend.
- Extensive discussions/negotiations have taken place over the past four months with BA and Virgin with a view to entering into a code share agreement that would protect Jamaica's tourism and national interests on this route and realize the value of the LHR slots.
- In addition, several major international carriers, including American Airlines and Singapore Airlines, were contacted with regard to a possible lease of the slots; no carrier expressed any interest in this regard, as was the case with BA and Virgin.

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Competitive Landscape

- Significant overcapacity currently exists in the market:

		<u>Seats Per Week</u>			
Scheduled:		<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
JM	Daily	1,946	1,946	1,946	2,502
BA	3x wk. (KIN)	840	840	840	840
Virgin *(service began July1, 2006)	2x wk. (MBJ)	<u>902</u>	<u>*451</u>	<u>0</u>	<u>0</u>
		3,688	3,287	2,786	3,342
Charters from UK		2,087	<u>1,808</u>	<u>1,276</u>	<u>1,939</u>
Total seats		5,775	5,095	4,602	5,281

- The overcapacity situation has caused a major drop in fares, with no signs of abating. For example, Virgin recently announced a fare as low as \$384.00. JM's average fare in the market is \$473.00, and at that level, JM's breakeven load factor is 106%. At JM's current load factor of 52%, the average fare required to breakeven would be \$959.00.
- Both BA and Virgin enjoy the benefit of substantial connecting traffic from their respective networks into their hub complexes at LGW and marginal additional overheads for operating this route.
- Historically, JM derived 35% of its total traffic on the Route from *Virgin Holidays*, which now stays with Virgin

Operational Factors

- JM operates the Route with two A340-300's (4-engine aircraft with 278 seats); BA uses a B777 (2-engine aircraft with 280 seats); and Virgin uses a B747-400 (4-engine aircraft with 451 seats).
- JM has neither consistent nor attractive slots at LHR:

	<u>Local Time Slots</u>	
Mon	1245	1425
Tues	1400	1550
Wed	1050	1240
Thurs	1050	1240
Fri	1200	1405
Sat	1050	1240
Sun	1050	1240

- JM's slot configuration, the use/lose criteria for maintaining slots, and the prohibitive EU rules with respect to cancellations, mandates that JM utilizes two A340's to service the Route, notwithstanding that only daily service is offered.
- The London Route constitutes an '*Airline within an Airline*'. Operational issues when encountered on London require top priority, oftentimes to the detriment of JM's entire system.
- The A340-300 has a range of 7,400nm vs. a requirement of 4,072nm for London/Jamaica. At JM's current monthly lease cost of \$637,000 per aircraft, the A340-300 can only be used effectively on very long-haul business routes with high yields, which is how other operators of this aircraft normally deploy this type of equipment.
- Lastly, even if a more appropriate and affordable 2-engine aircraft were to be used on the Route, such as A330 or B767ER (none of which are available), the operational cost savings would not be anywhere near sufficient to overcome the aforementioned economic issues.

Disposition of A340's

Critical in the recommendation to exit the London Route is a satisfactory disposition of the two A340 aircraft from the fleet. As noted earlier, JM has no effective and efficient use for these aircraft over the remaining lease period – leases go to the first half of 2012. In this regard,

- BA expressed no interest (do not operate the A340).
- Virgin, which initially had interest in the aircraft, has since declined due to the cost and downtime that would be required to modify the aircraft to their unique specs.
- In coordination with ILFC, the owner of the aircraft, two candidates were identified and meaningful discussions have ensued – Turkish Airlines and Aerolineas Argentinas (both operate A340's).
- ILFC seems to prefer Turkish Airlines on the basis of that carrier being the better credit risk. Turkish Airlines has conducted a physical inspection of both aircraft, and we have been advised that the results of the inspections were favorable.
- We have made it know to all parties that we are seeking an early termination of the leases with no penalty. **However**, given the reputation of ILFC and JM's experience with respect to the early return of an A340 in 2005, we will remain cautiously optimistic pending final resolution.

BA and Virgin Proposals

After several iterations by both carriers during the negotiation process, the respective proposals are now at a point where additional deliberations should now be with the carrier of choice to leverage some desirable changes. *In addition, time is now of the essence to bring the matter to resolution.*

The offers for the slot purchase from BA is \$9.4 million and from VS ^{10.1}~~\$9.7~~ million. Both carriers are ready to assume full utilization of the slots beginning with the winter season of 2007 (starts Oct. 27th).

- BA has increased their slot offer from a starting point of \$7.0 million, and VS has moved from their starting position of full utilization of the slots beginning with the winter 2008 season.
- BA has offered a guarantee of a daily slot pair at LGW at a cost of \$1.8 M should they exit the Jamaica market prior to contract completion. (We will seek to get this agreement to include a failure to renew their agreement with JM).
- Both will add additional service of at least 2x per week to the Jamaican city not currently served (BA to MBJ and Virgin to KIN). The BA offer represents 560 seats configured for 4 classes; and, the VS is for 900 seats in a 3 class configuration.
- Both will offer *Frequent Flier* earn/burn reciprocity.
- Both will offer code-share and SPA's (Special Prorate Agreements) from their respective gateway cities in North America.
- Marketing agreements go for 3-years in both cases, but we believe the "winner" will agree to go longer to get the deal, as well as the possibility of common-rating the fares out of Manchester with those out of London.

Our Pick is BA:

- BA's network is substantially larger – they serve ^{seven}~~eight~~ common gateways with JM in No. Am., compared to ~~only three~~ ^{five} for VS.
- BA has been in the JM market for ~~60~~ ^{five} years; VS entered the market only last summer. There is much less uncertainty with respect to BA's continued commitment and support of the Jamaican market.
- BA appears to have a much better understanding of the West Indian population in the UK, and in our view, BA will be a better partner in achieving a smooth transition from both a commercial and political standpoint.
- Lastly, and given the similarities in the two offers with respect to the key commercial factors, it is of interest to note that the current overcapacity and low yield condition on the route is due largely to Virgin's entry into the Jamaican market this past summer.

Recommendation

Set forth below is the Company's recommendation regarding the London Route.

- LHR slots be sold to BA for a *minimum* of \$9.4 million concurrent with the execution of a long-term comprehensive marketing and code-share agreement.
- Service levels be reduced from daily to 5x per week from July 1 – Sept. 5th; this will allow one A340 to be used on the North American system during the peak summer period and will substantially reduce the need for wet-leasing from other carriers.
- Service further reduced to 4x per week Sept. 6th – Oct. 27th; this will allow one A340 to exit the fleet.
- Total exit from Route on Oct. 28th; remaining A340 exits the fleet.

Estimated Financial Impact of Decision to Exit the London Route.

- Transition Year 2007:

Proceeds from sale of slots	\$9.4
Return condition costs of A340's after application of deposits and maintenance reserves	(7.4)
Severance and other costs with respect to closing of London operation	<u>(2.0)</u>
	<u>Wash</u>

- Steady State beginning 2008

Elimination of projected losses from operating the Route:

\$28.0 million per year (\$2.3 per month)

\$91.0 on an NPV basis over a 5-year period
(using a rate of 9%)

M J Conway
President & CEO
April 17, 2007