Operating Risks

The following risks could have a significant effect on the judgment of investors in the ANA Group. Further, the forward-looking statements in the following section are the ANA Group’s judgments as of March 31, 2011.

(1) Risk of Economic Recession

An economic recession in Japan that causes personal consumption to decrease and corporate earnings to deteriorate could reduce demand for air transportation. A recession overseas could reduce passenger and logistics demand. Economic recession could therefore affect the ANA Group’s performance.

(2) Risk from the Impact of the Great East Japan Earthquake

The impact of the Great East Japan Earthquake is expected to depress Japan’s economy. Business demand decreased after the earthquake due to issues including corporate restrictions on business trips, while leisure demand decreased as a result of factors including cancellation of travel due to uncertainties about the future and voluntary restraint. Circumstances such as these could potentially become long-term issues.

In addition, the impact of the accident at the Fukushima Daiichi Nuclear Power Station, including rumors about the accident, has caused fears about radioactive contamination that have resulted in restrictions on business trips and travel cancellations. The impact on demand for inbound travel to Japan has been particularly pronounced. Circumstances such as these could potentially become long-term issues. As a result of the impact of the accident, the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) implemented a no-fly zone with a radius of 30km from the Fukushima Daiichi Nuclear Power Station from March 15, 2011. On May 31, 2011 the radius of the no-fly zone was changed to 20km. Expansion of this no-fly zone in the future could stop service on existing routes and affect operations on routes to northeast Japan and Hokkaido.

Electricity supply constraints and the occurrence of large-scale power outages could render the ANA Group unable to maintain the operation of required systems such as reservation and operational control systems, which could affect the provision of services and operational continuity.

These effects of the Great East Japan Earthquake could affect the ANA Group’s performance.

(3) Risks Related to ANA’s Management Strategy

1. Risks Related to ANA’s Fleet Strategy

In air transportation operations, the ANA Group is pursuing a Fleet Strategy centered on using medium-body and small-size aircraft, integrating aircraft models, and introducing highly economical aircraft. This strategy involves ordering from The Boeing Company, Bombardier Inc. and Mitsubishi Aircraft Corporation. Delays in delivery from any of the three companies for financial or other reasons could create obstacles to the ANA Group’s medium-to-long-term operations.

In addition, measures related to the Fleet Strategy could prove ineffective or their expected benefits could diminish significantly due to the factors given below.

Dependence on The Boeing Company

In accordance with its Fleet Strategy, the Company had ordered 97 aircraft as of March 31, 2011, 76 of which have been ordered from The Boeing Company (Boeing). Therefore, should Boeing be unable to fulfill its agreements with ANA due to financial or other issues, the Group would be unable to acquire aircraft in accordance with its Fleet Strategy. Such eventualities could significantly affect the ANA Group’s performance.

Boeing announced a new Boeing 787 production schedule on January 18, 2011, and changed its scheduled date of delivery to the Company from between January and March 2011 to between July and September 2011. Further material delays in delivery could create obstacles to the ANA Group’s medium-to-long-term operations.

Delay of Aircraft Development Plan

In accordance with its Fleet Strategy, the Company has decided to introduce the Mitsubishi Regional Jet (MRJ) that Mitsubishi Aircraft Corporation is developing. Any delays in development that result in a significant postponement of delivery, which is currently planned to start from the year ending March 2014, could create obstacles to the ANA Group’s medium-to-long-term operations.

2. Risks Related to Flight Slots

The ANA Group has made various investments and operational changes to take advantage of significant business opportunities created by the expansion of capacity at the two Tokyo-area airports, including an increase in arrival and departure slots at Haneda Airport in 2010. The additional slots at Haneda Airport that became available in 2010 have already been allocated, but the specific allocation of the second stage of slot increases covering 407 thousand slots annually has not been announced in detail and remains undecided. Given these circumstances, variance between the actual scale and timing of expansion of the two Tokyo-area airports (Haneda and Narita) and the ANA Group’s projections could affect the ANA Group’s strategy of generating significant growth by taking advantage of Tokyo-area airport capacity expansion, and could also affect achievement of the targets of the ANA Group management strategy.

3. Risks Related to Cargo Business Strategy

The cargo business, including the express business, is highly dependent
on shipments of cargo to and from China and other parts of Asia. Economic conditions in Asia may cause the volume of cargo the ANA Group handles and shipping prices to decrease.

(4) Risks Related to Crude Oil Price Fluctuations

Jet fuel is a crude oil derivative and its price tracks the price of crude oil. Jet fuel price fluctuations can affect the ANA Group’s performance as follows.

1. Risk of Increase in Crude Oil Prices

Generally, an increase in the price of crude oil causes an increase in the price of jet fuel, which imposes substantial additional costs on the ANA Group. Accordingly, to control the risk of fluctuations in the price of jet fuel and to stabilize jet fuel expenses, ANA hedges risks using crude oil and jet fuel commodity derivatives in planned, continuous hedging transactions for specific periods of time. The Company's hedging transactions are limited to a certain percentage of scheduled purchases of fuel in Japan and overseas, with plans for hedging volume set quarterly. Individual transactions are maintained within limits that are set in such a way that the Company’s transactions will not affect the spot market, and margins are settled monthly without any physical delivery.

The ANA Group had a hedge ratio of approximately 60% of fuel volume for the fiscal year ended March 2011. Because the prices of hedging instruments generally rise in tandem with the markets, in the event that crude oil prices once again rise further in the future, there are limitations to the ANA Group’s ability to offset increases in crude oil prices through the cost reductions it is implementing and higher fares and charges, which could affect the ANA Group’s performance over the medium-to-long term.

2. Risk of Sudden Decrease in Crude Oil Prices

The ANA Group hedges against changes in the price of crude oil. Therefore, a sudden decrease in oil prices during a given fiscal year may not directly contribute to earnings because hedge position and other market conditions may preclude the immediate reflection of a sudden drop in crude oil prices in results.

(5) Risks Related to Pandemic Illnesses Including New Strains of Influenza

All of the ANA Group’s businesses including but not limited to its international routes are exposed to the risk of decreased demand due to the outbreak and spread of major illnesses including new strains of influenza. The spread of disease and the harm it may cause, including reduced desire to travel by air among customers due to rumors, could affect the ANA Group’s performance by causing the number of passengers on the ANA Group’s domestic and international routes to drop sharply.

Furthermore, more employees and contractors than expected could fall ill due to the spread or increased virulence of highly contagious new strains of influenza and other diseases, which could affect the continuity of the ANA Group’s operations.

(6) Risks Related to Foreign Exchange Rate Fluctuations

Jet fuel purchases account for a significant share of the ANA Group’s expenses and are conducted in foreign currencies. Therefore, depreciation of the yen significantly affects the ANA Group’s profits. In addition, appreciation of the yen has an increasingly large effect on ANA Group revenues because of growth in revenue from international routes. Accordingly, to the greatest extent possible, foreign currency taken in as revenue is used to pay expenses denominated in the same foreign currency, thereby minimizing the risk of foreign exchange rate fluctuations. In addition, the Group uses forward exchange agreements and currency options for its jet fuel purchases to limit the risk of fluctuations in foreign exchange rates and to stabilize and control payment amounts.

(7) Risks Related to the International Situation

The ANA Group currently operates international routes, primarily to North America, Europe, China and elsewhere in Asia. The occurrence of any future political instability, international conflicts, large-scale terrorist attacks, or other incidents could affect the ANA Group’s performance due to the accompanying decrease in demand for travel on these international routes.

(8) Risks Related to Statutory Regulations

As an airline operator, the ANA Group undertakes operations based on the stipulations of statutory regulations relating to airline operations. The Group is required to conduct passenger operations and cargo operations on international routes in accordance with the stipulations of international agreements, including treaties, bilateral agreements, and the decisions of the International Air Transport Association (IATA). Further, the Group’s operations are constrained by Japanese Antitrust Law and similar laws and regulations in other countries with regard to the pricing of fares and charges.

(9) Risks Related to Litigation

The ANA Group’s businesses are subject to various lawsuits that could affect the ANA Group’s performance. Moreover, the following may result in lawsuits or other legal action in the future, which could result in similar investigations in other countries and regions.

1. U.S. Antitrust Laws

Since February 2006, ANA had been cooperating fully with a U.S. Department of Justice (USDOJ) investigation of charges including price fixing
for international air cargo and passenger services. Upon due consideration of the circumstances surrounding the investigation, ANA agreed to pay a fine of $73 million (approximately ¥5.3 billion) in October 2010 under a plea bargaining arrangement, and concluded the agreement in November 2010. Also in October 2010, ANA agreed to pay a fine of $10.4 million (approximately ¥800 million) to settle a class action suit in connection with cargo services related to the USDOL investigation. Consequently, for the fiscal year ended March 2011 ANA recognized settlement expenses totaling ¥6.8 billion as a non-operating expense.

No specific damages have been sought in a class action suit in connection with air passenger services, making detailed analysis of the situation difficult.

2. Notice from the Korea Fair Trade Commission

The Korea Fair Trade Commission issued an Examiner’s Report in October 2009 pointing out that ANA’s air cargo operations might be violating Korean fair trade laws. In May 2010, the Commission announced its decision on measures subsequent to public hearings. In November 2010, ANA received a resolution notice ordering payment of a surcharge of 1,633 million won (approximately ¥100 million), but in December 2010 submitted an appeal to the Higher Court of Seoul for revocation of the surcharge.

In the fiscal year ended March 2010, the Company made provision of ¥600 million at an estimated amount of contingent losses that could arise from these antitrust proceedings. In the fiscal year ended March 2011, the Company recognized non-operating income of ¥500 million from reversal of this provision for loss on antitrust proceedings.

(10) Risks Related to Public-Sector Fees

Public-sector fees include landing and navigation fees. In the fiscal year ended March 2011, public-sector fees for the ANA Group totaled ¥93.8 billion. While the government is currently implementing measures to reduce landing fees, such measures could be later scaled back or terminated.

(11) Risks Related to Environmental Regulations

In recent years, numerous Japanese and overseas statutory environmental protection regulations have been introduced or strengthened with regard to such issues as aircraft emissions of CO2 and other greenhouse gases, use of environmentally polluting substances and their disposal, and energy use at major offices. The ANA Group shoulders a considerable cost burden in order to adhere to such statutory regulations. However, the Group may have to shoulder a large additional cost burden if current regulations are strengthened or if new regulations, such as changes to the European Union Emission Trading System or environmental taxes, are introduced by the governments of EU countries.

(12) Risks Related to the Operating Environment of the Airline Industry

The operating environment of the airline industry is changing dramatically. The progress of Open Skies agreements, the rise of discount airlines, and mergers and acquisitions among existing airline companies are among the developments taking place as significant changes occur in the competitive environment. In Japan, airline administrative policies are changing and the government is providing support for the operations of competitor Japan Airlines Co., Ltd. Material changes in the competitive and operating environment could affect the ANA Group’s performance.

(13) Risks Related to Competition

The possibility of future increases in costs related to the ANA Group’s air transportation operations due to such factors as jet fuel expenses, the cost of raising funds, and responses to environmental regulations cannot be denied. If such costs increase, in order to secure income, it is necessary for the Group to reduce indirect fixed costs, reduce costs by enhancing efficiency through the standardization of aircraft types, and pass on costs through higher fares and charges. However, because the Group is in competition with other airlines in Japan and overseas as well as with alternative forms of transportation, such as the Shinkansen, on certain routes, passing on costs could diminish competitiveness and lead to the loss of customers to competitors. Further, because price competition with competitors greatly restricts the passing on of costs, an increase in costs could affect the ANA Group’s performance.

(14) Risks Related to Ineffective Strategic Alliances

Mainly through its membership in the Star Alliance, the Company enjoys a variety of benefits, including not only customer mix and market diversification as a result of heightened name recognition outside Japan, but also the sale of tickets by alliance partners (code-sharing) and the usage of its flights by members of other companies’ mileage plans. In addition, on April 1, 2011 ANA, United Airlines and Continental Airlines initiated a joint venture covering trans-Pacific routes based on antitrust immunity (ATI). On June 1, 2011, ANA received ATI approval from MLIT enabling a joint venture with Deutsche Lufthansa AG covering routes between Japan and Europe. However, the benefits of Star Alliance membership would diminish if a strategic partner withdrew from the Star Alliance, an alliance between two of the member companies ended, operating conditions deteriorated or the Star Alliance was restructured, or restrictions on activities were tightened due to external factors. Such eventualities could affect the ANA Group’s performance.
(15) Risks Related to Flight Operations

1. Aircraft Accidents

An aircraft accident involving a flight operated by the ANA Group or a code-share partner could cause a drop in customer confidence, creating a medium-to-long-term downturn in demand that could affect the Group’s performance. A major accident suffered by a competitor could similarly lead to a reduction in aviation demand that could affect the Group’s performance. Although an aircraft accident would give rise to significant expenses including compensation for damages and the repair or replacement of aircraft, such direct expenses would be largely met by aviation insurance.

2. Technical Circular Directives

If an issue arises that significantly compromises the safety of an aircraft, the MLIT by law issues a technical circular directive. In some cases, operations of the same type of aircraft are not permitted until the aircraft’s safety has been confirmed. Further, even when the law does not require the issuance of a technical circular directive, in some cases, when safety cannot be confirmed, the operation of the same type of aircraft is voluntarily suspended in accordance with in-house regulations. The occurrence of such a situation could affect the ANA Group’s performance.

(16) Risks Related to Unauthorized Disclosure of Customer Information

The ANA Group holds a large amount of information relating to customers, such as that pertaining to the approximately 22.00 million members (as of March 31, 2011) of the ANA Mileage Club. The Personal Information Protection Law requires proper management of such personal information. The Group has established a privacy policy, apprised customers of ANA’s stance regarding the handling of personal information, and established full measures to ensure information security, including in its IT systems. In addition, work procedures and information systems are continuously monitored and revised when needed to eliminate any potential security gaps. Despite these precautions, the occurrence of a major leak of personal information caused by unauthorized access, an error in conducting business or some other factor could carry significant cost, in terms of both compensation and loss of public confidence, which could affect the Group’s performance.

(17) Risks Related to Disasters

The ANA Group’s data center is located in the Tokyo area, while the operational control for all of the ANA Group’s domestic and international flights is conducted at Haneda Airport. Further, more than 60% of the ANA Group’s passengers on domestic routes use Haneda Airport. As a result, a major disaster, such as an earthquake, in the Tokyo area or a disaster, such as a fire, at the above-mentioned facilities could lead to a long-term shutdown of the ANA Group’s information systems or operational control functions that could significantly affect the ANA Group’s performance.

In addition, the extended closure of airports outside of Tokyo, either in Japan or overseas, due to an earthquake, a tsunami, a typhoon, heavy snow or volcanic eruption could lead to the suspension of flight arrivals and departures at that airport during the period of closure and could affect flights by constraining flight paths using that airport, which could affect the ANA Group’s performance.

(18) Risks Related to Cost Structure

Fixed costs such as aircraft expenses and personnel expenses account for a significant proportion of the ANA Group’s costs, which limits the Group’s ability to immediately change the scale of its operations in response to changes in economic conditions. Therefore, decreases in the number of passengers or volume of cargo could affect the ANA Group’s income.

(19) Risks Related to IT Systems

Customer service and air transportation operations are highly dependent on information systems for such critical functions as reservations and sales, boarding procedures, operational control, and operational management. A major disruption of one of those systems or of telecommunications networks would make it difficult to maintain customer service and operations and would result in a loss of public confidence, which could affect the ANA Group’s performance. Further, the ANA Group’s information systems are also used by its strategic partners, so the impact of systems failure would not be limited to the ANA Group.

A large-scale power outage or mandated electricity conservation could cause concerns about insufficient supply of electricity to operate key ANA systems including reservations and operational management, and could affect ANA’s ability to maintain system operations.

(20) Financial Risks

1. Increase in the Cost of Raising Funds

The ANA Group raises funds to acquire aircraft primarily through bank loans, bond issuances and leasing. However, the cost of raising funds could increase due to turmoil in capital and financial markets, changes in the tax system, changes to systems at governmental financial agencies, or a downgrade of ANA’s credit rating that makes it difficult or impossible to raise funds on terms advantageous to the Company. Such eventualities could affect the ANA Group’s performance.

2. Risks Related to Asset Impairment

If the profitability of various operations deteriorates, or a decision is made to sell an asset, the ANA Group may be required to recognize asset impairment losses in the future.