

Questions & Answers

Profit Participation Plan (PPP)

What is EBIT, or the EBIT margin?

EBIT is a defined financial indicator describing Earnings Before Interest and Taxes (also known as operating income). EBIT is an important measure of a firm's profitability. A company's capital structure does not enter into the evaluation of EBIT, so profitability can be compared irrespective of equity.

The EBIT margin is the measure of EBIT in relation to total sales, and is expressed in %. SWISS aims to achieve an average EBIT margin of 5 to 8 % over the full business cycle. On 30 June 2007, the SWISS EBIT margin stood at 12.4 %.

Can management manipulate the EBIT margin?

We have long calculated EBIT according to the requirements of the IFRS (International Financial Reporting Standards), which are applied equally throughout the Lufthansa Group. This figure, and others, are verified by an external auditor during preparation of the year-end financial statements.

The EBIT margin, which is key to the profit-sharing model, is determined as described above in accordance with International Accounting Standards. Exactly the same EBIT margin is used to calculate the variable salary element payable to management staff (performance based compensation). The EBIT margin applies to everyone across the board: there is only one EBIT figure, resp. one EBIT margin, for in-house SWISS purposes.

Any worries about deliberate underreporting of EBIT are unnecessary. Any manipulation of this kind would be detrimental for the company as a whole, and therefore not in our best interest.

Won't EBIT be massively reduced with the purchase of new aircraft such as the nine A330-300s in the next few years? What is the impact of liquidity?

An investment such as ours in the new A330-300 aircraft is nothing more than an outflow of cash equivalents, i.e. the balance sheet cash position is reduced by the purchase value. This outflow of liquidity has no impact on EBIT.

The A330-300s will influence EBIT as a result of the following important factors: increased revenues (more seats, better product = better yield), improved unit costs per seat, and depreciation. On the EBIT side, the attributable depreciation on the investment in the A330-300s will be posted to Profit and Loss. This will be offset by the discontinuation of current leasing costs for the A330-200, which will in turn impact beneficially on Profit and Loss.

SWISS would not invest over a billion francs in purchasing new A330-300s if the investment were not expected to pay off. Subject to a calculated risk, the new aircraft should have a positive impact on our company's profitability and financial stability, i.e. should be reflected positively in our EBIT. Over the next few years, SWISS will need to deliver EBIT margins in excess of 8% to achieve the required sustainability (average EBIT values of 5-8 %).

Can the EBIT margin be artificially reduced by resorting to unnecessarily high depreciation, e.g. on the new aircraft?

Under IFRS, there are clear rules for evaluation purposes, and the calculation is certified "true and fair" by our auditors. This also explains why depreciation cannot be adjusted annually. The depreciation period for capital goods is published in the Lufthansa Annual Report: it is twelve years for aircraft, with a residual value of 15 %. Any change in this practice would have to be approved by the Lufthansa Group Supervisory Board, and disclosed in the Annual Report. All analysts use IFRS-based year-end statements, because these reflect actual operating performance, not a set of results deemed desirable in any given situation.

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Can year-end financial results be presented in varying lights depending on what suits the company?

SWISS prepares two sets of year-end results: one in line with IFRS ("International Financial and Reporting Standards") and one according to the Swiss Code of Obligations. SWISS is required to draw up both sets; the first set serves as the basis for the EBIT calculation, and the figures are incorporated in the consolidated year-end Lufthansa results.

The results drawn up in line with Swiss commercial law (Code of Obligations) are prepared for statutory reasons and provide the basis for taxation. With regard to evaluation purposes, both the Code of Obligations and Swiss tax law allow considerably more room for manoeuvre than IFRS. These results are not published, and are drawn up purely for the tax office.

Only 80% of the profit participation is paid out quarterly: why is this?

When the PPP negotiations were underway, SWISS felt it was important not to have a single payment, but to spread the benefit over the year, on a quarterly basis. This does carry a risk, however. If, in the middle of the business year, SWISS suffers large fluctuations in the EBIT margin, or huge shortfalls in income and profit (e.g. as a result of a pandemic, terrorist attacks), the part-payments already effected are not supposed to amount to more than the total sum defined in individual contracts. Hence the part-payment includes a 20% "security buffer" and other mechanisms to lessen that risk. The final payment in April goes hand in hand with a final reckoning-up for the previous year: at this point all the calculations for the previous financial year can be concluded, and the profit participation sum is paid out in full. These safety measures paved the way to an agreement with the unions that SWISS would not reclaim any sums already paid.

How Profit Participation is calculated: some examples

The examples below illustrate how profit participation is calculated, and the way in which the minimum and maximum payments function. The following examples are based on the Collective Labour Agreement table (CLA) and the PPP rules.

Example 1

→ Actual annual basic salary: **CHF 42,000**

- a) At an **EBIT margin of 5 %**, and according to the table, the employee would receive 3 % of the actual annual basic salary, i.e. CHF 1,260.
In this case, however, the minimum payment rule ensures that the amount actually paid out is **CHF 2,000**, i.e. almost double, and equal to **4.8 %** of the actual annual basic salary.
- b) At an **EBIT margin of 8.5%**, and according to the table, the employee would receive 6.5% of the actual annual basic salary, i.e. CHF 2,730.
In this case, however, the minimum payment rule ensures that the amount actually paid out is **CHF 4,450**, which is equivalent to **10.6%** of the actual annual basic salary.
- c) At an **EBIT margin of 12 %**, and according to the table, the employee would receive 10 % of the actual annual basic salary, i.e. CHF 4'200.
The minimum payment rule would ensure that the amount actually paid out is **CHF 7,000**, which is equivalent to **16.7 %** of the actual annual basic salary.

Example 2

→ Actual annual basic salary: **CHF 84,000**

- a) At an **EBIT margin of 5 %**, and according to the table, the employee would receive 3 % of the actual annual basic salary, i.e. CHF 2,520. According to the table, that is above the minimum payment and below the maximum, i.e. the employee actually does receive **CHF 2,520 (3%)**.

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- b) At an **EBIT margin of 8.5%**, and according to the table, the employee would receive 6.5% of the actual annual basic salary, i.e. CHF 5,460. According to the table, that is above the minimum payment and below the maximum, so the employee actually does receive **CHF 5,460 (6.5%)**.
- c) At an **EBIT margin of 12 %**, and according to the table, the employee would receive 10 % of the actual annual basic salary, i.e. CHF 8,400. According to the table, that is above the minimum payment and below the maximum, so the employee actually does receive **CHF 8,400 (10%)**.

Example 3

→ Actual annual basic salary: **CHF 180,000**

- a) At an **EBIT margin of 5 %**, and according to the table, the employee would receive 3 % of the actual annual basic salary, i.e. CHF 5,400. That is above the maximum payment according to the table, so the amount actually paid out would be **CHF 4,500 (2.5%)**.
- b) At an **EBIT margin of 8.5%**, and according to the table, the employee would receive 6.5% of the actual annual basic salary, i.e. CHF 11,700. That is above the maximum payment according to the table, so the amount actually paid out would be **CHF 9,750 (5.4%)**.
- c) At an **EBIT margin of 12 %**, and according to the table, the employee would receive 10 % of the actual annual basic salary, i.e. CHF 18,000. That is above the maximum payment according to the table, so the amount actually paid out would be **CHF 15,000 (8.3%)**.