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**INDEPENDENT RESEARCH OPINION**

# Air Canada 3Q-2010 Results and Comparison with WestJet 3Q-2010

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### *AC Net Income Down – but solid operational performance*

For an airline with a track record of making more money below the operating line, Air Canada today reported exceptional 3Q-2010 Operating Income of CAD 327 million, a massive increase of 381% over the same period in 2009.

Net Income fell by 16 million dollars in the Third Quarter to CAD $261 million. However, it must be emphasized that Third Quarter 2009 net income of $271 million included non-operating foreign currency gains of $295 million. Excluding the effects of foreign currency gains, Air Canada's 3Q-2010 net income also represents a substantial improvement over the prior year.

Improving traffic and yields in the key premium travel segment was the key driver behind a 13.3% surge in operating revenues. Growth in operating expenses was comparatively much lower at 3.7% owing the assistance of a stronger Canadian Dollar, reduced maintenance expenses, and ongoing improvements from the carriers Cost Transformation Program (CTP).

### *AC results versus WestJet*

On a unit basis, Air Canada's ability to tap into premium and long-haul routes that were less affected by the lingering economic malaise in the US market enabled it to post a 3.2% increase in passenger yield. That compares favourably against the 2.1% Third Quarter increase posted yesterday by Canada's WestJet Airlines.

Air Canada and WestJet both recorded double-digit increases in operating revenues. The key differentiator was Air Canada's more modest growth in operating expenses of 3.7% versus the 13.5% recorded by WestJet. The principal driver behind this difference was capacity management. Air Canada's growth came primarily through improved utilization of existing capacity. In comparison WestJet's fleet utilization was unchanged at an average of 11.6 hours per aircraft per day, meaning capacity growth was largely fuelled by an 11.1% increase in average fleet size.

Comparing the Third Quarter fortunes of the two carriers using the industry's gold standard approach, Air Canada posted a considerable positive spread between its unit revenues and unit costs while WestJet managed a much more modest gain.

For example, Air Canada saw its revenue per available seat mile (RASM) increase by 0.7 cents (+ 4.7%) and its cost per available seat decrease 0.7 cents (-4.1%), resulting in a favourable spread per available seat mile (ASM) of 1.4 cents. In comparison, WestJet's RASM and CASM increased by 0.3 cents (+ 2.0%) and 0.2 cents (+ 1.6%) respectively, resulting in a much lower favourable spread per ASM of 0.1 cents.

In the key fuel expense line item and in total non-fuel expenses, Air Canada outperformed WestJet on both a quarter/quarter percentage change basis and on a unit cost basis per ASM. Air Canada's fuel cost rose by 7.5% while decreasing 0.6% per ASM. In comparison, fuel cost at WestJet rose by 13.4% and increased 1.5% per ASM.

Grouping all non-fuel operating expenses together, on a unit basis the difference between the two carriers' Third Quarter performance was even more striking. Air Canada saw its non-fuel CASM decrease by 5.3% while WestJet's non-fuel CASM increased by 1.1%.

Investors should continue to expect favourable results from Air Canada through continue savings in its Cost Transformation Program, a continuing strong Canadian Dollar, and through improving economic fortunes in the key premium segment and across the markets it serves worldwide.

Some potential headwinds are looming on the horizon. For example, Air Canada's pension obligations are increasing by around $136-million next year. As well, if Air Canada's stock price remains above $4 a share for 20 consecutive days, there are about 90 million warrants outstanding that could be converted to common stock that would dilute shareholders if triggered.

### ***Specific comments on WestJet***

Despite the worries of some analysts that WestJet's rapid capacity expansion would come at the expense of profits, the airline's 3Q-2010 fundamentals came in quite strong. Operating margin of 13.2% in the quarter grew from 12.8% in 2009, and is on par by comparison with the 13.5% and 13.6% operating margins recorded by Delta Air Lines and JetBlue Airways in their respective 3Q-2010 results. Built on a 71.8% improvement in net income, WestJet's earnings of 37 cents per share (diluted) represent a 54.2% increase from the same period in 2009.

With no change in cabin load factor and despite a 11.7% increase in seat capacity, WestJet's 2.0% increase in revenue per seat mile (RASM) managed to outpace the 1.5% increase in cost per available seat mile (CASM). Clearly, WestJet continues to demonstrate its ability to manage its growth.

In light of some continuing economic uncertainty WestJet should continue to be vigilant about the growth of its non-fuel expenditures and the pace of its capacity additions.

Per AIRTRAV INC.

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