THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Copyright Reserved

No. of Pages = 24

TOP CA CASE STUDY EXAMINATION

DECEMBER 2012

ADVANCE INFORMATION

1. Group Skyfly

1.1. Skyfly Airlines

Skyfly is one of the leading airlines in Asia, with the slogan, 'Now, we make you fly' having Serendib International Airport as its hub airport and is a legacy carrier which operates with multi-class (Business and Economy) configuration with complimentary in-flight services. Skyfly was initially established under the name Aerofly in 1982 as a flag carrier airline with the full ownership held by the Serendib government. Commercial operations of Aerofly began in 1983, with three Boeing 707's flying to six international destinations. The new airline flew 265,000 passengers in its first year. Within three years, various destinations were added to the network, and new aircraft were added to the fleet. But the Serendib government being the management of Aerofly then faced problems with lack of adequate air traffic and was not in a position to compete with international airlines. Five years later, the government wanted to have a strategic partner to run the commercial operations of Aerofly. As a result, in 1988, the government entered into a management agreement with Lionfly Group – a leading airline in Asia having its base and hub in Malaysia. With management agreement, the government sold 49% of ownership stake in Aerofly to Lionfly. The government retained majority of ownership stake in the airline but gave full control to the management of Lionfly for investment and management decisions. Accordingly, in 1989, the Aerofly brand was abandoned and Skyfly was born. Under the management of Lionfly, the airline continued to grow during the late 1980's and early 1990's, adding to its fleet and expanding its route network. Also the Skyfly brand achieved a strong position among the leading brands of other major airlines in Asia. By January 1994, it had increased its original network to a total of 21 destinations. In December 1996 the airline purchased its first Airbus, the A320, in what was to become an all Airbus fleet.

During 1999 -2000, five Airbus A330-200s and four A340-300s were added to the fleet, and the existing A320s was upgraded to a two-class configuration –Business and Economy class. Visionary leadership has been observed in the Skyfly from the management change in 1988. Then CEO of Skyfly (1988- 2001) – Mr. Prekhasanthi had been leading Skyfly recording year on year continuous growth until 2000.

Introducing “FLYpass” frequent-flyer programme in early 2000 helped the company to attract and retain customer loyalty. "FLYpass" also refers to the blue card which Skyfly frequent flyers are given. The motto of FLYpass is "Beyond your imagination". The programme's elite levels are comparable to those of other airlines' frequent flyer programmes, requiring members to fly 30,000 miles per two-year cycle.

Balance sheet of the company as of 31st December 1999 showed that the total assets of the company amounted to Serendib currency -SR. 31 billion. Skyfly was then one of the cash-rich airline companies in Asia. Income Statement for the same year recorded SR. 6 billion Net Profit which was the highest ever profit recorded in Skyfly’s eighteen years history. By late 2000, Skyfly was able to become a reputed international airline in Asia and the brand Skyfly was known to passengers as an airline delivering quality; quality in-flight, quality on ground and quality onboard. At the same time, it took in the best attributes of Serendib and its people, the attributes of warmth and hospitality. Therefore, Skyfly’s aspirations were quality, combined with warmth and hospitality of its people. During this time, Skyfly has had over 6,000 employees, operating regular flights to 45 destinations in 23 countries in Europe, the Middle East, South Asia, Southeast Asia, and the Far East.

In July, 2001, the attack by the terrorists on the Serendib Airport affected very badly the wellbeing of operations of Skyfly. The attack disabled half of Skyfly’s fleet which had 12 aircraft in use. Four aircraft were fully destroyed and two badly damaged. Revenue for the year 2001 dropped by more than 50% when compared with revenue in 2000, which ultimately resulted in net loss for the period. Even with difficulties, Skyfly was able to survive thanks to several billions of cash received as insurance claim. Unfortunately, bad external conditions did not support not only Skyfly but also the travel and tourism industries in Serendib. Airline companies had to pay high insurance premium to operate airlines in Serendib and the cost had to be passed on to customers by increasing price of air tickets. While the negative impact from adverse country situation prevailed, another unfortunate incident happened within the management of Skyfly in early 2002. Mr. Prekhasanthi –the CEO of Skyfly resigned from the company due to personal reasons. Mr.Sriprakash from Malysia was appointed as the new CEO in March 2002. But the strategic approach to leadership followed by Sriprakash was totally different from the approach of former CEO Mr. Prekhasanthi.

Within a short period of time, he took a series of decisions such as shutting down a few routes. Using Male as a hub due to adverse travel advice and bad publicity in Serendib at that time, the airline plied the lucrative markets of Europe, Japan and China. But operating cost significantly increased due to these decisions resulting in lowering the profitability.

In late 2002, country situation was again favorable for the Airline industry in Serendib due to the government and terrorists signing a ceasefire agreement. Weapons decommissioning begins, the A19 Highway – the only land link between the Jaatsa Peninsula and the rest of Serendib – reopens, and passenger flights between Jaatsa and the rest of the country resume.

By looking at the short term potential in the domestic air travel, after having several discussions with the government, the management then was able to get the license to operate domestic charter flights. The management invested a considerable amount to operate charter flights from Combilo to a few destinations such as Jaatsa, Armapur, Nuwar and Mawi etc. The purpose behind this was mainly to find another source of income as an alternative to loss of capacity to operate international routes due to the 2001 terrorist attack. But the new business of domestic air travel was limited to less than a year due to the fact that the terrorists pull out of peace talks, arguing too little was being done to rebuild war-damaged areas, but the ceasefire holds during April 2003. Again the country situation seemed unfavorable with the first suicide bomb since 2001 exploding in Combilo in 2004 (July). Same year in December the Indian Ocean tsunami kills around 35,000 people, Serendib community was affected. All these factors adversely hit the performance of Skyfly. In this context, the management of Lionfly Group did not want to hold the investment in Skyfly further. Since then, Lionfly had been searching for a potential buyer to sell the ownership stake in Skyfly and transfer the management functions of the same. After sometime, an Institutional Investor – Scroon Airline based in Singapore realized that the investment stake of Lionfly in loss making Skyfly can be acquired at a discounted price and proposed to purchase Lionfly’s stake in Skyfly.

After several deal negotiation meetings between the top management of Lionfly and Scroon, the deal went at a discounted price in early February, 2006. Serendib government entered into an agreement with Scroon Airline and allowed Scroon to control Skyfly under the same terms and conditions given to the previous management -Lionfly.

Scroon appointed Mr. Neaotra Sweng-an engineer by profession and who has been the Vice President Operations of Scroonwest Airline a subsidiary of Scroon Airline as the new CEO of Skyfly and requested him to undertake his responsibility at Skyfly with effect from 1st April 2006. Another 10 people from Scroon Head Office in Singapore have been transferred as a management team to support Sweng. When Mr. Sweng and the team undertook the new management, all interested parties of Skyfly expected a change that would bring Skyfly to a new era. Sweng and the team implemented their strategies with a view to turnaround Skyfly's position. New management wage structure was determined by Scroon Airline and wages are paid by a separate third party company. New management took several measures for the purpose of enhancing revenue and profitability of the company. Decision was taken again to commence the airline operations on routes that were suspended by previous management. He convinced the board that immediate investment is required to acquire a few aircraft to add to the current fleet so that the capacity would be strengthened to face future demand, because a tremendous growth in Air traffic to US, Europe, Middle East, Asia Pacific and even to leisure destinations was expected during that time. Accordingly, with board approval, the management aimed to boost Skyfly's fleet to 18 aircraft by end of 2012 and was in talks with Airbus BAS and Boeing Co, with regard to a deal which was to consist of up to six long haul aircraft. As a result, initially the company bought two long haul aircraft in late 2007. Total cost for the two aircraft was financed through external borrowings. Further, it also leased out another four Airbus A320 aircraft. One arrived in December 2007 and others were expected to be delivered during September 2010, January 2011 and February 2012, respectively.

The lease agreements were cancelled and expected deliveries did not happen due to unexpected world economic downturn in 2008/09 and the oil price hike in 2008. At the end of Financial Year 2009, Skyfly recorded a loss of SR 6.5 billion. The performance during 2009 and 2010 also continuously weakened further. (Please refer to annexure I). The management had to take various short term measures to ensure that the company has adequate working capital to operate the airline business. Salary increments and annual benefits such as bonuses were temporally suspended making employees unhappy giving rise to a few union actions against the management decisions.

Management claimed that the reason for the significant losses was mainly due to bad economic condition around the world and skyrocketing fuel cost. Management wanted to reduce losses in the financial statements. In both 2009/10 and 2010/11, the management was able to record non-operating gain in the financial statements by entering into sale and lease back transactions of aircraft. By the end of year 2011, except for two aircraft, the management sold all the owned aircraft and 10 aircraft were leased back to the company. The airline lost SR 16 billion in the year ended 31st March 2012, compared with a loss of SR 8.9 billion in the period a year earlier. Passengers and travel agents appear to be increasingly avoiding the carrier, especially after it cancelled scores of flights in August 2012. Currently the company employs approximately 420 staff per aircraft while the industry average is closer to 100. The airline's passenger load factor, a measure of how full its flights are, fell to 50 percent in the 1st six months of 2012, from 54 percent in the period a year earlier. A lot of people are now unhappy and do not want the hassle of travelling Skyfly.

Skyfly's problems have been brewing for years. The company has frequently accumulated large arrears to oil companies, airports, and its employees. In recent months, many pilots and key technical officers have quit and joined other airlines.

1.2. Subsidiary Company of Skyfly Airlines

Launched in 1982, Skyfly Catering Limited (previously known as Aerofly catering) is the sole airline caterer in Serendib and is a wholly owned subsidiary of Skyfly Airlines. Its hub is at Serendib International Airport where it provides services for many of the world's finest airlines. Winner of many awards in the global flight catering industry, Skyfly Catering's main line of business is in-flight catering to airlines that operate to Serandib International Airport (SIA). Skyfly Catering also manages two Restaurants and a Lounge Bar at SIA and provides food for 9 other Restaurants and Lounges there. Its state-of-the-art flight kitchen at SIA has a capacity of 35,000 meals per day.

The company is currently diversifying its business operations into hospitality related fields such as management of Serendib Transit Hotel Operation of Aero Clean industrial laundry and Outdoor Catering operations etc.

The company was recently awarded the franchise through the year 2022 to be the exclusive provider of in-flight catering for airlines at SIA and also for food and beverage products at all of SIA's restaurants and lounges. Skyfly Catering is one of the few airline caterers in the world to hold four global certifications namely (I) ISO 9001:2008 for Quality Management System, (II) ISO 22000:2005 for Food Safety Management Systems (III) HACCP-Codex Alimentarius for Food Safety Assurance and (IV) ISO 14001:2004 for Best Environmental Practices.

The company has been profitable from its inception and strongly supportive to its parent in different ways. There is a significant contribution from Skyline Catering Limited to the overall group performance. (Please refer annexure IV)

1.3. Flyingair – Budget Carrier Airline of Serendib

Flyingair, was incorporated on 27 October 2005 and is the budget carrier of the Serendib government. Flyingair is based at the Serendib International Airport. Flyingair started operating on 31st January 2007 with three wet leased Airbus A320 aircraft. Initially, Flyingair connected Combilo with nine other destinations including Tiruchirappalli, Thiruvananthapuram, Bodhgaya, Bangkok, Singapore, and Malé and Gan in the Maldives. Start-up capital of SR.250 million was financed by the ministry of finance by purchasing 100% equity stake of the company.

Initial journey of the operation of Flyingair was limited to less than two years. In August 2007 Flyingair was forced to ground the A320 serving Bangladesh after the aircraft's owners DH Air had instructed its pilots not to fly the aircraft as Flyingair had not settled its lease payments .

In the same month Skyfly Airlines withdrew its ground handling facilities for non-payment forcing Flyingair to manually pushback its aircraft before takeoff and use its own staff to handle the check-in counters. In January 2008, Flyingair lost one of its aircraft, a A321, after its owners took it back for non-payment of lease. In April 2008, it lost its other two aircraft after its owners took them back for non-payment of lease.

Having lost all of its aircraft the company was forced to suspend all operations in May 2008 and it was announced that Mr.Ranathunga (then the CEO of Flyingair) would resign his position but remain on the board. Ranathunga didn't resign but was dismissed and was replaced by Jaymin Bandula in July2008.

Early in 2009 Flyingair leased a 19 year old A320. Mr.Nirmal Wikremasinghe replaced Mr.Bandula as CEO in February 2009. Flyingair re-commenced operations on 15th February 2009 with a flight to Dubai. In November 2009 Flyingair took over an ex Air Deccan Airbus A320.

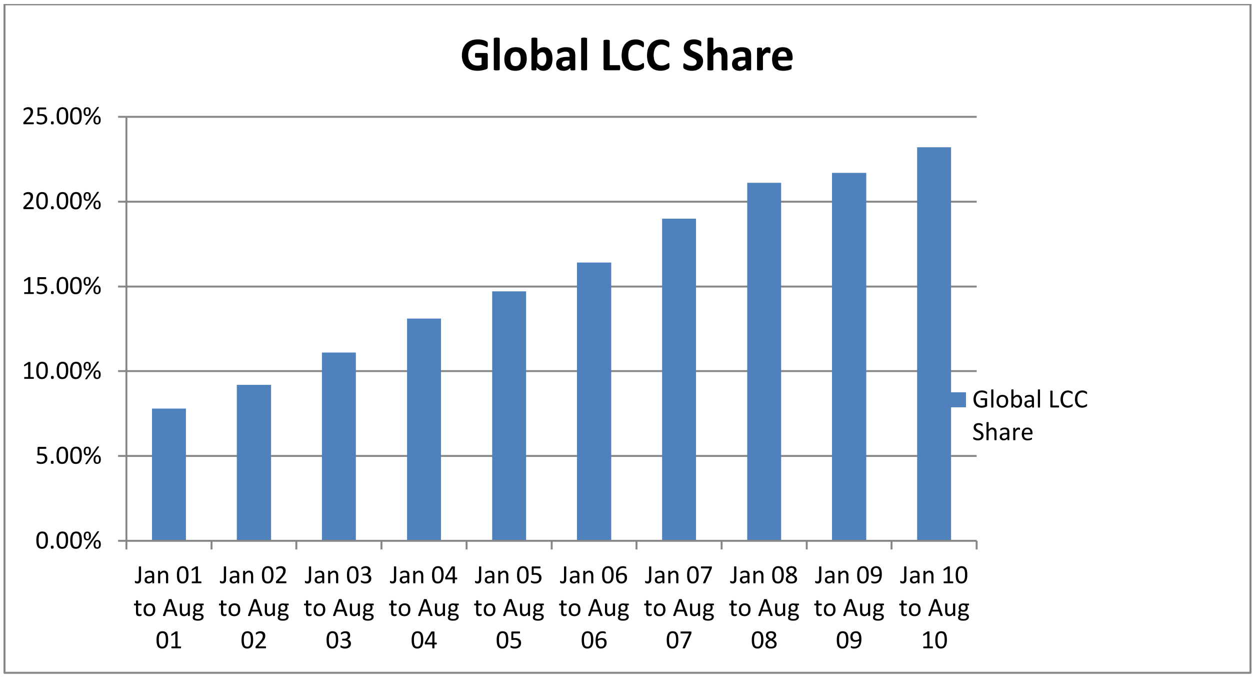
In January 2012, Flyingair announced that it plans to serve Bangkok, Chittagong, Kozhikode, Manila and Singapore, once it takes delivery of its third aircraft. In August 2012, the airline took delivery of its third aircraft, an Airbus A321and is planning to serve New Delhi and Madurai in the near future. Flyingair is represented by appointed General Sales Agents in India, Dubai, Maldives, Kuwait ,Dhaka and Jakarta. In Serendib the company has more than 100 active agents out of whom 75 agents are registered with Flyingair and actively promote its services.

Negative financial performance observed since inception of Flyingair weakened the financial position to a level where company needs further capital infusion. In 2011/12, Flyingairs`s revenues rose to SR. 2.9 billion from SR 656 million in 2010/11. But its loss is SR.2.6 billion in 2011/12. Since starting in 2007, the airline has lost SR 7.9 billion. By end of March 31st 2012 its balance sheet showed negative net assets of SR 7.6 billion. (Please Refer annexure V –Tables 1 and 2)

2. Low Cost Carriers Around the World

2.1. An overview

Today, "low cost" is perhaps the most over-used term in aviation industry and it will be used even more in the future. With short-haul, low fare and no-frill flights, low cost carriers (LCC) have made fundamental changes in the airline business model. The quick expansion of LCCs in US, Europe and Asia has given passengers the opportunity to travel by air with costs that they could have never imagined before. As per the statistics of Centre for Asia Pacific Aviation, the proportion of global seats provided by low cost airlines has seen an extraordinary growth, from a mere 7.8% in 2001 to 22% in 2010.



(Table 1) –Global LCC share as a % of Total Global Seat capacity for Air travel from 2001 to 2010 (only from January to August each year)

This result is amazing especially in the situation of worldwide economic crisis, terrorist attacks and diseases. Hence, many people think that LCC is a moneymaker that they can use in all markets. But in fact, besides the success stories of Southwest Airlines, Ryanair, EasyJet etc, many LCCs went bankrupt just after a few years of operation.

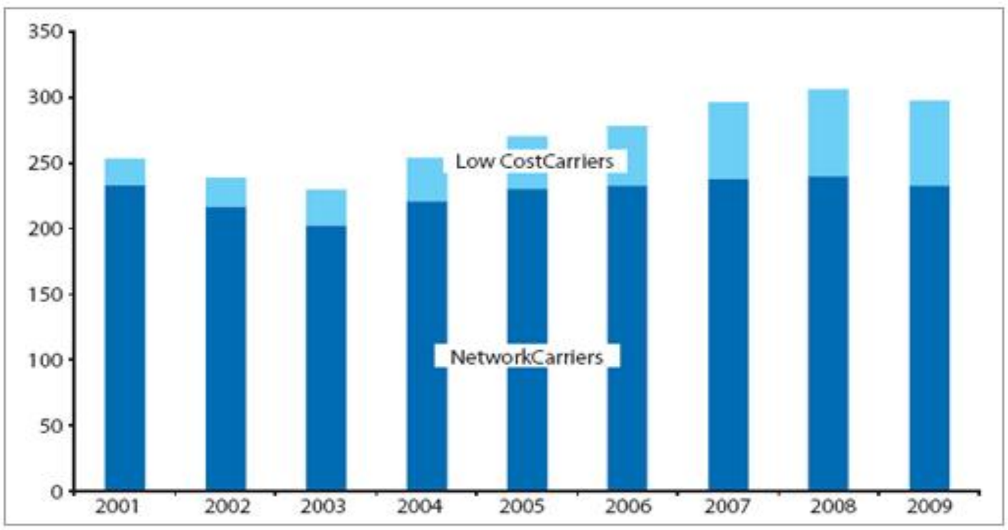
One of the biggest hidden problems behind these collapses may be improper business plans due to lack of air transportation data for market analysis. This fact is especially true in emerging countries where the aviation market is regulated by government authorities and is dominated by one or two major airlines.

2.2 Successful Stories

The first and foremost successful story of low cost airlines was in America with Southwest Airlines in Dallas, Texas. It is the only airline which has been profitable since 1973 till now and its model was copied and spread around the world. The key success of Southwest Airlines is to keep the product simple - from using single type of aircraft to no-frill flights, point to point flights, no reserved seat etc. Their success inspired a wave of new LCCs to enter aviation market. In early stages of 1980s and 1990s in the USA, the new start-ups tried to follow a low cost approach such as People Express, Continental Lite, Delta Express etc. In Europe, the Irish airline, Ryanair became the pioneer for the LCC wave after the liberation of the flight market in the European Union in the 1980s. The two main LCCs in Europe - Ryanair and EasyJet have indeed reached Europe scope: in 2004, they have transported 26.4 and 24.3 million passengers respectively . Furthermore, both airlines have ambitious plans to expand their fleet as they have ordered 125/120 new aircraft in 2009 with another option of 125/120 in 2010. Ryanair plans to carry 70 million passengers in 2012. In Asia, LCCs are a much more recent phenomenon. In 1998, the first two LCCs, Skymark Airlines and Air Do entered the Tokyo–Fukuoka route and the Tokyo–Sapporo route respectively. But the LCCs wave in Asia just exploded after the LCCs from Southeast Asia entered the market. The most successful story is AirAsia. Having benefited from the Malaysian aviation deregulation in 2000, Air Asia has converted from full service carrier to low cost carrier. This conversion has been successful. Today, AirAsia has become the major carrier in the region, operating right across the subcontinent and opening up the possibility of flying for many Asians who previously would never have considered it due to the cost. And from the success story of AirAsia, many low cost airlines have been established such as Tiger Airways, Jetstar etc.

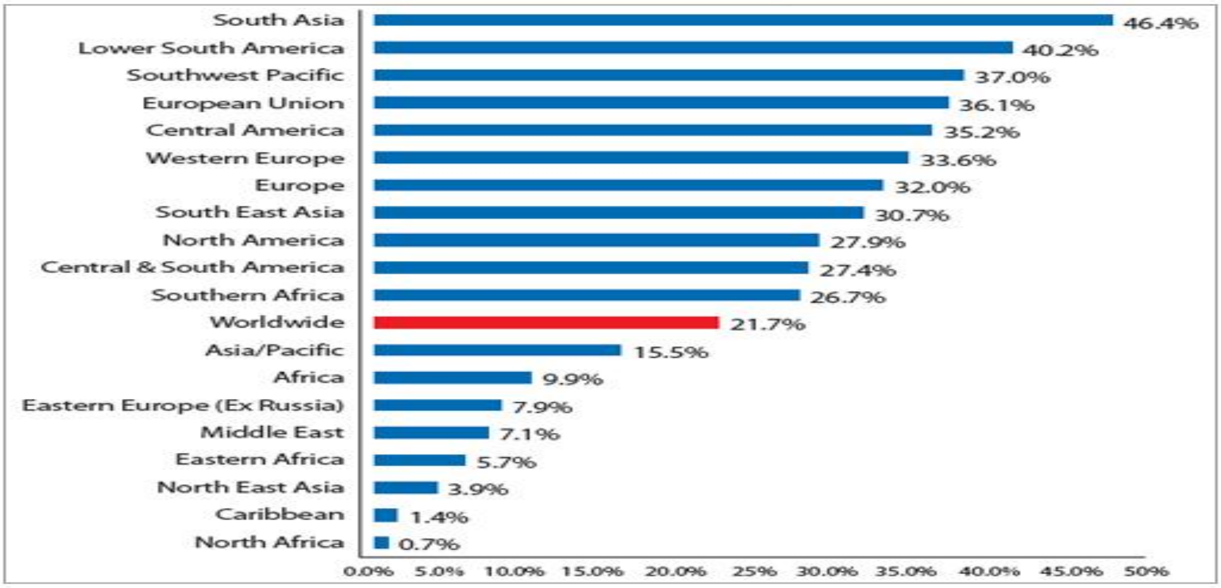
2.3 LCC- Global Outlook

Given the traditional dominance of a relatively small number of international airlines and national flag carriers, the impact of new entrants has been as surprising as it has been swift. The number of seats flown worldwide in May 2009 was 298 million, up 27% from 234 million in 2001 (although it peaked at 307 million in May 2008). Between 2001 and 2009, Low Cost Carriers (LCCs) grew from 7.7% of the total to 22% (66 million seats) at compound annual growth rate of 16%.The full service airline seat numbers have remained static over the eight years; low cost airlines have more than trebled, now exceeding well over 20% of all global seats.



(Table II)- Expansion of Worldwide Aviation Capacity (seats - millions): May-2001 to May-2009

From a mere 7.8% in 2001, the proportion of global seats provided by low cost airlines is now 22% - an extraordinary growth story. The growth story varies by market, depending on size, maturity and features such as international vs domestic operations.



(Table III) - LCC penetration within major regions (%): 2001 to 2009

3. Asianfly as a LCC

History: Asianfly was established in 1993 but it started the first flight in November 1996. In 2001, the heavily-debted airline was purchased by former Time Warner executive Keneth Fernando's company AirTune for the token sum of one Ringgit and was converted to a competitive cost airline. Just after one year from reconstruction, Asianfly registered profits in 2002. This achievement came from Asianfly's business strategies such as quick turnaround time and maximizing flight utilization while continuously maintaining the most important elements like safety, service and security. Asianfly provide no-frill services on the flight but passengers are given a choice of purchasing a variety of food and drinks on board at low rates. Additionally, Asianfly is point to point and does not encourage connecting flights. For fleet development, Asianfly replaced the existing B737-300s with A320-200s. This conversion began with the first order made for 40 Airbus A320 aircraft and 40 more on option in a Memorandum of Understanding made on 17 December 2004. Asianfly is currently the largest customer for the Airbus A320, having placed a firm order for 175 aircraft, plus additional 50 options, with deliveries scheduled through to 2014.

The Asianfly Group carried 18.3 million passengers in 2008 and reached its 50 million passenger milestone in June 2008, within six years of operations.

The Group now confidently expects to carry 60 million passengers per annum by 2013, as it forecasted and achieved a capacity growth of 20% in each quarter of 2009. The rapid expansion of Asianfly is also demonstrated by share purchasing of other airlines as well as mergers.

Expansion:

Thai Asianfly: In January 2004, Asianfly formed a joint venture with a company of former Thailand Prime Minister Thakushan Shriniwantra, Shine's Corporation, called Thai Asianfly.

Indonesia Asianfly: In November 2004 AA International Limited, the company that is 99.8% owned by Asianfly, successfully concluded a sales and purchase agreement with the Indonesian private airline AWAIR. In December 2004, AWAIR was re-launched successfully as an LCC serving Indonesian domestic routes. Indonesia Asianfly was, in the following December, established through AWAIR.

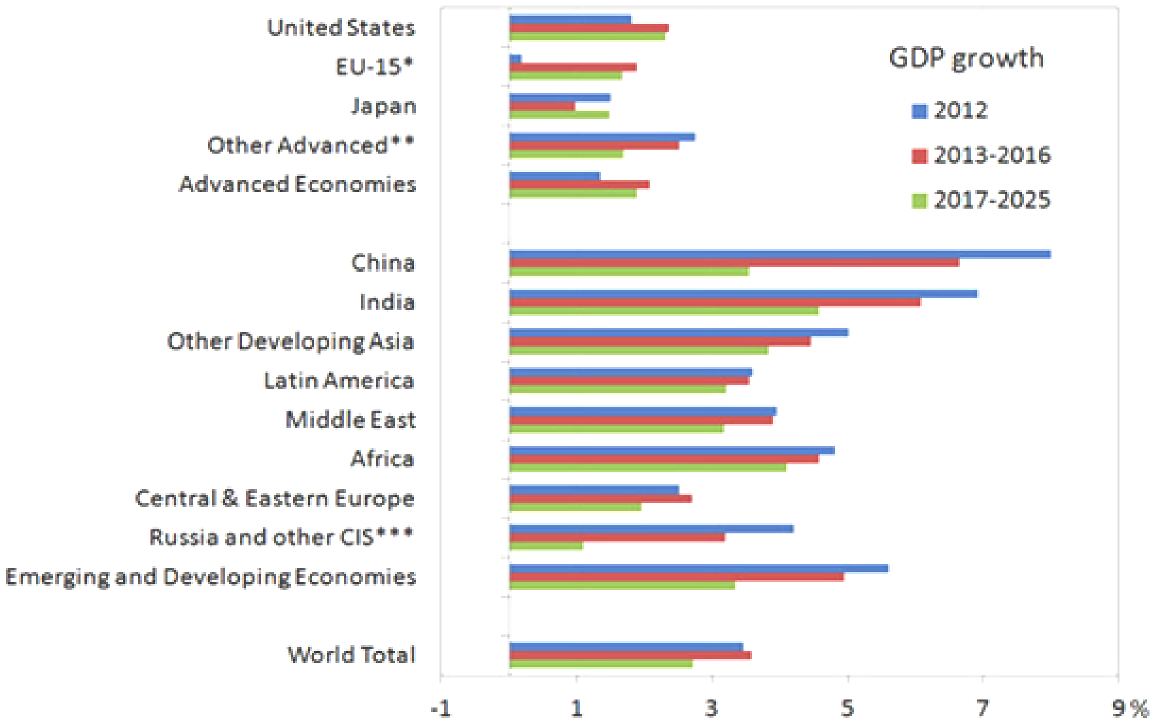
AsianflyY: is a service operated by Asianfly Y Sdn. Bhd. (previously known as FlyAsianYpress Sdn. Bhd.) as a franchise of Asianfly. It offers long-haul services from Kuala Lumpur to Australia and China using an Airbus A330-300. Its inaugural flight was on 2 November 2007 to Gold Coast, Australia.

4. Global Economic Outlook 2012

(article extract published by the Conference Board Global Economic Outlook)

Until at least the middle of the next decade, global economic growth is likely to slow to approximately 3 percent per year on average–a rate somewhat below the average of the last two decades. A recovery in advanced economies will be more than offset by a gradual slowdown in emerging ones as they mature, with the net result that global growth will slow. But the biggest risk ahead for the global economy is not this slower overall growth in output but a slowdown in average output per capita, which will determine how fast living standards can be supported and raised.

Global growth is projected to grow at 3.5 percent in 2012, then accelerate somewhat to 3.6 percent from 2013-2016, and then show a further slowdown to 2.7 percent from 2017-2025. Advanced economy growth is expected to slow down from an already meager 1.6 percent in 2011 to 1.3 percent in 2012. For 2013-2016, the outlook suggests some recovery in advanced economies, bringing these countries back to the pre-recession growth trend of a little more than 2 percent. In 2012 emerging economies will slow in growth by 0.7 percentage points on average, going from 6.3 percent growth in 2011 to 5.6 percent in 2012, partly as a result of slower export growth and partly because several of them have been growing above trend. From 2017-2025 emerging and developing countries are projected to grow at 3.3 percent. Many economies will begin to show signs of maturing, at which point the rapid catch-up growth abates. The greatest challenge for the global economy in this slow growth environment is to raise productivity without losing job opportunities for the millions who are looking for reasonably paid jobs to support their living standards. The growth rate of per capita income globally has been around 2.5 percent since the beginning of the century but sometime between 2017 and 2025, this rate will fall below 2 percent. In contrast to the past half century, that slowdown will also be accompanied by slower growth in population.



(Table IV)- Global Outlook for Growth of Gross Domestic Product, 2012-2025 (January 2012)

*EU-15 refers to states that joined the European Union before 2004.
**Other advanced economies include Canada, Switzerland, Norway, Israel, Iceland, Cyprus, Korea, Australia, Taiwan Province of China, Hong Kong, Singapore, New Zealand and Malta.
***CIS is Commonwealth of Independent States which includes all former republics of the Soviet Union, excluding the Baltic States.

Annexure I. – Past Performance of SkyFly – from FY 2001/02 to FY2011/12

		Eleven Year Review										
Income Statement		**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
Passenger Revenue	SR.Million	26,628.03	25,799.12	29,949.78	28,897.91	44,885.41	52,071.12	57,569.56	66,409.28	63,761.60	55,360.66	59,290.77
Cargo Revenue	SR.Million	4,229.16	4,097.51	4,756.73	4,589.67	6,600.80	8,270.12	9,419.75	10,547.36	9,491.55	9,106.60	9,300.00
Other	SR.Million	469.91	455.28	528.53	509.96	1,320.16	918.90	974.46	1,171.93	1,054.62	6,646.65	6,542.86
Total Revenue	SR.Million	31,327.10	30,351.91	35,235.04	33,997.54	52,806.37	61,260.14	67,963.77	78,128.57	74,307.77	71,113.91	75,133.63
Operating Expenditure	SR.Million	32,807.28	30,347.87	34,660.83	33,441.82	53,145.20	61,720.29	65,406.68	83,854.01	84,735.26	79,225.35	90,235.25
Net Profit/ (Loss)	SR.Million	(1,980.18)	(395.96)	574.21	105.72	(988.83)	(885.15)	2,082.09	(6,525.44)	(11,252.49)	(8,951.44)	(16,581.62)
Balance Sheet												
Share Capital/Stated Capital	SR.Million	6,645.35	6,645.35	6,645.35	6,645.35	6,645.35	6,645.35	6,645.35	6,645.35	6,645.35	6,645.35	6,645.35
Long Term Interest Bearing Liabilities	SR.Million	3.12	4.13	5.62	5.82	6.83	1,123.00	8,723.00	9,142.00	1,190.00	12,103.00	15,003.00
Non Current Assets	SR.Million	14,952.28	12,826.78	12,229.44	13,072.68	10,908.79	13,136.77	17,568.73	14,730.43	14,338.18	16,531.75	17,830.13
Current Assets	SR.Million	14,247.30	12,061.52	18,713.33	24,954.44	22,303.26	21,866.73	21,347.46	32,209.67	20,008.38	18,910.82	17,205.39
Total Assets	SR.Million	29,199.58	24,888.30	30,942.77	38,027.12	33,212.05	35,003.50	38,916.19	46,940.10	34,346.56	35,442.57	35,035.52
Current Liabilities	SR.Million	16,239.83	11,503.25	16,623.38	20,517.23	22,348.59	25,843.25	25,006.64	29,133.25	26,303.36	28,393.53	32,345.24
Yield/Unit Cost												
Overall Yield	SR. tkm	31.3	36.6	45.2	47.25	48.2	51.3	55.6	61	60.21	54.3	53.2
Unit Cost	SR. tKm	26.23	27.3	31.53	34.9	36.32	37.8	40.35	46.53	51.25	48.32	52.25
Breakeven load factor	%	81.2	71.35	73.35	68.75	73.45	72.1	72.35	76.15	78.13	79.35	80.35
Revenue per RPK	SR/RPK	3.65	4.42	4.81	4.12	5.63	5.71	5.72	6.91	7.33	6.61	6.31
Production												
Passenger Capacity	ASK Millions	8533.21	8,552.92	8,423.73	9,692.03	11,323.53	11,933.86	12,379.63	12,599.53	11,733.53	10,273.82	10,233.84
Overall Capacity	ATK Millions	1135.21	1,143.73	1,122.79	1,239.93	1,483.03	1,596.56	1,696.92	1,743.10	1,636.63	1,542.03	1,753.25
Staff												
Average Strength	Nos.	4200	4103	4048	4189	4715	5139	5364	5275	5113	4839	4825
Revenue Per employee	SR.	7,458,833	7,397,492	8,704,308	8,115,908	11,199,654	11,920,634	12,670,352	14,811,103	14,533,106	14,695,993	15,571,737
Capacity per employee	Tonne-km	270,288.10	278,754.57	277,369.07	295,996.66	314,534.46	310,675.23	316,353.47	330,445.50	320,091.92	318,667.08	363,367.88
Fleet												
A320-200	Nos.	2	2	1	2	3	3	5	5	3	3	2
A330-200	Nos.	5	5	4	4	4	4	4	4	4	4	3
A340-300	Nos.	5	5	3	3	5	5	5	5	5	5	5
Turbo Otter	Nos.	0	0	0	0	0	0	2	0	0	0	
Aircraft in service at year end	Nos.	12	12	8	9	12	12	16	14	12	12	10
Aircraft -Owned	Nos.	12	12	8	9	12	12	12	9	5	2	1

Annexure II-Extracted Notes from Recent annual Audited Financial Statements of Skyfly Airlines Ltd.

	Company	
	2011/12	2010/11
	SR.Mn	SR.Mn
Finance Cost		
Interest cost on Borrowing and Bank OD	707.33	313.84
Finance Charges on Deferred Earning Upgrade	180.23	141.66
Finance Charges on Lease Liabilities	593.35	385.21
	1480.91	840.71
Operational Expenses includes but not limited to the following:		
a. included in Cost of Sales		
Staff Costs	8,015.33	6511.33
Defined Benefit Plan Costs- Gratuity	293.26	410.23
Defined Contribution Plan Costs- EPF & ETF	709.21	610.56
Operating Lease Rentals	8,393.15	8051.26
Depreciation/Amortization	3,821.52	7992.33
Provision for Slow-moving Items	99.39	332.91
Loss on Fuel Risk Management Program	489.33	352.69
Franchise fee	233.25	139.68
b. included in Administrative Expenditures		
Staff Costs	759.34	754.33
Defined Benefit Plan Costs- Gratuity	63.83	94.64
Defined Contribution Plan Costs- EPF & ETF	103.76	92.5
Depreciation/Amortization	-	81.52
Loss on Exchange	135.10	147.78
Provision/write off of Maintenance Reserve	566.28	524.28
c. included in Sales and Marketing Costs:		
Advertising Costs	315.26	288.34
Staff costs	1,353.26	1135.39
Defined Benefit Plan Costs- Gratuity	10.77	16.18
Defined Contribution Plan Costs- EPF & ETF	79.33	71.33
Depreciation/Amortization	16.33	19.35
Marketing Fees Charge	295.39	139.83

Annexure III – Service Mix of Skyfly

The services of Skyfly can be classified into three types- Passenger services, Cargo & Logistic services and Catering service.

Passenger Services: This area deals with products and services for passengers, and has three main functions: design(marketing and network), communication (advertising) and sales via Skyfly offices in Serendib and abroad, as well as direct sales channels such as call centers and websites. The sector's work force is made up of about 4200, of whom 3000 are based in Serendib and 1,200 abroad. Constant attention to the network system is a top priority. The system is centered on Serendib Airport, and offers a wide range of destinations in Serendib and other parts of the world.

Cargo & Logistic: Skyfly deals with cargo transportation and logistics with a reputation of offering top quality specialized services at competitive prices to a selected group of clients such as import-export firms, top fashion houses, major industries etc, who conduct business on a world wide scale. Skyfly's cargo division employs around 750 people, working their offices all over the world. Apart from ordinary transportation, they deal with specialized items such as racing cars, fashion, artwork, valuables, as well as dangerous, voluminous or heavy objects and perishables goods. In addition, the highest level of care and attention is given to transportations of human organs, life support medicines and animals. Apart from the network of airports served by the passenger fleet, there are several all-cargo destinations, chosen to meet the growing demands of intercontinental commercial traffic.

Catering Service: Catering service arm of Skyfly group is separately operated by the subsidiary of Skyfly Airlines –Skyfly Catering Limited. Skyfly Catering's main line of business is in-flight catering to airlines that operate to Serandib International Airport (SIA). Skyfly Catering also manages two Restaurants and a Lounge Bar at SIA and provides food for 9 other Restaurants and Lounges there

Annexure IV – Segmental Information for Skyfly Group – Extract from the Annual Report 2011/12

Segment Information (SR. Mn) - Group

Primary Reporting by Geographical Segment - Revenue by Origin of Sales

	2011/12						2010/11					
Revenue	**Asia**	**Europe & Africa**	**Middle East**	**North & South America**	**South West Pacific**	**Total 2011 SR. M**	**Asia**	**Europe & Africa**	**Middle East**	**North & South America**	**South West Pacific**	**Total 2010 SR. M**
Scheduled Services - Passenger	28,376.69	18,618.53	9,437.51	2,167.20	690.84	59,290.77	28,082.21	16,353.86	9,239.00	1,467.95	217.64	55,360.66
- Cargo	7,737.93	996.62	514.44	40.06	10.95	9,300.00	8,049.68	630.00	346.36	73.86	6.70	9,106.60
- Excesss Baggage	360.10	25.32	224.93	2.43	0.42	613.20	392.32	28.25	211.63	1.59	0.18	633.97
	36,474.72	**19,640.47**	**10,176.88**	**2,209.69**	**702.21**	**69,203.97**	**36,524.21**	**17,012.11**	**9,796.99**	**1,543.40**	**224.52**	**65,101.23**
Air Terminal and Other services	5,093.34	-	-	-	-	5,093.34	5,110.18	-	-	-	-	5,110.18
Duty Free	162.70	213.31	172.30	-	87.49	635.80	182.59	239.38	193.36	-	98.18	713.51
No-Scheduled Services	200.52	-	-	-	-	200.52	188.99	-	-	-	-	188.99
Flight Catering	2,639.23	-	-	-	-	2,639.23	2,432.51	-	-	-	-	2,432.51
	44,570.51	19,853.78	10,349.18	2,209.69	789.70	77,772.86	44,438.48	17,251.49	9,990.35	1,543.40	322.70	73,546.42

Secondary Reporting by Business Segment	2011/12			2010/11		
	Business Segment			Business Segment		
Revenue	Airline	Flight Catering	Group Total	Airline	Flight Catering	Group Total
sales to external customers	75,133.63	2,639.23		71,113.37	2,432.51	
Inter-Segment Sales	31.71	1,987.75		91.43	1,627.40	
	75,165.34	4,626.98	77,772.86	71,204.80	4,059.91	73,545.88
Results						
Profit/(Loss) After Tax	(8,951.44)	1,679.29	(7,272.15)	(16,701.64)	1,435.74	(15,265.90)

Annexure V – Financial Information –Flyingair Pvt.Ltd Table 1

Flyingair (Pvt) Ltd.

Balance Sheet as at: 31st March

All amounts in Serendib Currency "SR"

	2011/2012	2010/2011
Assets		
Non-Current Assets		
Property Plant & equipment	39,871,103.20	58,929,366.89
Intangible assets	3,030,322.43	3,624,851.41
	42,901,425.63	62,554,218.30
Current Assets		
Inventories	8,090,160.13	10,736,907.05
Trade amd other receivables	477,611,294.45	157,503,328.41
Cash and cash equivalent	87,555,678.46	269,398,766.70
	573,257,133.04	437,639,002.16
Total Assets	616,158,558.67	500,193,220.46
Equity		
Capital and Reserves		
Stated capital	283,500,453.60	283,500,453.60
Accumulated losses	(7,928,545,594.71)	(5,280,690,281.58)
Total Equity	(7,645,045,141.11)	(4,997,189,827.98)
Liabilities		
Non Current Liabilities		
Advance against share capital	4,013,562,128.94	3,123,165,052.60
Retirement benefit obligation	2,131,543.51	5,188,617.00
	4,015,693,672.45	3,128,353,669.60
Current Liabilites		
Trade and other payables	3,666,449,747.95	1,687,129,380.34
Borrowings	579,060,279.38	681,899,998.50
	4,245,510,027.32	2,369,029,378.84
Total Liabilities	8,261,203,699.78	5,497,383,048.44
Total Equity and Liabilities	616,158,558.67	500,193,220.46

Annexure V – Financial Information –Flyingair (Pvt) Ltd. **Table 2**

Flyingair (Pvt) Ltd.		
Income Statement for the Year Ended 31st March		
All amounts in Serendib Currency "SR"		
	2011/12	**2010/11**
Revenue	2,991,466,836	656,812,691
Cost of Sales	(4,800,807,745)	(2,085,131,976)
Gross Profit /(Loss)	(1,809,340,909)	(1,428,319,285)
Sales and Marketing Costs	(392,462,783)	(178,382,676)
Administrative Expenses	(197,041,764)	(200,565,349)
Other Income	17,044,498	89,234
Operating Profit /(Loss)	(2,381,800,957)	(1,807,178,076)
Finance Cost	(266,054,356)	(766,172,114)
Profit/(Loss) Before Income Tax	(2,647,855,313)	(2,573,350,190)

Annexure VI

Number of Tourist Arrivals to Serendib by Carrier							
		December			Jan-Dec		
	CARRIER	**2010**	**2011**	%cha.	2010	**2011**	%cha.
(A)	SCHEDULED CARRIER						
	TOTAL (a) + (b)	83,275	93,822	12.7	645,435	838,941	30
(a)	**Inter - Regional Total**	**73,311**	**82,864**	**13**	**551,904**	**738,067**	**33.7**
	Skyfly Airlines (International)	25,485	23,890	-6.3	216,456	203,558	-6.0
	S.I.A.	3,234	4,079	26.1	22,962	31,793	38.5
	Saudia	1,432	1,982	38.4	10,817	18,701	72.9
	Thai Airways	987	1,032	4.6	6,032	8,576	42.2
	Kuwait Airways	2,675	591	-77.9	14,525	8,516	-41.4
	Emirates	12,987	18,903	45.6	90,396	166,136	83.8
	Royal Jordanian	897	1,503	67.6	7,895	11,894	50.7
	Cathay Pacific	3,324	2,526	-24	21,591	20,378	-5.6
	Condor	453	1,115	146.1	6,677	4,506	-32.5
	Kingfisher	4,900	1,114	-77.3	25,826	15,994	-38.1
	Qatar Airways	5,534	6,774	22.4	45,230	68,092	
	Malaysian Airline	1,987	493	-75.2	8,917	7,344	-17.6
	Asianfly (AK)	1,786	3,298	84.7	18,351	27,389	49.3
	Air Arabia	1,987	2,230	12.2	9,770	19,892	103.6
	Ethihad	1,098	1,557	41.8	11,582	13,558	17.1
	Euro-Fly	761	-	-	2,378	404	-83
	Jet Air	2,341	3,251	38.9	18,611	44,843	140.9
	Flyingair	675	2,080	208.1	8,218	20,380	148
	Island Aviation(Q2)	768	-	-	5,670	-	-
	Gulf Air	-	1,366	-	-	13,091	-
	Spice jet	-	2,661	-	-	20,780	-
	China Eastern	-	267	-	-	1,801	-
	Fly Dubai	-	974	-	-	4,897	-
	Ukrain International	-	-	-	-	3,606	-
	Aerosvit	-	352	-	-	810	-
	Aeroflot	-	660	-	-	1,128	-
	P.I.A	-	166	-	-	166	-
(b)	**Intra - Regional**	**9,964**	**10,958**	**10**	**93,531**	**100,874**	**7.9**
	Skyfly Airlines (Regional)	6,786	6,456	-4.9	63,752	65,767	3.2
	Jetlite	1,654	453	-72.6	8,877	2,691	-69.7
	Indian Airline	501	2765	451.9	6,000	12,319	105.3
	Air India Express	1,023	1,284	25.5	14,902	20,097	8
(B)	**CHARTER CARRIER**	**1,021**	**3,215**	214.9	**7,765**	**14,721**	89.6
		1,021	**3,215**	**-41**	**7,765**	**14,721**	**-181**
	Edelweiss	332	196	-41	1,302	371	-71.5
	First Choice	254	-	-	3,170	48	-98.5
	Smart Wings(QS)	435	-	-	2,761	1,076	-61
	Rossia Airline(FV)	-	-	-	532	798	50
	NVR Airline	-	1,033	-	-	8,757	-
	Meridiana Airlines	-	-	-	-	337	-
	Jetair Fly	-	-	-	-	110	-
	PB Air	-	1,207	-	-	2,645	`
	TNT Airline	-	363	-	-	579	-
	Fin Air	-	416	-	-	-	-
(C)	**SEA CARRIER**	**331**	**480**	**45**	**1,276**	**1,731**	**35.7**
	Combia Harbour	331	480	45	1,276	1,731	35.7
	Galia Harbour	-	-	-	-	-	-
	TOTAL (A + B + C)	**84,627**	**97,517**	**15.2**	**654,476**	**855,393**	**30.7**

Annexure VII

International travellers

	Inbound tourism - Arrivals						
	Thousands						
	1995	2000	2005	2008	2009	2010	2011
East and North-East Asia	**41,313**	**58,349**	**85,939**	**100,939**	**98,045**	**111,571**	
China	20,034	31,229	46,809	53,049	50,875	55,665	
DPR Korea							
Hong Kong, China		8,814	14,773	17,320	16,926	20,085	
Japan	3,345	4,757	6,728	8,351	6,790	8,611	
Macao, China	4,202	5,197	9,014	10,610	10,402	11,926	
Mongolia	108	137	339	446	433	456	
Republic of Korea	3,753	5,322	6,023	6,891	7,818	8,798	
South-East Asia	**28,400**	**36,076**	**48,543**	**61,759**	**62,085**	**69,618**	
Brunei Darussalam			126	226	157		
Cambodia			1,333	2,001	2,046	2,399	
Indonesia	4,324	5,064	5,002	6,234	6,324	7,003	
Lao PDR	60	191	672	1,295	1,239		
Malaysia	7,469	10,222	16,431	22,052	23,646	24,577	24714
Myanmar	117	208	232	193	243	311	
Philippines	1,760	1,992	2,623	3,139	3,017	3,520	
Singapore	6,070	6,062	7,079	7,778	7,488	9,161	
Thailand	6,952	9,579	11,567	14,584	14,150	15,842	16,250
Timor-Leste				19	27		
Viet Nam	1,351	2,140	3,478	4,236	3,747	5,050	
South and South-West Asia	**4,233**	**6,085**	**8,147**	**10,256**	**9,888**	**11,070**	
Afghanistan							
Bangladesh	156	199	208	467	267		
Bhutan	5	8	14	28	23	27	
India	2,124	2,649	3,919	5,283	5,168	5,584	
Iran (Islamic Rep. of)	489	1,342	1,889	2,034			
Maldives	315	467	395	683	656	792	
Nepal	363	464	375	500	510		
Pakistan	378	557	798	823	855	914	
Serendib	403	400	549	438	448	654	855
Turkey	7,083	9,586	20,273	24,994	25,506	27,000	
North and Central Asia							
Armenia	12	45	319	558	575	684	
Azerbaijan			861	1,409	1,430	1,495	
Georgia	85	387	560	1,290	1,500	2,033	
Kazakhstan		1,471	3,143	3,447	3,118	3,393	
Kyrgyzstan	36	59	319	2,435	2,147		
Russian Federation							
Tajikistan		4					
Turkmenistan	218	3	12				
Uzbekistan	92	302	242	1,069	1,215		
Pacific	**8,083**	**9,632**	**10,982**	**11,103**	**10,917**	**11,580**	
Asia and the Pacific	**82,029**	**110,143**	**153,611**	**184,057**	**180,936**	**203,838**	
Africa	**18,859**	**26,462**	**35,368**	**44,379**	**46,021**	**49,376**	
Europe	**304,085**	**385,638**	**439,447**	**485,193**	**461,509**	**476,550**	
Middle East	**13,704**	**24,090**	**36,271**	**55,237**	**52,886**	**60,332**	
Americas	**109,011**	**128,193**	**133,322**	**147,953**	**140,722**	**149,765**	
Other countries/areas							
World	**527,689**	**674,527**	**798,019**	**916,818**	**882,074**	**939,860**	

Annexure VIII - Airline Industry Outlook – 2012

(Extract of Article published by Air Transport World)

We call it a year of contradictions. The global airline industry went on a spending spree in 2011 and sealed deals for new aircraft that broke all records. Yet it was also a year where economies faltered and oil prices soared, with their inevitable impact on airline profits. And as 2011 drew to a close, American Airlines, the only legacy US carrier never to declare bankruptcy, filed for Chapter 11. Our 2012 forecast package tracks the highs and lows the industry has weathered this past year and also illustrates the continuing contradictions that will likely be the hallmark of 2012. Manufacturers are bullish about continued demand for new, fuel-efficient aircraft and there is optimism across much of Asia and Latin America where new middle-class markets are driving demand for air travel. But the uncertainty surrounding Europe's economy and the ultimate outcome of the euro crisis is a concern not just for the European carriers but to all those carriers for which Europe remains an important market. Similarly, the sluggish US economy will likely have a global impact, albeit at a less severe level. US carriers, for the most part, are earning their profitability the hard way through strict capacity discipline. Cargo carriers, meanwhile, are showing signs of stress and are once again likely to prove to be the bellweather of things to come; tough economies typically hit the freight industry first. And even some of the traditional "hotspot" areas, such as the Middle East and China, are anticipating slower growth this year. Reflecting this uncertainty, IATA has downgraded its 2012 forecast and highlighted the widening fortunes of those carriers in growing economies and those where the economic outlook remains bleak.

"Even our best case scenario for 2012 is for a net margin of just 0.6% on revenues of $618 billion. But the industry is really moving at two speeds with highly taxed European carriers headed into the red," IATA DG and CEO Tony Tyler said at the organization's forecast briefing in Geneva in December.

The regional differences expected in 2012 are stark, according to IATA forecasters:

- European carriers are expected to fall into losses of $600 million, hit by the weakness of their home market economies and further increases in passenger taxes.

- North American carriers are expected to generate profits of $1.7 billion, maintaining the strongest EBIT margin of 2.4%, as limited capacity growth is providing some protection against the downward pressure on profits.
- Asia-Pacific carriers are expected to deliver the largest absolute profit at $2.1 billion. This is weaker than 2011's performance but the deterioration is limited by high load factors on markets such as China, where the increases in demand are structural and to some extent shielded from the cycle.
- Middle East carriers are expected to post a $300 million profit, less than half the previously forecast $700 million profit, as long-haul market conditions deteriorate, in particular those linked to the weak European economies.
- Latin American carriers will see profits decline to $100 million—a $400 million negative swing from the previous forecast, partly a carry-over from the recent weakness of profitability in the large Brazil market.
- African carriers will fall into losses of $100 million, unchanged from the previous forecast. Economies and air transport markets continue to grow in the region, but load factors are not expected to be strong enough to offset the impact of weaker yields on profitability.

Reflecting this uncertainty, IATA announced revisions to its industry outlook in December. For 2011, profitability remains weak but unchanged at $6.9 billion for a net margin of 1.2%. Looking ahead to 2012, however, IATA downgraded its central forecast for airline profits from $4.9 billion to $3.5 billion for a net margin of 0.6%.At the top of IATA's uncertainty factor is the eurozone crisis, which it says puts severe downside risk on the 2012 outlook. In a worst case scenario—a full-blown banking crises and European recession, IATA estimates that the global aviation industry could suffer losses exceeding $8 billion in 2012.

-The End-