SCANDINAVIAN AIRLINES SYSTEM
ANNUAL REPORT 1986-87

CONTENTS

THE SAS GROUP

The SAS Group's commercial organization comprises the following business areas: SAS Airline, SAS International Hotels, SAS Service Partner, SAS Leisure, SAS Trading and SAS Finance. In addition, there are a number of independent subsidiaries and affiliated companies.

Together, the Group's operations form an international, integrated chain of travel services, designed to be the best alternative for the business traveler.

Group Management has overall responsibility for the strategic and commercial development of the SAS Group and its business areas.

SAS's organization is based on management by objectives and decentralized profit responsibility. Each business area is responsible for ensuring its own growth in both the short and long term. Moreover, each business area has a defined role in the travel service chain.

SAS Airline, as part of the SAS Consortium[1], handles the Group's scheduled air services.

SAS International Hotels is responsible for the Group's hotel operations and cooperates with outside interests through SAS Associated Hotels. SAS Airline and SAS International Hotels work together through SAS Destination Service, reciprocal airline and hotel check-in services, and so on.

SAS Service Partner handles the Group's flight kitchen operations and airport restaurants, and supports SAS Airline in the air and on the ground.

SAS Trading[3] conducts and develops businesses related to the Group's air services.

SAS Leisure consists of Vingresor and Scanair[2].

SAS Finance[3] arranges funding and short-term investments on behalf of the Group's business areas.

GROUP MANAGEMENT

SAS AIRLINE	**SAS INTERNATIONAL HOTELS**	**SAS SERVICE PARTNER**	**SAS LEISURE Vingresor, Scanair[2]**	**SAS TRADING[3]**	**SAS FINANCE[3]**

OTHER SUBSIDIARIES **AFFILIATED COMPANIES**

[1] The SAS Consortium includes the Group Management, SAS Airline, SAS Finance, SAS Trading and joint Group projects.
[2] Independent consortium.
[3] From January 1, 1988.

1986/87 IN BRIEF

Effective January 1, 1988, SAS will apply the calendar year as its fiscal year. This annual report covers a fifteen-month period beginning October 1, 1986 and ending December 31, 1987. The SAS Group submitted an interim report for the twelve-month period ended September 30, 1987, which corresponds to previous fiscal years. Unless otherwise specified, comparisons with previous years are made against the interim results. Twelve-month figures are unaudited.

Development of an integrated chain of travel services for the business traveler continued during the year. The traffic network was expanded with new nonstop routes, as well as with more frequent flights. Investments in expanded cooperation between the airline and hotel operations continued. In Copenhagen, SAS has worked together with the Danish Aviation Authorities to create one of the most attractive airports in Europe.

The SAS Group's income before extraordinary items amounted to 1,698 MSEK for the period October 1, 1986 – December 31, 1987. Of this total, 1,663 MSEK (1,515) was attributable to the 12-month period ended September 30, 1987.

SAS Airline noted continued growth in Scandinavia and the rest of Europe. Intercontinental traffic was marked by greater competition and downward pressure on fares. As a step in the buildup of a more competitive intercontinental route network, the decision was made to invest in a fleet of Boeing 767s, which are well suited for the market and the future traffic program.

Earnings weakened toward the end of 1987 following a slight improvement during the first three quarters. A program designed to reduce the cost level at SAS Airline, while maintaining service and quality, has been adopted.

SAS signed an agreement with Thai International in 1987 involving strategic cooperation in Europe and Southeast Asia.

In cooperation with Air France, Iberia and Lufthansa, SAS began development of the Amadeus information and distribution system.

SAS International Hotels is making substantial investments in new hotels at important SAS destinations. Income of the hotel operations was affected by greater capital cost for hotel projects and the fierce competition brought on by newly established hotels.

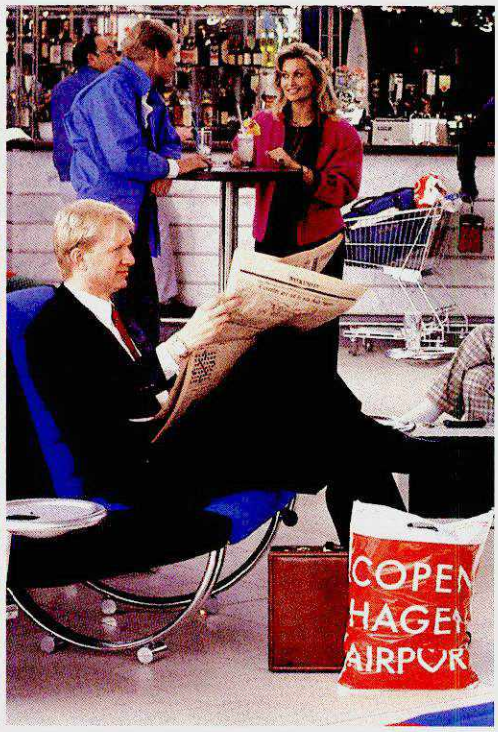
SAS Service Partner reported further improvements in income. The greatest success was noted for the airport restaurant and offshore operations.

Vingresor strengthened its position as Scandinavia's largest inclusive-tour operator. The number of Vingresor customers rose by 20 percent on an annual basis. New facilities boosted the hotel capacity on Gran Canaria, Rhodes and Crete.

Development costs for the information and distribution system are included among **Other Units and Projects.**

SUMMARY OF RESULTS – SAS GROUP

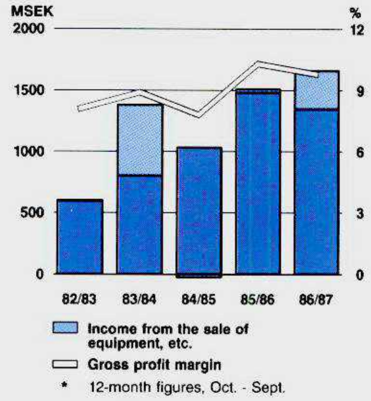
MSEK	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
Revenue	**29 924**	23 870	21 585
Operating income before depreciation	**2 517**	2 346	2 216
Depreciation	**–1 380**	–1 126	–863
Income from the sale of equipment, etc.	**394**	313	34
Financial items, net	**167**	130	128
Income before extraordinary items	**1 698**	1 663	1 515
Investments	**3 493**	2 660	4 128
Share of risk-bearing capital	**35%**	36%	29%



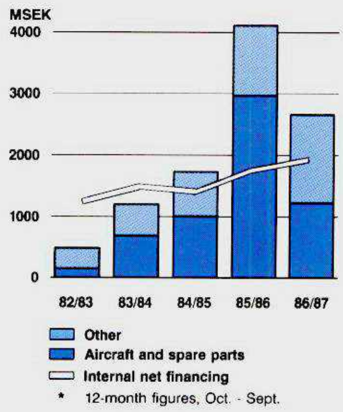
INCOME BY BUSINESS AREA

MSEK	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
SAS Airline	**1586**	1453	1305
SAS International Hotels	**63**	73	69
SAS Service Partner	**202**	180	123
Vingresor	**106**	141	133
Other units and projects	**−128**	−99	−28
Joint Group cost	**−88**	−44	−69
Group eliminations	**−43**	−41	−18
Income before extraordinary items	**1698**	1663	1515

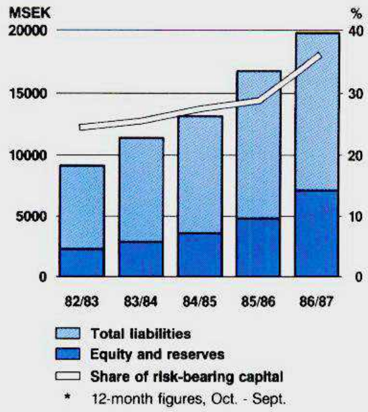
SAS GROUP
TREND OF INCOME
(INCOME BEFORE EXTRAORDINARY ITEMS)*



SAS GROUP
INVESTMENTS*



SAS GROUP
FINANCIAL POSITION*



"FLEXIBILITY AND ADAPTATION – A MUST FOR TOMORROW"

In the early 1980s SAS formulated The Businessman's Airline strategy. Accordingly, we developed new products that were immediately welcomed by the market. We recovered lost market shares, gained new shares, and achieved good profitability. SAS has become a trendsetter in improving quality and service for the business traveler at unchanged economy-class fares.

At the same time, we saw the dramatic changes approaching in our business environment. The web of regulations that had protected commercial aviation since World War II began to untangle. The deregulation of the American airline industry quickly left its mark on intercontinental air traffic.

Three years ago, we began to concentrate on three strategic development areas in our ambition to become one of five international air lines operating out of Europe by the end of this century. The strategies were to increase the cost-effectiveness of operations, to develop an information and distribution system that would give us unhindered exposure for our products and services on the market, and to expand our airport and Scandinavian traffic systems.

Where Do We Stand Today?

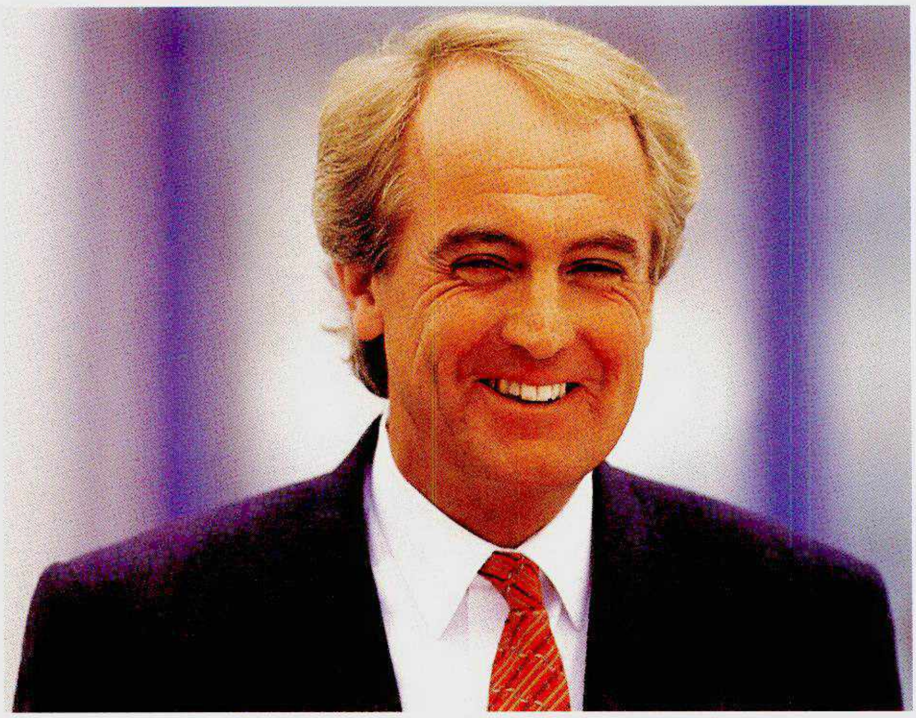
Until early 1987, SAS Airline was becoming cost-effective. Our goal was a 13-percent gross profit margin, to allow us to continue on our course of expansion and essential investments. This margin deteriorated in the latter half of 1987 and, once again, we are faced with the task of reversing a negative trend to reach the necessary levels of effectiveness and profitability. I am convinced that we will succeed.

In our choice of an information and distribution system, we had the option of developing our own or cooperating with other airlines. The first alternative was quickly ruled out, since it would be too expensive and would take too long to develop. Therefore, in 1987 we joined Air France, Iberia and Lufthansa, and formed the Amadeus system. Many other European airlines have since joined this system. Amadeus is hereby assured access to at least 60 percent of the European market.

As for the traffic network, SAS is very strong in Europe. Our geographic location favors us in traffic to and from other European countries. At the same time, our base of 18 million people is far too limited to support intercontinental traffic with frequent flights to many destinations. We therefore base our efforts on two main strategies: broadening our passenger base through cooperation in Europe, and establishing new gateways on other continents. By establishing alliances with local airlines in these foreign locations, we can extend our fully integrated system to our passengers in their continued travel. A prime example of this is the agreement we reached with Thai International in 1987. Similarly, we are now engaged in talks with airlines in North and South America.

A Partial Victory

Our contacts with Sabena and British Caledonian fit in with the strategy of cooperation in Europe. In contrast to the rapid deregulation of the airline industry in the U.S. just over ten years ago, the European air travel market is being liberalized gradually, with strong consideration for the countries' national carriers. This process mainly favors those located centrally in Europe: the survival of the fattest, not the fittest. Many countries still consider it vitally important to maintain national control of their own airlines. For this reason, our venture with British Caledonian was a partial victory, not only for us, but also for the rest of Europe's carriers, because it stimulated a more open view to crossborder cooperation and ownership. After a series of negotiations we won the approval of the British authorities to simply make an offer for cooperation based on a 25-percent interest, without affecting B-Cal's traffic rights. When British Airways then increased its bid to acquire all of B-Cal – which a national airline can do without restriction – we decided the price had become too high. The key factor is that the outcome was determined by purely commercial principles: British Airways put a greater price on keeping us out of the British market than what we considered entering it worth.



Doing Better Business

Another aspect of our quest for a strong position in the face of growing competition is to help the business traveler do better business. Our goal is to create an integrated travel service, combining flights, hotels, ground transport, airport service, hotel check-ins and so on, to save the business traveler time and money.

The competition has intensified considerably in recent years. In 1984 there was one American carrier flying 16 times a week over the North Atlantic from Scandinavia. In 1988, four companies together fly 52 times a week, meaning price will play an increasingly competitive role. The cost level in Scandinavia makes it difficult for us to compete on price with airlines from Asia and the U.S. We want to create a quality product that is far ahead of the rest of the market – a product that concentrates on the total needs of business travelers and gives them full value for their money.

Solid Links in the Chain

Our other business areas play a vital role as solid links in a chain of services. At the same time, they have experienced very strong growth in their respective market segments. For the SAS Group, this entails maintaining a favorable balance both in terms of products and geography to strengthen the whole and boost the Group's resilience, even in a climate marked by lower demand and greater price competition. The coming changes will put great demands on flexibility. This applies to all aspects of our operations. We must foster a propensity for change to quickly adapt our strategies to new developments. What is good today is perhaps not the best alternative tomorrow.

I want to emphasize that we have great opportunities to continue our successful growth to date. We have a highly businesslike organization. We have an effective combination of business areas and products. We have the profitability to expand and continue investing. It is now important that we gain the strength and flexibility to adapt to new realities.

JAN CARLZON
President and Chief
Executive Officer

THE OPERATING ENVIRONMENT

Growth of international air traffic and changes in flows of passenger and cargo traffic basically follow worldwide economic developments. Business travel is also a reflection of the trend toward greater global production and international and regional trade in goods and services.

In the 1970s increases in traffic were generally high. The recessions in the wake of the two major oil crises led to stagnation in Europe in the beginning of the 1980s, followed by a period of renewed growth. At the same time, structural changes in the economies of Western Europe, the United States and the Far East have altered traffic patterns for passengers and cargo.

Changes in Conditions

In contrast to other industries, the international airline industry does not have a free right of establishment. Traffic between and over countries is based on bilateral agreements which specifically regulate operating conditions. As a result, each country tries to promote its own interests as far as possible. These agreements therefore reflect the relative political and economic clout of the parties in question.

SAS's traffic system is dependent on a limited population base of 18 million people in Europe's northern periphery and the economic and competitive strength of Scandinavian industry at home and abroad.

SAS maintains a strong position in Scandinavia and on routes between Scandinavia and the rest of Europe. Improvements in intercontinental traffic will require a wider geographic spread and economies of scale.

The future of SAS's international traffic therefore lies in exploiting the coming liberalization of the European airline industry and in establishing alliances with other carriers on other continents. In this way, SAS can gain access to new markets and create the groundwork for a cost-effective international traffic system.

Tough Competition on Intercontinental Routes

Deregulation of domestic traffic in the United States has led to the rise of a few so-called mega-carriers: American Airlines, United Airlines, Delta, Northwest Airlines and Texas Air.

Their dominance can be traced to a combination of a few important factors: *nationwide traffic systems* with two or three hubs and a few exclusive feeder carriers that operate on a franchise basis, effective *booking systems*, *economies of scale* in marketing and production, competitive *personnel costs*, and *financial strength*.

Many tickets sold in the U.S. are highly discounted. However, the new structure of the industry has led to a gradual improvement in profitability, at least for the major carriers.

Consumer organizations and politicians in the U.S. are demanding better service, higher quality and punctuality – as well as regularly published statistics on delays and cancellations.

Technological advances have now made intercontinental flights possible with twin-engine aircraft, such as the Boeing 767 for 200 passengers.

Several American carriers plan to establish or add nonstop flights to new destinations in Europe in 1988. In 1986 U.S.-owned airlines offered 15 direct flights to Scandinavia. In 1988 that number is expected to increase to 52. In addition, American carriers have opportunities to expand their own limited traffic systems in Europe. As regards traffic over the North Atlantic, the low value of the dollar will be an important competitive advantage for U.S. airlines in relation to their European competitors. This will intensify competition.

In the Far East, the base for intercontinental business traffic is expanding. Business travel is concentrated in countries with strong or growing economies such as Japan, South Korea, Taiwan, Singapore, China and Hong Kong. Their strong markets, in combination with such technological developments as the Boeing 747-400, which can fly to Europe nonstop, will benefit the national airlines of these countries. In the long term, Japan Airlines, All Nippon Airways, Cathay Pacific, Singapore Airlines and Thai Airways International will all likely gain in strength.

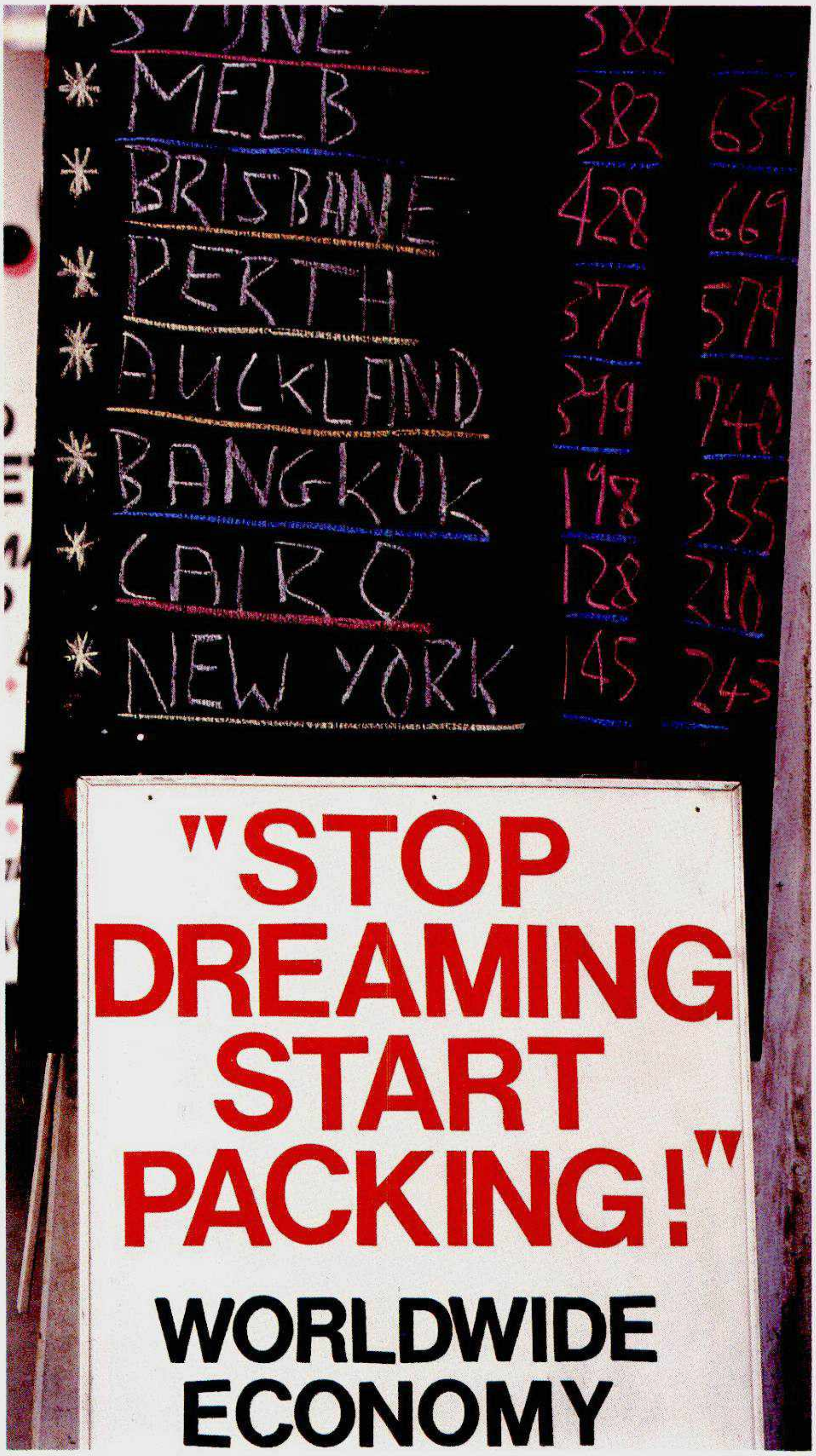
Tourist traffic will increase from economically strong countries, such as Japan. Due to the size of the market, tourist traffic will favor carriers that can offer the largest aircraft with the lowest per-seat costs.

Common Market in '92

Work is continuing in Europe to create a genuine common market by 1992, with 350 million consumers and no barriers restricting the flow of goods, labor and capital.

As planned, this free market will also apply to air traffic by eliminating claims to national sovereignty over air space.

European air traffic policies are greatly influenced by national prestige; each country goes out of its way to protect its own air space and its own airlines. Immediate, total deregulation would produce major problems for the entire industry. At least in the short term, current agreements between airlines on flights, timetables and ticket booking cooperations give consumers a wide selection of products, freedom of choice and flexibility. Moreover, the managements and unions of the major airlines are facing strong pressure to increase cost effectiveness in operations.



Liberalization and the resulting combination of regulation and deregulation will therefore lead to problems for the industry. In some cases, airlines will be forced to compete with each other and in others to cooperate, at the same time that various national authorities place conditions on their operations.

In 1987, the EC's Council of Ministers passed a resolution to gradually accommodate freer competition in the airline industry. The measure went into effect on January 1, 1988. Under the new regulations, the authorities must approve airline fares if justifiable in light of each carrier's costs. Also, the earlier regulation, by which each country's carrier is in principle insured half of the traffic in bilateral agreements, has been relaxed. In 1988 the new ratio is 45/55; in 1989 it will be 40/60.

This may seem like a marginal change, but in 1989 a carrier with 40 percent of the market can increase its share to 60 percent, a 50-percent gain. It will also be possible for several carriers to share traffic from one country to others.

In addition, regional airlines have been given the right to serve the major airports, paving the way for agreements on feeder traffic.

For large airlines like British Airways and Air France, both of which have sizable domestic markets and advantageous geographic positions from an intercontinental perspective, the new rules will not radically change the operating conditions. Authorities that monitor and control air traffic in accordance with national regulations can still protect national policies, where desired. For carriers in Europe's periphery that have significantly smaller population bases, continued regulation is a disadvantage.

Changes in Domestic Traffic, Too

SAS has also been subjected to the current political trend of selling off government and collective services. In Scandinavia, some people are advocating that SAS's traffic rights should be shared with other carriers to stimulate competition. This applies to domestic, intra-Scandinavian and European routes and, to a lesser extent, to intercontinental routes.

In Norway, certain domestic routes were earlier reserved for Braathen, while others were reserved for SAS. Now, parallel concessions have been introduced, by which Braathen also flies Oslo–Bergen, earlier an SAS route. In the same way, SAS can now fly Oslo–Stavanger, where Braathen previously had exclusive rights.

The debate in Denmark has primarily centered on other carriers' rights to international traffic. Of principal importance are new routes from Jutland, by which fairly small cities would be accessible to direct traffic to the Continent and, as a result, would feed the traffic systems of other intercontinental airlines.

In Sweden, SAS and Linjeflyg share the traffic rights of their parent company, ABA. Linjeflyg in turn commissions Swedair to fly certain routes with small traffic bases, where Swedair's fleet and resources are better suited. Sweden also has a number of regional and local carriers.

Environmental Concerns

The financial performance of the major airlines is affected not only by air traffic regulations, but by environmental concerns as well. In general, this includes noise-reduction measures, particularly in the vicinity of major airports. At present the EC is discussing a further reduction in noise levels in 1992. A large number of aircraft would be affected by these rules. SAS would be forced to replace a number of DC-9s and DC-10s earlier than would be technically or financially motivated. The environmental effects of emissions from jet propulsion fuel is also a topical concern. In Sweden, special taxes have been proposed.

GOALS AND STRATEGIES

"Helping the business traveler do better business"

The SAS Group consists of a number of business areas, each of which operates independently in its respective market, but which is also a link in SAS's integrated travel service chain. Throughout the 1980s SAS has been a trend-setter in both the business-travel and tourist sectors.

The overall goal of the SAS Group is to survive and grow in a future in which substantial changes can be expected. This is why SAS, with Scandinavia and Europe as its base, must further develop into a company that offers

- travel services to business travelers around the world,
- quick cargo handling for businesses, and
- leisure travel services.

These goals must be achieved while at the same time meeting profitability objectives and without jeopardizing long-term financial stability. Each business area also has individual objectives in light of its capital requirements.

Strategies

Against the background of current and expected changes in the market, SAS has formulated a number of strategies to achieve its overall market and financial objectives.

The SAS Group's main strategy is to be the best alternative for the frequent business traveler. SAS aims to provide a complete, integrated chain of products and services for the travel sector, to meet the complete needs of people traveling on business. In the same way, SAS's strategy is to provide comprehensive services for tourists.

The continued success of The Businessman's Airline strategy requires a broader base in current markets, access to new markets, and a reduction in SAS's current costs to an internationally competitive level.

European dominance in intercontinental traffic – by carriers such as British Airways, Lufthansa and Air France – will more likely increase than decrease. SAS's discussions with Sabena and its offer to purchase a share in British Caledonian should be viewed with this in mind.

As regards the intercontinental network, SAS's strategy is to fly to select hubs in the U.S., the Far East and South America. From there, SAS passengers should be able fly with other airlines that complement SAS's integrated service chain. In 1987 SAS reached agree-

ment with Thai International, resulting in two daily nonstops between Scandinavia and Bangkok. From there, Thai's traffic system takes over. Timetables, coordinated ground services at airports, reservations and bookings, and service in general should be organized in such a way that the traveler experiences his trip as if it where with a single airline.

Access to the market is also dependent on information and reservation systems. This is why SAS must develop its own system or join in a mutually owned system that guarantees that the Group's products will receive the proper exposure and that its position cannot be limited.

In general, cost-effectiveness in operations must be improved if the SAS Group is to be competitive in a freer market. SAS International Hotels, SAS Service Partner and SAS Leisure are already competitive costwise, but the Airline's cost level is too high. This situation will be even further accentuated, since inflation in several of SAS Airline's most important competitor-countries is lower than in Scandinavia.

SAS'S OWNERSHIP STRUCTURE

The first agreement covering the SAS cooperation was signed in the autumn of 1946. The current agreement was ratified in 1951 between the three national carriers: Det Danske Luftfartselskab A/S (DDL – Denmark), Det Norske Luftfartselskap A/S (DNL – Norway) and Aktiebolaget Aerotransport (ABA – Sweden). In this way three domestic airlines joined forces in a single organization, the SAS Consortium. The current agreement, a revision of the original, extends to September 30, 1995.

DDL and DNL each own two-sevenths of the Consortium, while ABA owns three-sevenths.

The three parent companies have given total responsibility for operations to the Consortium. At the end of each reporting period the Consortium's income statement and balance sheet are divided between the parent companies in a 2-2-3 ratio. The SAS Consortium includes the Group Management, SAS Airline, SAS Finance, SAS Trading and joint Group projects.

Parent Companies

DDL and DNL are corporations listed on their respective countries' stock exchanges. Half of their shares are owned by their governments and the remainder by private interests, primarily businesses and institutions.

The 50 percent of ABA's shares not controlled by the government is owned by Svenska Interkontinental Lufttrafik AB (SILA), a listed company.

In addition to their participations in SAS and Scanair, the parent companies also have interests in other, national airlines.

Decision Making

SAS's highest decision-making body is the Assembly of Representatives, which is made up of the parent companies' boards of directors. The Assembly of Representatives appoints SAS's board of directors, approves its financial accounts and decides on the portion of income to be transferred from the Consortium to the parent companies to cover their administrative costs, taxes and dividends. SAS's parent companies each have two members on SAS's board. One member represents the government interests and one the private. In addition, the unions in each country appoint a member and his or her deputies.

Responsibility for overall management rests with the president and chief executive officer of the SAS Group.

Capital and Taxes

The SAS Consortium's equity is made up of the capital account, which consists of funds contributed by the parent companies and surpluses retained in operations. Thus, the Consortium cannot issue shares. Instead, increases in capital are made through contributions from the parent companies. The Consortium is responsible for its own external financing.

The Consortium is not a tax-paying entity. The parent companies each file income tax returns and pay taxes on their share of the Consortium in accordance with national regulations. The Consortium's subsidiaries pay their own taxes in the usual manner.

The Consortium's accounts are examined by external auditors from the member-countries.

DDL	DNL	ABA
50% Private interests	50% Private interests	50% Private interests (SILA)
50% Government	50% Government	50% Government
2/7	2/7	3/7

SAS CONSORTIUM

SUBSIDIARIES

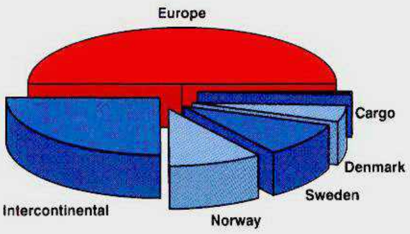
AFFILIATED COMPANIES

SAS AIRLINE

MSEK	86/87 15 mths	86/87 12 mths	85/86 12 mths
Revenue	**21 953**	17 510	16 483
Operating income before depreciation	**2 146**	1 935	1 900
Gross profit margin, %	–[2]	11	11
Income before extraordinary items	**1 586**	1 453	1 305
Investments	**2 446**	2 112[1]	3 733[1]
Return on capital employed[1], %	–[2]	14	21
Number of employees	**20 479**	20 356	19 666

[1] SAS Consortium.
[2] Not relevant for 15-month period.

TRAFFIC REVENUE PER ROUTE SECTOR



SAS Airline's business concept is to meet the business traveler's air travel needs around the world at competitive prices and with a high level of service – to be The Businessman's Airline.

The traffic network covers domestic routes in Denmark, Norway and Sweden, intra-Scandinavian routes, and routes to other European cities, North and South America, the Middle East and the Far East. In total, the network covers more than 80 destinations in 34 countries.

Aside from the primary target group – the business traveler – SAS serves two groups: tourists and cargo customers. In the fifteen months of the 1986/87 fiscal year the total number of passengers was approximately 16 million. Business travelers, who pay full fare, account for the large share of revenue, while tourists contribute to the profitability of each individual flight.

Cargo flown on passenger aircraft is basically a byproduct, since the traffic program is geared to meet the needs of the passengers. However, cargo is gaining in significance in pace with the development of new service concepts and products.

Product and Price Differentiation

Product and price differentiation play a dominant role in SAS's strategy. Prices are differentiated based on the content of the products. On international routes the business class alternative is called EuroClass, which has a high level of service at normal economy fares. Discount-fare alternatives are offered on all routes to meet demand for inexpensive tourist and vacation travel.

SAS's products are distinguished by high quality with concern for safety and service. Fares are set competitively yet profitably.

Decentralized Organization

The commercial organization consists of six route sectors – Denmark, Norway, Sweden, Europe, Intercontinental and Cargo – each responsible for its development and marketing of air travel products, and profitability. Production is managed through an integration of three divisions – Technical, Operations and Traffic Services – together with a unit for small aircraft operations.

SAS Trading

External Enterprises, which develops and handles businesses in conjunction with air travel, is a complement to the route sectors and operating divisions. These businesses include purchasing and selling duty-free goods. External Enterprises was reorganized in the beginning of 1988 into a separate business area in the SAS Group under the name SAS Trading.

Goal

SAS Airline's goal is to survive and develop in freer competition. SAS intends to be one of the five major airlines in Europe after 1995. To do so, it must expand its traffic system, develop efficient information and reservation systems, and achieve a competitive cost level. This requires a long-term gross profit margin of 13 percent, to insure that capital can be obtained to finance the expansion and replacement of the aircraft fleet and other resources.

Dependence on Economic Swings

Demand for air travel largely follows the trend of the gross national product in each country. In times of high economic activity and industrial growth, travel increases. In times of recession, travel falls off.

The market for business travel in Europe has increased by an average of five percent annually in the 1980s, but with large variations between years. There are now signs that the rate of increase will drop due to an economic downturn forecasted for the second half of 1988.

Tourist travel has increased in recent years. Growth in the economies of the Western World has left more room for private consumption, including travel. Air fares are extremely important, which is why the fare decreases brought on by tougher competition have also had a positive effect on demand.

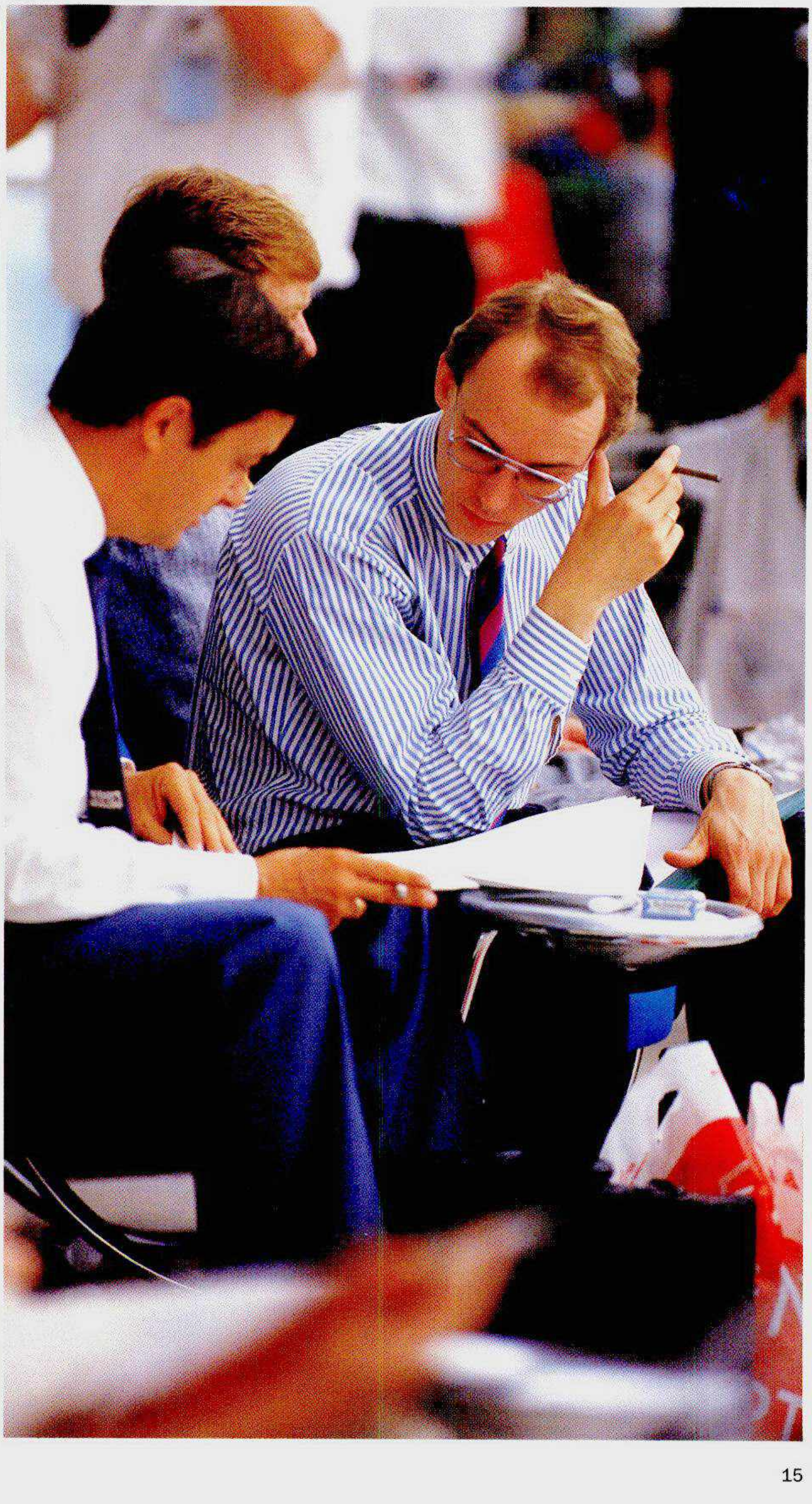
Factors Affecting Revenues

Decisive to an airline's revenues is the relation between full-fare and discount-fare traffic in combination with the cabin factor on each flight.

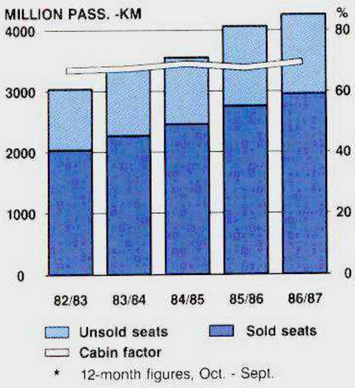
By systematically applying its strategy of price and product differentiation, SAS has been able to limit increases of both full and discount fares. Moreover, SAS has the largest share of full-fare passengers of any European airline – but with a large difference between the share of full-fare passengers on European routes and on intercontinental routes. In Europe, SAS's share of full-fare passengers averages between 30 and 35 percent on each flight, while the corresponding figure for long routes is only 15–20 percent.

A successfully implemented strategy has also helped SAS to gradually increase its total average cabin factor to around 60 percent in Europe and to approximately 80 on its intercontinental network.

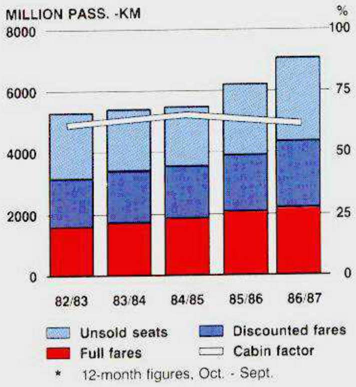
Air fares must be approved by the authorities in each country, and increases are generally based on expected economic developments. During the past four years, full fares from Scandinavia to other parts of Europe have risen by less than half the rate of inflation in the Scandinavian countries.



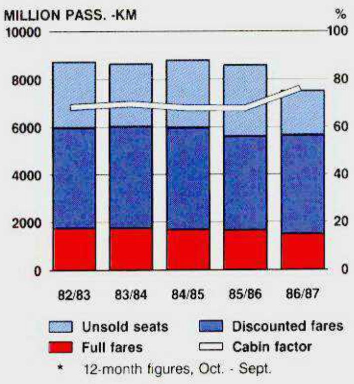
PRODUCTION, TRAFFIC & CABIN FACTOR
DOMESTIC*



PRODUCTION, TRAFFIC & CABIN FACTOR
EUROPE*



PRODUCTION, TRAFFIC & CABIN FACTOR
INTERCONTINENTAL ROUTES*



Restrictive Government Policies

In 1987 SAS was permitted to raise its domestic fares by an average of just under 3 percent. Although most countries permitted fare increases to Scandinavia, SAS was not allowed to raise its fares from Scandinavia to other parts of Europe. Full fares on intercontinental routes were raised by 2 percent. In practice this had little effect, however, since the total share of full-fare passengers is low. For competitive reasons, increases in tourist fares were only marginal.

As a whole, SAS's revenue has risen at a significantly slower pace than its costs. Several of SAS's major competitors have been permitted to raise their fares despite that inflation in their countries has been lower than in Scandinavia. For SAS, the ratio of revenue to costs declined in 1986/87 compared to earlier years and to the competition.

Choice of Aircraft

SAS's strategy – with many flights and nonstops to a large number of destinations – requires medium-size, cost-effective aircraft. SAS has therefore decided to stick with DC-9-size aircraft for short and intermediate distances and DC-10-size aircraft on long-distance routes. The alternative would be to switch over to larger planes such as the Airbus A300 or Boeing 747. Product and price differentiation in combination with smaller aircraft has resulted in a high cabin factor and a high per-flight ratio of revenue to costs. This strategy is a fundamental reason for SAS's success during the 1980s.

The same reasoning is the basis for the selection of new aircraft to replace the fleet of DC-9s and DC-10s. SAS has decided not to commit itself, pending new technological developments which would significantly improve operating economy and cabin environments for passengers and crew. As regards the long-distance fleet, SAS has decided on a gradual changeover to Boeing 767s. The total investment for the nine aircraft ordered to date is 4 billion kronor; the new planes will be placed in service starting in 1989. Higher capital expenditures will be balanced out by lower operating expenses.

Factors Affecting Costs

An airline's largest costs are salaries and social fees, government fees for take-offs, landings and overflights, fuel, commissions paid to agents, and depreciation and interest expenses.

Higher Personnel Costs

SAS's strategy has a direct effect on personnel costs. The Airline's commitment to service and high quality requires a relatively large number of employees. Like most other Scandinavian companies, SAS has high personnel costs. This is especially true in comparison with carriers in Southeast Asia. In the U.S., the average salary cost per employee in the airline industry fell in 1986. During the period 1983-1987, SAS's personnel costs rose twice as fast as its passenger revenue. This trend must be broken.

No Subsidies

The Scandinavian authorities have expressed as their objective that civil aviation bear its own costs. Some countries subsidize their airlines with low tariffs or by covering deficits. Since SAS has a large part of its traffic in the Scandinavian countries, where tariffs are high, these costs are relatively burdensome in comparison with many of its competitors.

Fuel Prices Up Again

Airline fuel costs dropped rapidly in 1985 and 1986 on account of lower oil prices and the drop in the U.S. dollar. In the early 1980s, fuel accounted for approximately 20 percent of airline costs. In 1985 the corresponding figure was 15 percent, in 1986 10 percent, and in 1987 7 percent. During the autumn of 1987 oil prices rebounded. Thus, fuel expenses are expected to be significantly higher in 1988 than in 1987.

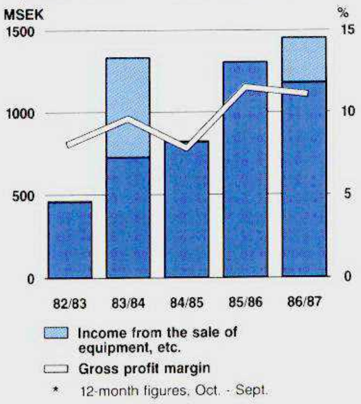
Since the trend in fuel prices affects all carriers to almost the same degree, fluctuations have little effect on competitiveness.

New Information and Distribution Systems

Commissions paid to agents constitute 8-10 percent of an airline's costs. To insure contact with the market and to cut costs, airlines are increasingly investing in their own information and reservation systems. Such systems can also be used by other producers of travel and related services, making them commercially attractive from the standpoint of product development. However, the investments involved are very large, so that few airlines can bear the costs to develop new systems by themselves.

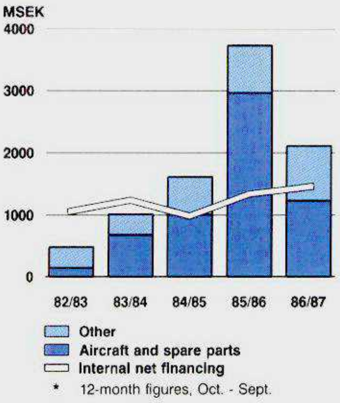
Of the systems used in the U.S., American Airlines' Sabre and United's Apollo dominate the market. Both carriers intend to establish their systems in Europe. To meet future competition from the Americans, development was begun in 1987 on two European systems. Together, the two systems will cover bookings for all European airlines. Amadeus, one of the two, is owned by SAS, Lufthansa, Air France and Iberia. Braathen, Finnair, Linjeflyg and Air Inter have also joined in. Since Amadeus carriers have a large portion of European traffic, the system will encompass roughly two-thirds of all bookings in Europe. Amadeus is scheduled to be in operation in 1990.

SAS AIRLINE
TREND OF INCOME
(INCOME BEFORE EXTRAORDINARY ITEMS)*



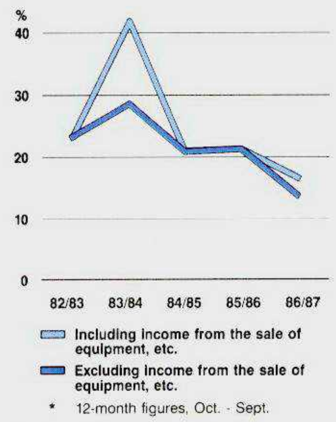
82/83–84/85 refer to the SAS Consortium

SAS AIRLINE
INVESTMENTS*



Refers to the SAS Consortium

SAS AIRLINE
RETURN ON CAPITAL EMPLOYED*



Refers to the SAS Consortium

The other system, Galileo, is owned by British Airways, Swissair, Austrian Airways, Alitalia and KLM. Other members include British Caledonian, Aer Lingus, TAP Air Portugal and United Airlines. These airlines hold a large share of intercontinental traffic, with major sales outside Europe.

Amadeus will be tied to nationwide communications systems, which will allow local suppliers to hook into the system. Thus, it will offer a complete, worldwide selection of travel services to travel agencies and other customers. An unbiased presentation of suppliers' products will always be available as well, so that the local sales agent can favor certain suppliers if he so desires. Printouts of documents and customer invoices will be handled at the point of sale.

Together with SJ (the Swedish State Railways) and Braathen in Norway, SAS has developed SMART, a communications system which already has a strong position in Scandinavia.

Timing Investments

Viewed over a long period, an airline's investments occur in cycles. Since lead times for acquiring aircraft and pilots are between two and three years, airlines tend to secure deliveries of new materiele as early as possible. If the market does not expand in pace with the increased capacity, the cabin factor drops, as does profitability. Then the companies cannot bear increased capital costs for new, more expensive aircraft. This is what happened in the late 1970s, causing major financial problems for many carriers in the beginning of this decade. Though difficult, capacity planning in relation to expected market growth is therefore essential. In the 1980s, annual changes in traffic volume in Europe have fluctuated between a 3-percent drop one year and a 9-percent gain in another.

What is SAS Doing to Improve Its Competitiveness?

In the beginning of the 1980s SAS was suffering from overcapacity, products poorly-suited to the market's needs, low service levels, and a lack of customer confidence. This led to a financial crisis. At that point, SAS revised its strategy, marketing and product development and created The Businessman's Airline. The portion of full-fare passengers quickly increased and market shares were regained. This, in combination with favorable market growth, led to greatly improved profitability.

SAS grew gradually into the size it had originally intended, and capacity is now fully utilized. The Airline expanded with new aircraft and more employees. However, capacity was added at higher than average costs, at the same time that revenue fell below average for the added volume due to the fare structure and product mix.

To strengthen competitiveness and profitability in a market with stagnant fares, SAS is continuing to emphasize quality in service, increased productivity and expansion.

After review, suitable levels of product and service quality were determined and norms were established for overbooking, baggage handling, reply times, and a number of other technical and operative tasks. Priority has been given to safety, punctuality and service.

Service must be provided at the right quality and a cost not exceeding the competition. But to do so requires significantly higher productivity than we have today. Since labor is more expensive in Scandinavia than in most other areas of the world, higher productivity demands will necessitate increased automation and computerization.

Expansion applies to both the route network and SAS's service concepts. The latter includes the continued development of The Businessman's Airline concept as a complement to the integrated travel service chain. Other important elements include airline check-in for SAS passengers at hotels and hotel check-in at airports, special EuroClass lounges at all airports where SAS is represented, transfer services, and cooperation with other airlines for continued travel to other parts of the world.

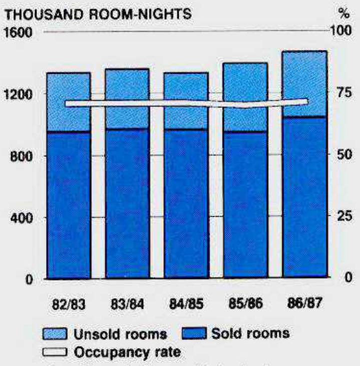
Up until 1986 SAS focused primarily on its existing route network. Now, new routes are again being opened, starting with Reykjavik in 1987. Malaga, Cairo, Toronto and Beijing are next in line. Moreover, Buenos Aires will be a point of connection for continued travel to other destinations in South America.

SAS INTERNATIONAL HOTELS

MSEK	86/87 15 mths	86/87 12 mths	85/86 12 mths
Revenue	**1 564**	1 230	1 083
Operating income before depreciation	**189**	169	149
Gross profit margin, (GOP) %	—[1]	22	21
Income before extraordinary items	**63**	73	69
Investments	**212**	173	110
Return on capital employed, %	—[1]	13	17
Number of employees	**3 446**	3 301	2 992

[1] Not relevant for 15-month period.

SAS INTERNATIONAL HOTELS
HOTEL OCCUPANCY*



* 12-month figures, Oct. - Sept.

SAS International Hotels manages first-class hotels in Scandinavia, Austria and Kuwait. It also has hotels in northern Norway, marketed under the name North Cape Hotels.

SAS International Hotels' business concept is to operate and develop hotels in and outside Scandinavia and thereby be an integrated link in the travel service chain. The buildup of its own hotel chain is therefore a natural element in the SAS Group's development from an airline to a travel-service company primarily for the frequent business traveler.

SAS International Hotels' goal is to establish, within a five-year period, hotels at a minimum of another ten destinations where SAS has nonstop connections from Scandinavia. Hotel projects far along in their planning include those in Amsterdam, Brussels, Helsinki and Beijing.

SAS International Hotels' qualitative goal is to be one of the best alternatives for the businessman. This means that all hotels should have the same high standard and offer services particular to SAS.

Product Development and Price Differentiation

In implementing the Group's Businessman's Airline strategy, SAS International Hotels has adapted many of its products and services. A concept with higher standards and special services is marketed as Royal Club. The basic idea is to make the business traveler's hotel stay effective from the standpoint of work, relaxation and recreation. Airline check-in is offered at all hotels in cooperation with SAS Airline.

The hotel strategy is based on a clear product and price differentiation, designed to increase the occupancy rate and improve profit margins. The product range has the same structure as in SAS Airline: an exclusive first class, a high standard for regular-price customers, and discount alternatives on weekends, during vacation periods and at other times less interesting to business travelers.

Demand Parallel With Air Travel

Demand for hotel rooms by businessmen follows general economic trends and shows the same pattern as air travel. The tourist sector is dependent on the scope of disposable income and is more sensitive to external factors.

Growth in demand has generally been good in recent years, with the exception of 1986, when the effects of the Chernobyl accident in the Soviet Union and the falling dollar reduced tourist travel to Europe from North America. The market recovered in 1987, reaching on average the same level as earlier in the decade.

First With Integrated Services

Most major hotel chains are owned by or affiliated with airlines. Swissôtel is owned by Swissair, Meridien by Air France, Golden Tulip by KLM, and so on. More than other airlines, however, SAS has integrated air travel, hotels and ground services in its product range.

SAS's integrated products are still ahead of the competition. Several European airlines are now beginning to copy the concept, as was the case with The Businessman's Airline.

As an element in the development of its business traveler services, SAS is cooperating with a number of first-class hotels – marketed together with air travel under the name SAS Destination Service. Seventy hotels around the world, selected by SAS for their quality, location, price, service and standard, are currently part of the program.

Many of these hotels are offering airline check-in for SAS passengers, for example.

Local Competition

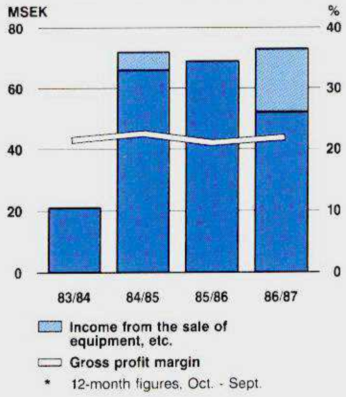
About 70 percent of hotel bookings are made locally. A hotel's image in the local market is therefore extremely important. However, the share of local bookings will likely decrease as the major information, reservation and payment systems grow.

Factors Affecting Profitability

Two main factors affect a hotel's profitability: the occupancy rate and the price per room.

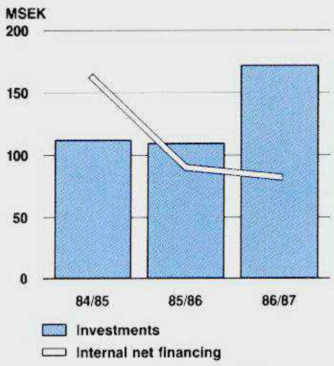
A well-established first-class hotel generally has a high, steady number of business travelers on weekdays during the autumn, winter and spring. Customer loyalty is often very high. However, the opening of new hotels can quickly alter the balance of a local market, as was the case in 1986/87 in Bergen and Gothenburg.

SAS INTERNATIONAL HOTELS
TREND OF INCOME
(INCOME BEFORE EXTRAORDINARY ITEMS)*



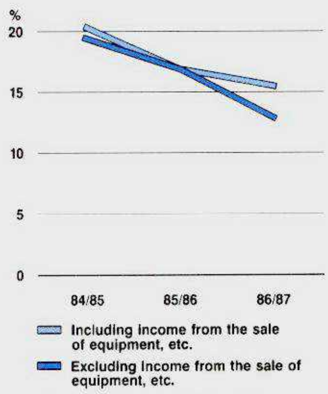
* 12-month figures, Oct. - Sept.

SAS INTERNATIONAL HOTELS
INVESTMENTS*



* 12-month figures, Oct. - Sept.

SAS INTERNATIONAL HOTELS
RETURN ON CAPITAL EMPLOYED*



* 12-month figures, Oct. - Sept.

The summer season and weekends are utilized for marginal sales, which are decisive to the hotel's total profitability. That is why poor weather during the summer can greatly affect a hotel's overall profitability, as happened in Sweden in 1987.

The average price level depends on costs, local competition, the balance of supply and demand, and the hotel's general attraction. Its restaurant business plays an important role in the hotel's image and for service to its guests. Restaurants account for an average of approximately 40 percent of a first-class hotel's total revenues, though this rarely covers more than operating costs. Increasing the efficiency of restaurant operations is therefore one way for a hotel to improve its profitability.

Comprehensive Investments

SAS International Hotels owns six hotel properties, with a total market value of 1.5 billion kronor. These holdings are booked at a substantially lower value, leaving a hidden reserve in the range of one billion kronor.

In 1987 three hotels in northern Norway were sold, one of which is now leased. The capital gain on these sales was 21 MSEK.

SAS International Hotels' investment program calls for two or three new hotels each year. This requires a high degree of internal financing. The strategy for purchasing and constructing new properties is to finance the investments internally, retain ownership for a few years and then sell the building with a sale-and-leaseback agreement. SAS International Hotels' current holdings are an important source of financing for this strategy.

Owning hotel properties is not necessary, however. If a hotel is to serve as a link in the travel service chain, operational management and control over quality, costs and standard are the decisive factors. That is why leasing agreements or combinations of different financing alternatives are also of interest if SAS International Hotels is to meet the goals of its investment program.

SAS Service Partner is one of the largest international airline catering companies in the world. The business area actively supports the SAS Group's strategy by producing and distributing meals and related services on commercially viable terms to business travelers and tourists using SAS's traffic system. SAS Airline accounts for approximately 29 percent of SAS Service Partner's total revenue. To improve its know-how, profitability and spread its risks, SAS Service Partner's resources are being utilized in other, similar business activities.

Business Concept

SAS Service Partner's business concept is to produce and supply meals and related services that improve upon customers' total products and give them a competitive edge.

These customers include airlines, aviation authorities, exhibition centers, conference facilities, hospitals and large companies.

SAS Service Partner's goal is to be the best alternative as a partner to selected customer groups. This goal will be achieved by developing, producing and supplying competitively priced products and services that are tailored to each customer's individual needs.

During the past four years operations have been concentrated to two main areas: catering and restaurants. Earlier operations were focused in Scandinavia, but SAS Service Partner has gradually diversified in other areas of Europe.

Catering

Airline catering accounts for 60 percent of SAS Service Partner's total revenue. This does not include Offshore & Industrial Catering – which supplies meals and other services to oil platforms in the North Sea and construction sites – or Hospital Catering and Party Service.

SAS Airline is the single largest customer of the Scandinavian flight kitchens, accounting for 58 percent of Airline Catering Scandinavia's revenue. Outside Scandinavia, other customers account for 91 percent of Airline Catering International's revenue.

On January 1, 1988 SAS Service Partner acquired Catering Services Gesellchaft, a West German company operating flight kitchens in Munich, Hamburg, Hannover and Stuttgart, and Sky Shop Catering, which operates a flight kitchen in Berlin. Together with its other West German flight kitchens – in Frankfurt, Dusseldorf and Munich – SAS Service Partner is now able to cover most of SAS's traffic network in West Germany. SAS Service Partner is today Europe's largest airline caterer.

International Service Partners, formed in 1987, is a 50/50 joint venture with Dobbs, America's second largest airline-catering company. As part of the collaborative effort, the two companies' operations in Chicago have been coordinated under a single management. This cooperation opens opportunities in the North American market.

With its Offshore & Industrial Catering operation, SAS Service Partner is the leading supplier to oil platforms in the North Sea, with a 60-percent market share. However, stagnation in the oil market is having a negative effect on demand for SAS Service Partner's products.

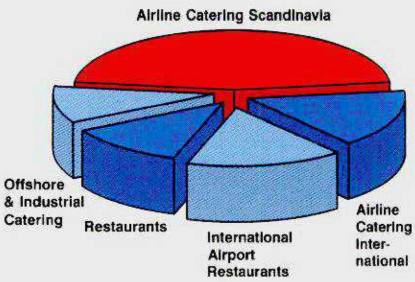
The Hospital Catering division is a new, independent unit that provides meals for hospital kitchens and staff canteens in Sweden. Hospital Catering made its market breakthrough in 1987. Interest in this type of service is growing in both Scandinavia and elsewhere, making for an expansive market.

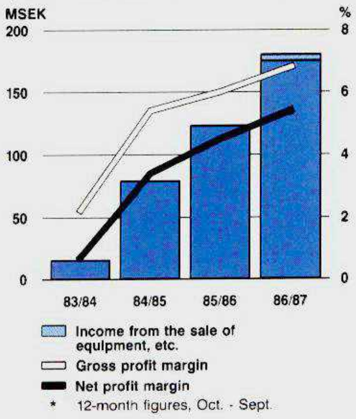
SAS SERVICE PARTNER

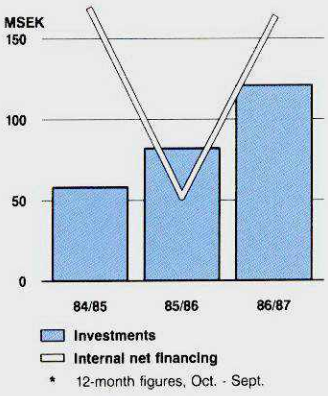
MSEK	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
Revenue	**4063**	3223	2712
Operating income before depreciation	**252**	219	163
Gross profit margin, %	–[1]	7	6
Income before extraordinary items	**202**	180	123
Investments	**159**	121	82
Return on capital employed, %	–[1]	40	36
Number of employees	**7344**	7311	6445

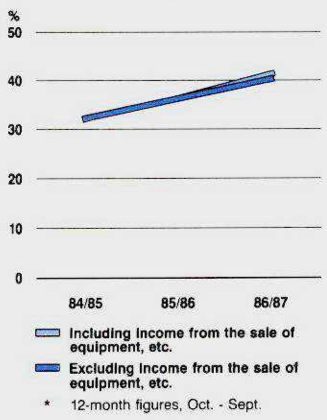
[1] Not relevant for 15-month period

SAS SERVICE PARTNER REVENUE









Restaurants

Restaurant operations include airport restaurants, canteens, roadside restaurants and restaurants in exhibition centers and sports facilities.

SAS Service Partner operates more than 100 airport restaurants at 35 airports. It operates all the restaurants, bars and newsstands at the new shopping area opened in 1987 at Copenhagen's airport.

Plans call for an expansion of operations outside Scandinavia. An important step toward this goal was reached when SAS Service Partner was awarded a contract to conduct all restaurant operations at the Barbican Centre in London, one of the world's largest cultural centers.

Other important contracts received in 1986/87 include the Stockholm Globe Arena (the Swedish capital's new sports arena), the restaurants at SAS's new headquarters outside Stockholm, as well as an additional 22 contracts to operate staff canteens.

Continued Expansion

During the past three years SAS Service Partner has noted very positive trends in revenue and income. These successes are rooted in a correct market and customer orientation, restraints on capital expenditures, efficiency in operations, and personnel development. Operations have been focused on areas with good growth potential and where risks are spread geographically and productwise.

SAS Service Partner's financial goal is a pre-tax net profit margin of 6 percent. The figure for 1986/87 was 5.6 percent.

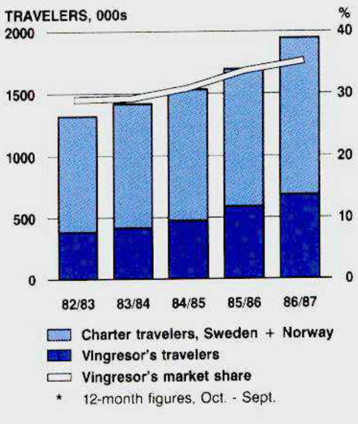
SAS Service Partner has an aggressive strategy for the future that includes investments in new projects and acquisitions of established flight kitchens and restaurants to strengthen its position in Europe.

SAS LEISURE

VINGRESOR MSEK	86/87 15 mths	86/87 12 mths	85/86 12 mths
Revenue	**2 935**	2 379	1 897
Operating income before depreciation	**105**	139	111
Gross profit margin, %	**–**[1]	6	6
Income before extraordinary items	**106**	141	133
Investments	**200**	150	200
Return on capital employed, %	**–**[1]	34	42
Number of employees	**2 341**	2 355	1 855

[1] Not relevant for 15-month period

VINGRESOR
MARKET SHARE IN SWEDEN AND NORWAY*



SAS Leisure comprises Vingresor, which is a wholly owned subsidiary of the SAS Group, and the charter operator Scanair, a separate consortium with the same ownership structure as SAS but not consolidated in the SAS Group's financial statements.

Expanding Market

Vingresor is the largest inclusive-tour operator in Scandinavia, with 845,000 travelers in 1986/87 (15 months). Scanair is Scandinavia's largest charter operator.

An important part of Vingresor's and Scanair's common strategy is high volumes to a limited number of destinations. Both companies have to date concentrated on Sweden and Norway, where they are market leaders.

Demand for vacation travel has grown during the past five years. In Sweden the market rose in 1987 to 1,215,000 travelers. The corresponding figure for Norway was 730,000. Approximately one-third of the total market travel once a year, while the others travel as often as their budget allows: on average once every third year. The latter group therefore has great potential.

The most important factor affecting demand in Sweden is economic growth and private consumption. Consumer patterns have been favorable for the vacation travel market, and 1987 was a very good year for Swedish inclusive-tour operators. The same trend – though even more accelerated – was evident in Norway until 1986, after which time the market leveled off following developments in the Norwegian economy.

The Scandinavian inclusive-tour market is dominated by operators with ties to airlines. The largest is Vingresor/SAS/Scanair, followed by Spies/Conair in Denmark and Fritidsresor/Star Tour/Sterling.

Profitability in the industry is generally weak, and many small competitors have been forced out of the market, which has led to a strong oligopoly.

VINGRESOR

Vingresor's business concept is to offer its customers competitively priced vacation trips. This idea is based on clear product and price differentiation with a systematic range of products for both the quality and low-price segments of the market. In the former, Sunwing resorts and Ving Centers are the most important elements. In the low-price segment, Vingresor's prices should be lower than the competition's for similar products.

Vingresor's qualitative goal is to have the market's most satisfied customers, its highest repeat purchase rate and the industry's best partners. The quantitative goal is a 40-percent market share in Sweden and Norway. In addition, Vingresor will be more active in other geographic markets. In Europe as a whole, Vingresor is a relatively large tour operator. The largest of all is the British company Thomson, which handles around 2.5 million travelers a year. Following Thomson are another British firm and two West German ones. Vingresor is fifth largest in size.

Size is important not only in competition for customers. It also makes it easier to find and maintain attractive partners – primarily hotel operators – to ensure product and service quality. Western Europe's largest operators, which have high capacity and volumes, are the toughest competitors in this respect. Nevertheless, Vingresor's relative size and good image have helped it to do well.

At the same time, Vingresor is adding new Sunwing facilities, including the Ving Centers. By owning its own facilities Vingresor has the advantage of full control over quality and service.

Thus, vacation packages can be tailored to the needs of Scandinavian customers.

In 1986/87 Sunwing and Ving Centers accounted for 25 percent of Vingresor's sales.

Positive Trend in Income

During the past five years Vingresor has noted a 17-percent average increase in its number of passengers. Revenue has risen by 20 percent per year and income after financial items by 40 percent.

Capacity utilization has remained steady at around 99 percent; in 1986/87 it was 99.4 percent. Achieving this requires a high repeat purchase rate, a clear strategy for prices, products and service, and a distribution system focused on company-owned outlets with total responsibility for customers and complete control over bookings as well as a highly-developed computer system.

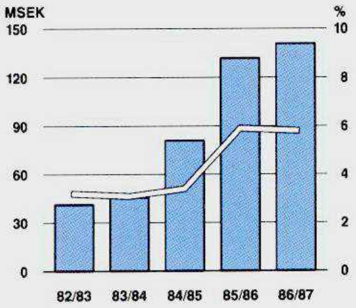
Continued Expansion

Spain, including the Canary Islands, and the other Mediterranean countries account for most of Vingresor's trips. The Canary Islands account for 68 percent of winter volume. These destinations will play a dominant role for Vingresor in the foreseeable future.

Vingresor's strategy for its future expansion includes continued efforts in existing locations, the continued upgrading of products, and efforts to cultivate new geographic customer bases. In the latter case Spain has great potential. The Canary Islands are increasing in popularity as a summer vacation spot among Spaniards. Vingresor hopes to offer its facilities on the Islands for this market during a period when they otherwise are under-utilized.

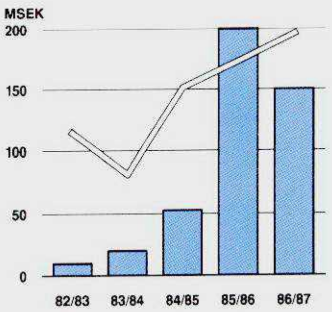
In 1987 Vingresor became a part-owner in Spanair, a new Spanish charter operator, in order to exploit opportunities in the Spanish market and insure flight capacity at competitive

VINGRESOR
TREND OF INCOME*



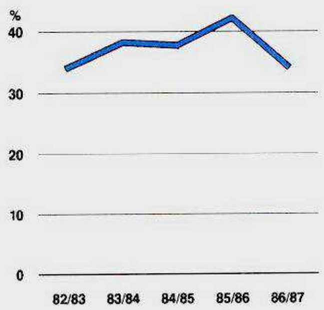
Income before extraordinary items
Gross profit margin
* 12-month figures, Oct. - Sept.

VINGRESOR
INVESTMENTS*



Investments
Internal net financing
* 12-month figures, Oct. - Sept.

VINGRESOR
RETURN ON CAPITAL EMPLOYED*



Return on capital employed
* 12-month figures, Oct. - Sept.

prices. Spanair's operations will begin in the spring of 1988 with four DC-9-83s flying to, from and between various destinations in Spain. In 1988 Spanair is expected to handle 10 percent of Vingresor's capacity needs.

During the past four years capacity at Sunwing facilities has been doubled to 6,620 room-nights.

SCANAIR

Scanair conducts charter operations from Sweden and Norway and, to a lesser extent, from Denmark.

Its Own Aircraft

During the year Scanair had six DC-8s on long-term lease from SAS. It also leased DC-9s and Airbus A300s from SAS and Fokker F28s from Linjeflyg.

During the autumn Scanair purchased six DC-8s from SAS, which is now converting to other types of aircraft better suited to scheduled traffic.

Scanair's customers are tour operators that purchase capacity on contract and thus assume the short-term financial risk. The company's long-term term growth will be determined by its ability to do business with financially stable and successful tour operators.

In 1986/87 Scanair served twenty tour operators, including fourteen from Sweden and four from Norway. The main destinations are the Canary Islands, and other locations in Spain and Greece, which together accounted for 79 percent of production. Revenue for the 15-month 1986/87 fiscal year was 1 993 MSEK. Income before extraordinary items amounted to 58 MSEK.

Market growth has allowed Scanair, which earlier developed as a marginal business alongside SAS, to become more independent. Increased demand for charter travel has also enticed other airlines to enter the market. In comparison with established companies, these new competitors often have a more advantageous cost structure. To date the extra capacity has absorbed excess demand in the inclusive-tour market, and increasing competition has had little effect on prices. Since prices play a decisive role in a tour operator's selection of an airline, Scanair must continue to streamline its operations and increase efficiency to maintain its position.

SAS FINANCE

An important element in the SAS Group's strategy is to maintain a stable financial position and good liquidity. This provides a greater freedom to decide over the Group's future development and the financing of the comprehensive investment program.

A continued high degree of profitability is necessary to finance coming investments. In addition, SAS must actively position itself in financial markets to ensure access to a large number of financial sources. To do so requires that SAS acquire and develop financial know-how, especially in light of the rapid technical developments in today's financial markets.

Effective January 1, 1988 SAS's financial operations are organized as a separate operating unit, SAS Finance, with the status of a business area. Its main role is to
– be responsible for arranging external funding at the best possible conditions,
– invest the Group's liquidity for optimal returns, and
– ensure that the Group's risk exposure, primarily currency and interest rate risks, is kept to an acceptable level.

SAS Finance's role in relation to Group subsidiaries and operating units is to offer short-term investments at commercially viable terms, serve as a lender, carry out currency transactions, and advise in such financial matters as leasing and project-related financing. In this way the Group's financial resources are optimized at the same time that its risk exposure is kept under control.

Last year the financial operations noted a high level of activity. A bond issue of USD 100 million with currency warrants was floated. Two private placements totaling JPY 14,500 million were arranged in Japan. Moreover, a number of loan and swap transactions were made, as were special financing arrangements for aircraft and hotel investments.

A USD 200 million Euro Commercial Paper program was arranged for short-term financing.

During the autumn a presentation of the SAS Group was held in Tokyo before 150 representatives of Japanese financial institutions. The presentation was one in a series of efforts to strengthen the Group's relations with the Japanese capital market.

SAS received an AA credit rating for medium and long-term bond issues from the Japanese credit-rating agency Nippon Investors Service. SAS also received an A1+ credit rating for short-term borrowing.

AFFILIATED COMPANIES

Affiliated companies are defined as those companies in which SAS's ownership is between 20 and 50 percent. These companies include Linjeflyg, Polygon Insurance Co. Ltd., Bennett Reisebureau A/S, Grønlandsfly A/S (Greenlandair) and Travel Management Group Sweden. Certain results are preliminary.

Linjeflyg AB (50%)

MSEK	**86/87 15 mths**	85/86 12 mths
Revenue	**2 573**	1 809
Income[1]	**134**	155
Adjusted equity	**395**	342
Number of employees	**1 896**	1 700

[1] Income before allocations and taxes

Linjeflyg's share of the Swedish domestic air travel market is approximately 60 percent. During the 1986/87 fiscal year 4 million passengers were transported, an 8-percent increase over a year earlier.

The aircraft fleet consists of 20 Fokker F28s. Linjeflyg's secondary routes are served with SAAB SF340s leased from Swedair.

To further improve its product, Linjeflyg, in cooperation with SAS, has begun development of a new booking system for Swedish domestic air travel. The system is expected to be gradually placed in operation in 1988.

Polygon Insurance Co. Ltd. (33%)

MSEK	**86/87**	85/86
Premiums, net	**130**	173
Income[1]	**36**	38
Adjusted equity	**149**	103

[1] Income before taxes

Polygon is owned one-third each by KLM, SAS and Swissair. Day-to-day administration is handled by Transglobe Underwriting Management Ltd.

The company has gradually developed an increasing presence in the world aviation insurance community, with a reputation founded on the quality of its ownership, sound underwriting and a strong balance sheet. Today it ranks among the major international aviation underwriters with approxi-

SAS INCOME AND EQUITY INCLUDING AFFILIATED COMPANIES

MSEK	Group excluding affiliated companies **86/87 15 mths**	85/86 12 mths	Affiliated company share[1] **86/87**	85/86	Group including affiliated companies **86/87 15 mths**	85/86 12 mths
Income before allocations and taxes	**1 698**	1 515	**85**	78	**1 783**	1 593
Untaxed reserves[2]	**436**	530	**143**	112	**579**	642
Equity	**6 039**	3 771	**171**	133	**6 210**	3 904
Adjusted equity	**6 475**	4 301	**314**	245	**6 789**	4 546
Book value of SAS shares in affiliated companies			**96**	84		

[1] Undistributed share; several small companies are not included in the figures.
[2] After standard 50 % tax.

mately 90 percent of its income derived from open market business. Polygon Insurance Company (UK) Ltd., the London-based subsidiary, was consolidated for the first time in December 1986 following a successful first year. The subsidiary provides the vehicle for expanding into the non-aviation insurance sector.

The decline in premium income during the year is a result of the lower value of the U.S. dollar.

Bennett Reisebureau A/S (31%)

MSEK	1987	1986
Revenue	**1494**	1483
Income[1]	**9**	15
Adjusted equity	**52**	43
Number of employees	**380**	396

[1] Income before allocations and taxes

The Bennett group of companies consists of the parent company, Bennett Reisebureau A/S in Norway, and three wholly owned subsidiaries in Denmark, France and the U.S. The group runs travel agency and inclusive-tour operations. Bennett is Norway's largest travel agent, with more than 60 sales outlets. It is one of the largest agents in Denmark as well.

Grønlandsfly A/S (25%)

MSEK	1987	1986
Revenue	**340**	260
Income[1]	**46**	22
Adjusted equity	**157**	120
Number of employees	**440**	405

[1] Income before taxes

This group consists of the parent company, Grønlandsfly A/S (Greenlandair), and three operating subsidiaries. Grønlandsfly primarily handles domestic air traffic in Greenland.

Travel Management Group Sweden AB (30%)

MSEK	1987	1986
Revenue	**3634**	3520
Income[1]	**3**	−3
Adjusted equity	**14**	15
Number of employees	**1113**	1146

[1] Income before allocations and taxes

Travel Management Group Sweden AB (TMG) includes the travel agent groups Resespecialisterna and Nyman & Schultz, as well as Globetrotter Tour Production, Scandinavian Express and the Swedish/Chinese Travel Agency.

In 1987 the two travel agent groups were merged under a common administration and management, Nyman & Schultz Resespecialisterna AB. In connection with this, the individual offices were converted to handle solely business travel.

During the autumn SAS and Nordstjernan sold 20 and 10 percent of their shares, respectively, in TMG to a consortium of fifty persons with upper management positions in TMG.

REPORT BY THE BOARD AND THE PRESIDENT*

October 1, 1986 – December 31, 1987

Effective January 1, 1988, the SAS Consortium and its subsidiaries will apply the calendar year as its fiscal year. This annual report covers a fifteen-month period beginning October 1, 1986 and ending December 31, 1987. The SAS Group submitted an interim report for the twelve-month period ended September 30, 1987, which corresponds to previous fiscal years. Unless otherwise specified, comparisons with previous years are made against the interim results.

Twelve-month figures are unaudited.

* *A translation of the Swedish original*

Summary

Growth in the international travel industry remained strong during the year. Economic activity was high in the U.S., Japan and Southeast Asia, while developments were dampened in Scandinavia and other parts of Europe towards the end of 1987. In general, demand for both business and vacation travel was high.

The competition intensified in all of the SAS Group's business areas as a result of increased overall capacity and the continued liberalization of the European airline industry. This, together with the greater interest of primarily American carriers in Scandinavia and Europe, led to downward pressure on fares and declining margins for most airlines. The American carriers also benefited from the low dollar. SAS's income was affected by its inability to raise fares on European routes.

Inflation in the Scandinavian countries continued to grow at a faster rate than in other Western countries. Consequently, the SAS Group's expenses rose more rapidly than those of its key competitors in the U.S. and Europe. Crude oil prices (quoted in U.S. dollars), which dropped sharply in 1986, rose again in 1987. This led to greater fuel costs for SAS Airline toward the end of the fiscal period.

During the year the SAS Group successfully continued its development of an integrated travel service for the business traveler. SAS Airline's route network was expanded with six new nonstop flights, as well as more frequent flights on other routes. Efforts at extending the cooperation between the airline and hotel operations continued. New SAS Hotels were inaugurated, and cooperation agreements were signed with other hotels within the framework of SAS Destination Service.

The first phase of the expansion and modernization of Copenhagen's airport was concluded during the summer. Together with the Danish aviation authorities, the SAS Group has helped create one of Europe's most attractive airports – an important element in the development of the traffic system. SAS Service Partner operates the airport's restaurants and bars. SAS also has an active role in providing goods for the airport's tax-free shops.

Negotiations with Thai Airways International resulted in a cooperation agreement in October 1987. The arrangement involves the integration of activities between the companies and includes the expansion of service from the airports in Bangkok and Copenhagen to important destinations.

During the autumn of 1987, after clearing a number of legal hurdles in the U.K., SAS made an offer to the shareholders of British Caledonian to purchase a minority shareholding in that company. British Airways, which had offered to take over all shares in British Caledonian, then raised its bid. For business reasons, SAS decided to withdraw from further bidding. SAS's handling of this situation received a great deal of public attention and was well received, further strengthening the company's international reputation.

During the year in review, SAS began development of a new travel-services information and distribution system (Amadeus), in cooperation with Air France, Iberia and Lufthansa.

The growth in traffic and focus on service in recent years have required greater resources and capacity. Along with the Group's continued growth has come a higher cost level, while the increasing volume has not yet yielded the benefits of economies of scale in terms of expenses.

The SAS Group's operating revenue for the period October 1, 1986 to

December 31, 1987 amounted to 29,924 MSEK, of which 23,870 MSEK (21,585) was generated during the twelve-month period ended September 30, 1987.

The Group's income before allocations and taxes amounted to 1,698 MSEK for the period October 1, 1986 to December 31, 1987. The corresponding figure for the twelve-month period ended September 30, 1987 was 1,663 MSEK (1,515). The level of income during the fifth fiscal quarter was weak.

Income before depreciation amounted to 2,517 MSEK for the full fiscal year. Continued expansion of the aircraft fleet, along with other investments in hotels, restaurants and flight kitchens, resulted in greater depreciation expense. The sale of aircraft, hotels, etc. yielded gains of 394 MSEK. Since the sale of fixed assets related to operations are being made as part of SAS's continued development and partly entail "reversals of depreciation," gains on these sales are reported as a separate item in the statement of income. The Group's net interest income improved partly due to a capital infusion of 1,050 MSEK made by the SAS parent companies during the year.

Revenue, income and key ratios of the SAS Group are shown in the table below.

SAS Airline noted continued growth in Europe and Scandinavia. Following slight improvements during the first four quarters, the income trend weakened toward the end of 1987. This decline is largely attributable to the restrictive position of the Scandinavian authorities, who have not allowed fare increases for quite some time; consequently, SAS has not been able to compensate for rising costs. An action plan has been adopted in the Airline to reduce costs without reducing service and quality.

SAS International Hotels is now investing considerably in new hotels at important SAS destinations, as part of the development of the Group's integrated travel service chain. Income of SAS International Hotels was affected by increased capital costs for new hotels and continued fierce competition stemming from other, newly established hotels.

SAS Service Partner reported a substantial increase in income, primarily from its international airport restaurants and offshore operations. Growth of

SAS GROUP INCOME AND KEY RATIOS

MSEK	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
Revenue	**29924**	23870	21585
Operating income before depreciation	**2517**	2346	2216
Depreciation	**−1380**	−1126	−863
Gain on the sale of equipment, etc.	**394**	313	34
Financial items, net	**167**	130	128
Extraordinary items	**–**	–	–
Income before allocations and taxes	**1698**	1663	1515
Investments	**3493**	2660	4128
Return on capital employed, %	**–**[1]	16	22
Share of risk-bearing capital, %	**35**	36	29
Average number of employees	**34463**	34207	31775

[1] Not relevant for 15-month period.

scheduled air traffic contributed to high capacity utilization.

Operating in a very positive market, **Vingresor** strengthened its position as the leading inclusive-tour operator in Scandinavia. Vingresor's income improved during the first four quarters, but deteriorated toward the end of the fifteen month period as a result of seasonal variations and increased jet fuel costs.

Development costs for information and distribution systems, as well as income from other businesses, are included among **Other Units and Projects.**

SAS Airline

Compared with the previous fiscal year (October-September), SAS's total passenger traffic rose by 4 percent, with an unchanged production level. This trend was similar throughout the remainder of 1987.

The average cabin factor improved to 68.9 percent (66.2). As of September 1987 the total number of passengers who flew with SAS rose by 7 percent to 12.5 million. The number of passengers for the full fifteen-month period in 1986/87 amounted to 15.7 million.

Intercontinental traffic was characterized by continued fierce competition, especially on North Atlantic routes. The earlier decision to change over from Boeing 747s to DC-10s led to an improved cabin factor.

During the autumn SAS began weekly service between Copenhagen and Tokyo, flying nonstop over the Soviet Union. This new route is the shortest connection between Europe and Japan. Also during the autumn, SAS became the first airline to offer daily service between Bangkok and Europe.

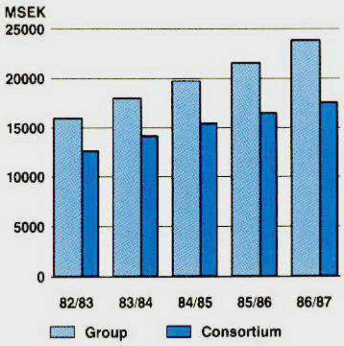
SAS's *European traffic* developed favorably. The percentage of full-fare passengers continued to increase, though not quite as rapidly as a year earlier. SAS still has the highest percentage of full-fare passengers of any European airline. New, discount-fare alternatives contributed to high capacity utilization.

The traffic program was expanded with additional nonstop routes and more frequent flights to major destinations. Service for business travelers was improved with the addition of EuroClass lounges at several airports.

A number of new DC-9-80 aircraft with greater capacity were introduced in *Danish domestic traffic*, resulting in a further increase in the percentage of business travelers. Certain flights to Greenland were transferred as planned to Grønlandsfly A/S (Greenlandair).

In *Norway*, parallel concessions were initiated during the year between SAS and Braathens SAFE; as a result,

REVENUE*



* 12-month figures, Oct. - Sept.

REVENUE BY BUSINESS AREA

MSEK	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
SAS Airline	**21953**	17510	16483
SAS International Hotels	**1564**	1230	1083
SAS Service Partner	**4063**	3223	2712
Vingresor	**2935**	2379	1897
Other units and projects	**976**	730	427
Joint Group costs	**–**	–	–
Group eliminations	**–1567**	–1202	–1017
SAS Group	**29924**	23870	21585

both companies now compete on the Oslo-Bergen, Oslo-Stavanger and Oslo-Trondheim routes. Due to a somewhat sluggish market, SAS's overall traffic production was cut, leading to high capacity utilization.

Domestic traffic in *Sweden* was once again hit with problems, this time from a conflict between air traffic controllers and the Swedish Civil Aviation Administration. Greater opportunities for advanced training and a new labor agreement are expected to provide a lasting resolution to this conflict.

During the year five new DC-9-80s, two DC-10-30s, two DC-8-63s and two DC-9-51s were delivered. SAS's three Airbus planes and a Boeing 747 were sold during the fiscal period. Six DC-8-63s were transferred during the autumn to the sister consortium Scanair.

Toward the end of the year it was decided to make the intercontinental route network more competitive with the addition of more frequent nonstop flights. Consequently, the Airline decided to make new investments in its long-distance fleet. The choice came to two versions of the Boeing 767, a twin-engine plane with 150 and 200 seats, respectively, and a range that is well suited to the planned route network. The order calls for nine aircraft with an option to purchase an additional fifteen. Deliveries will begin in spring 1989. The total investment for the first nine planes is estimated at approximately SEK 4 billion.

As per December 31, 1987, twenty-seven aircraft were on order for delivery in the coming years. Among these are a DC-9-80 ordered during the past year and the nine Boeing 767s mentioned above.

A breakdown of the aircraft fleet at year-end 1987 is provided in a table on p. 39.

SAS's rapid expansion during the 1980s, together with increased retirement-related vacancies, is requiring greater pilot recruiting measures. Newly started civilian training courses in Denmark, Norway and Sweden will not sufficiently fulfill SAS's needs in the short term. Cooperation was therefore initiated during the year with a number of flight schools in the U.S.

SAS Airline's operating revenue amounted to 21,953 MSEK. The corresponding figure for the twelve-month period ended September 30, 1987 was 17,510 MSEK (16,483), an increase of 6 percent.

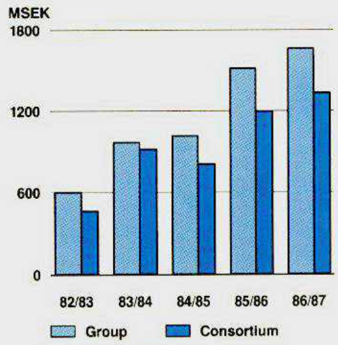
Of the increase during the twelve-month interim period, 5 percent was volume-related. Fare growth was weak, rising one percentage point.

No increases in full-fares were approved for SAS's European traffic originating from Scandinavia during

INCOME BY BUSINESS AREA

MSEK	86/87 15 mths	86/87 12 mths	85/86 12 mths
SAS Airline	**1586**	1453	1305
SAS International Hotels	**63**	73	69
SAS Service Partner	**202**	180	123
Vingresor	**106**	141	133
Other units and projects	**−128**	−99	−28
Joint Group costs	**− 88**	−44	−69
Group eliminations	**− 43**	−41	−18
Income before extraordinary items	**1698**	1663	1515

INCOME BEFORE ALLOCATIONS AND TAXES*

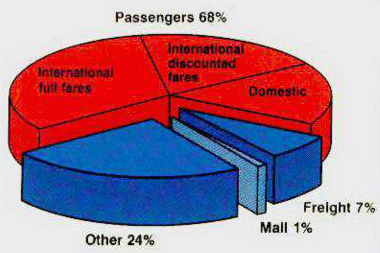


* 12-month figures, Oct. - Sept.

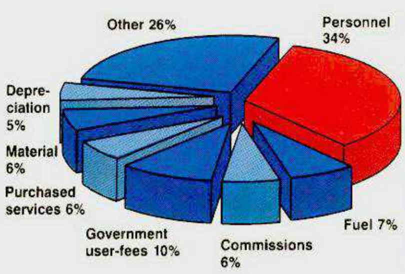
TOTAL PRODUCTION AND TRAFFIC

	AVAILABLE TONNE-KILOMETERS			REVENUE TONNE-KILOMETERS			LOAD FACTOR	
12 months	Million	Change %	Share %	Million	Change %	Share %	%	Change % pts.
North & South Atlantic	878	−9	37	651	−2	41	74.2	5.4
Asia, Africa	314	−9	13	232	−3	15	73.9	4.6
INTERCONTINENTAL	1 192	−9	50	883	−3	56	74.1	5.1
EUROPE (incl. Middle East)	780	10	32	409	8	26	52.4	−1.2
DOMESTIC	439	3	18	280	7	18	63.8	2.8
TOTAL NETWORK	2411	−2	100	1 572	2	100	65.2	2.0

CONSORTIUM REVENUE



CONSORTIUM TOTAL OPERATING EXPENSES



1987. For intra-Scandinavian traffic, the authorities have not allowed fare increases for two and a half years. Fare increases on domestic routes have also been restrained and have not compensated for inflation. On North Atlantic routes, fare increases have been offset by the weaker U.S. dollar. Finally, on SAS's intercontinental network, fares for the important high-volume tourist segment have decreased in response to intense competition.

In general, cost increases have been greater in Scandinavia than in the countries of SAS's most significant competitors. Personnel costs, government user-fees and other operating expenses rose more rapidly than inflation during the year. As of summer 1987, these costs were no longer offset by lower fuel prices as in the previous year.

Fuel costs, which accounted for 7 percent of the Airline's total operating expenses during the year (excluding depreciation), developed favorably up until the summer, after which time they began to drift upward due to price increases.

In total, operating expenses amounted to 19,807 MSEK, of which 15,575 MSEK (14,583) was incurred during the first twelve months of the year.

Income before depreciation totaled 2,146 MSEK for the full year. Income for the twelve-month period ended September 30, 1987 amounted to 1,935 MSEK (1,900). Depreciation rose to 1,060 MSEK for the full fifteen-month period. Sales of aircraft, etc. yielded a gain of 354 MSEK. The balance of financial income and expense amounted to a surplus of 146 MSEK.

Income before extraordinary items amounted to 1,586 MSEK. The coresponding figure for the twelve-month interim period ended September 30, 1987 was 1,453 MSEK (1,305).

A long-term gross profit margin of 13 percent is necessary to enable modernization and expansion of the aircraft fleet, investments in traffic systems and information and distribution systems. An action plan has been adopted in the Airline to reduce costs without jeopardizing service and quality.

SAS International Hotels

Conditions in the hotel market varied in the locations where SAS International Hotels operates. The market was favorable in Denmark and Sweden, with the exception of Gothenburg, where the competition intensified with the addition of new competitors. Demand in Norway remained weak.

PASSENGER, FREIGHT AND MAIL TRAFFIC

	PASSENGERS		CABIN FACTOR		FREIGHT		MAIL	
12 months	Pass. km	Change %	%	Change % pts.	Tonne km	Change %	Tonne km	Change %
North & South Atlantic	4168	1	75.9	8.4	258.8	−5	15.5	−12
Asia, Africa	1494	−4	74.6	5.3	85.7	2	10.7	−22
INTERCONTINENTAL	5662	0	75.5	7.5	344.5	−3	26.2	−17
EUROPE	4330	8	61.4	−1.3	26.3	11	13.8	9
Denmark	429	−3	70.0	1.8	3.2	−3	2.8	−7
Norway	1206	7	69.2	2.5	8.0	−5	5.3	2
Sweden	1322	12	69.6	0.9	3.9	22	0.9	−69
DOMESTIC	2957	7	69.5	1.7	15.1	1	9.0	−20
TOTAL NETWORK	12949	4	68.9	2.7	385.9	−2	49.0	−11

Consistent product and price differentiation, investments in travel services integrated with those of the Airline, and stepped-up marketing enabled continued improvement in room rates. In total, the average occupancy rate rose to 71.2 (68.7) percent during the twelve-month interim period.

Revenue amounted to 1,564 MSEK, of which 1,230 MSEK (1,083) pertains to the first twelve months of the fiscal year. A large part of this increase can be attributed to the newly acquired Strand Hotel in Stockholm, and the Royal Hotel in Stavanger.

Income before extraordinary items totaled 63 MSEK. Income for the first twelve months amounted to 73 MSEK (69). The decline is chiefly the result of seasonal variations, substantial marketing outlays in a lagging market, and expenses connected to new hotel projects.

Planned hotel investments in Brussels and Amsterdam are proceeding on schedule. In April 1987 a new hotel was opened in Stavanger, while in Stockholm, the Strand Hotel came under SAS's management in October 1986. In addition, participation in a joint venture was finalized in a contract for the construction and operation of the SAS Grand Hotel in Beijing.

SAS Service Partner

Increased charter and scheduled airline traffic have resulted in continued market growth. Intensive work on products, service and new concepts has contributed to greater demand for SAS Service Partner's products and services.

As an element in the newly established cooperation with the American catering company Dobbs, SAS Service Partner and Dobbs merged their operations at O'Hare Airport in Chicago. In addition, SAS Service Partner took over all restaurant operations at Palma de Mallorca's airport and at the Barbican Centre in London. A contract was also signed for the operation of restaurants in the Stockholm Globe Arena, a major sports and cultural center that will be inaugurated in 1989. In Denmark, agreements were reached for the operation of twelve staff canteens. Hospital catering achieved a breakthrough in the market through agreements with a number of Scandinavian hospitals. SAS Service Partner has also actively contributed to the major success of Copenhagen's airport. Toward the end of the year, Service Partner took over Catering Service Gesellschaft, a company with several flight kitchens in West Germany.

Revenue amounted to 4,063 MSEK during the full fiscal year, of which 3,223 MSEK (2,712) was generated in the first twelve months.

Income before extraordinary items amounted to 202 MSEK, of which 180 MSEK (123) applies to the first twelve months. The improvement is attributable to a correct market and customer orientation, continued consolidation of operations, implementation of efficiency-improvement measures and high capacity utilization.

Vingresor

The leisure market showed strong growth in both Norway and Sweden. The total number of Vingresor customers rose by 19 percent to more than 700,000 during the first twelve months; the corresponding figure for the full fiscal year was 845,000. The strong growth in volume has required substantial investment outlays, but has also facilitated further improvements in operating efficiency. Vingresor has improved its standing through the development of integrated service concepts in the form of Sunwings and Ving Centers. Simultaneously, Vingresor's market share has risen to 35 percent (34).

In order to capitalize on the opportunities in the expanding charter market in Spain, as well as to secure its future capacity, Vingresor bought a 25-percent stake in Spanair S.A., a new charter airline in Spain.

Construction of a Sunwing facility was completed in Arguineguin in the southern part of Gran Canaria during the year, while on Rhodes, a Club/33 conference hotel was also finished. Capacity at the Sunwing on Crete was doubled to more than 700.

Revenue amounted to 2,935 MSEK, of which 2,379 MSEK (1,897) was generated during the first twelve months.

Income before extraordinary items totaled 106 MSEK. Income during the first four quarters was reported at 141 MSEK (133). The lower results during the fifth quarter are the result of seasonal variations and higher fuel prices.

Other Units and Projects

A decision was made during the year to develop and operate a new information and distribution system for the 1990s (Amadeus). This work will be done by a special company in cooperation with Air France, Iberia and Lufthansa. The system is based on the American "System One," which is being adapted to the international market's needs and to the latest advancements in communications and computer technology.

Payments of travel services are increasingly being made with charge cards. Expansion of the Diners Club network is a step in the implementation of the SAS Group's distribution strategy.

For the Diners Club operations in the Nordic countries, the fiscal year was marked by problems created by new legislation in Denmark and Norway which prohibits international credit card companies from charging commissions on credit card payments made in the holders' own countries. Steps are being taken at Diners Club to counter the negative effects of this legislation. Parallel with its focus on new products, Diners Club acquired Danish Tax-Free Shopping, a company that arranges the repayment of value-added taxes for purchases made by non-Nordic residents in the Nordic countries.

The Air de Cologne cargo operations were discontinued in 1988.

A joint Group finance operation was formed during the year and became a business area on January 1, 1988.

SAS Trading (formerly External Enterprises in SAS Airline) was reorganized into a business area of the Group on January 1, 1988, with the purpose of developing and conducting businesses related to flights.

Affiliated Companies

Aside from the SAS Consortium and its subsidiaries, the SAS Group includes a number of affiliated companies (defined as companies in which SAS's ownership is between 20 and 50 percent). See note 14.

In addition to the consolidated income before allocations and taxes, which totaled 1,698 MSEK, SAS's share of the year's income retained in affiliated companies 85 MSEK (78).

The SAS Group's share of its affiliated companies' adjusted equity, after a 50% standard tax on untaxed reserves, amounted to 314 MSEK (245) on December 31, 1987.

SAS Airline's income includes share of income from Københavns Lufthavns Forretningscenter K/S.

The book value of shares in affiliated companies reported by the SAS Consortium amounted to 96 MSEK.

Profitability and Equity Ratio

The SAS Group's total pretax return on capital employed for the twelve-month period ended September 30, 1987 amounted to 16 percent (22).

The ratio of risk-bearing capital rose from 29 percent to 35 percent as of December 31, 1987. A capital contribution from the SAS parent companies accounted for 4 percentage points of this increase.

Investments

The SAS Group's investments amounted to 3,493 MSEK during the period, of which the SAS Airline accounted for 2,446 MSEK, SAS International Hotels for 212 MSEK, SAS Service Partner for 159 MSEK, and Vingresor for 200 MSEK. Investments in aircraft and other flight equipment totaled 1,694 MSEK. Other investments include SAS's new head offices, which were occupied in the beginning of 1988.

Financing and Liquidity

Net financing from the SAS Group's operations, after transfers of 350 MSEK to the parent companies, amounted to 2,559 MSEK.

A financing surplus of 131 MSEK was retained for the fifteen-month period, after net investments totaling 2,428 MSEK. As of March 1, 1987 the parent companies had supplied an additional 1,050 MSEK to the capital account.

In addition to the refinancing of older loans through two long-term loans totaling JPY 14.5 billion on the Japanese private market, new borrowing was taken up through a two-year bond issue of USD 100 million on the Eurobond market.

The SAS Group's liquid funds amounted to 5,107 MSEK on December 31, 1987 – an increase of 1,525 MSEK from September 30, 1986.

The Group's balance of financial income and expense amounted to a net surplus of 167 MSEK, of which 130 MSEK (128) pertains to the twelve-month interim period. As a result of lower gains from the sale of bonds and interest-rate swaps, net interest income was lower than in 1985/86.

The Group's favorable exchange rate outcome is primarily atributable to the falling U.S. dollar. Starting in 1986/87, unrealized currency losses on long-term debts have been offset by 126 MSEK against unrealized currency gains on loans. A surplus of unrealized currency gains increased the foreign exchange reserve by 136 MSEK to 364 MSEK during the fiscal year.

In a rating performed by the Japanese firm Nippon Investors Service, SAS received very high marks for both

THE FLEET

As per 12-31-87 Aircraft type	Owned	Leased	Total	Leased out	On order
Boeing 767					9
Boeing 747		2	2	1 [1]	
Douglas DC-10-30	11		11		
Douglas DC-8-63	2		2	1 [2]	
Douglas DC-9-81	8		8		2
Douglas DC-9-82	8		8		4
Douglas DC-9-83	1		1		1
Douglas DC-9-87					9
Douglas DC-9-21	9		9		
Douglas DC-9-33	2		2		
Douglas DC-9-41	48		48		
Douglas DC-9-51	2		2	1 [3]	2
Fokker F27	9		9		
	100	2	102	3	27

[1] Leased to GPA Group Ltd.
[2] Leased to Scanair.
[3] Leased to Hawaiian Airlines.

PERSONNEL*

	SAS CONSORTIUM		SUBSIDIARIES		SAS GROUP	
	86/87	85/86	**86/87**	85/86	**86/87**	85/86
DENMARK	**7073**	7059	**2151**	2173	**9224**	9232
NORWAY	**4605**	4273	**3549**	3675	**8154**	7948
SWEDEN	**6825**	6344	**2860**	2639	**9685**	8983
ABROAD	**1962**	2097	**5182**	3515	**7144**	5612
TOTAL	**20465**	19773	**13742**	12002	**34207**	31775

* 12-month period Oct.-Sept.

short- and long-term borrowing. This rating will facilitate future international borrowing.

Personnel and Payroll Expenses

The average number of employees in the SAS Group during the year was 34,463 (31,775), of whom 20,479 were employed in SAS Airline, 3,446 in SAS International Hotels, 7,344 in SAS Service Partner, and 2,341 in Vingresor.

The Group's total payroll, including payroll-related costs, was 9,886 MSEK. This can be compared with 6,771 MSEK for the 1985/86 fiscal year. Corresponding costs for the Consortium amounted to 7,273 MSEK (5,016).

The SAS Consortium

The SAS Consortium comprises the Group management, SAS Finance, SAS Airline and Group-wide projects.

The Consortium's revenue amounted to 22,020 MSEK. Income before allocations and taxes totaled 1,376 MSEK of which 1,331 MSEK (1,197) was attributable to the twelve-month interim period. Net financial items, totaling 193 MSEK, include dividends from subsidiaries in the amount of 37 MSEK.

Allocation of Income and Equity

Allocations are made by SAS's parent companies: DDL in Denmark, DNL in Norway, and ABA in Sweden, all of which also pay taxes in their respective countries on their share of SAS's income.

The Board of Directors and the President propose to the SAS Assembly of Representatives that of the Consortium's surplus for the fiscal year, 490 MSEK be paid to the parent companies (350 MSEK was transferred in 1985/86) and that the remaining amount, 886 MSEK (847), be transferred to the Consortium's capital account, which will thereafter total 5,162 MSEK (3,123).

Forecast 1988

In 1988, production efforts at SAS Airline will be significantly boosted along with measures already taken to improve cost-effectiveness. Income after depreciation and financial items is expected to remain level with 1986/87.

The income and financial position of the SAS Group and the SAS Consortium for the 1986/87 fiscal year are shown in the following financial statements and notes, as integral parts of this report.

Copenhagen, Stockholm and Oslo, March 21, 1988

HALDOR TOPSØE	CURT NICOLIN	TOR MOURSUND
KAJ IKAST	KRISTER WICKMAN	BJØRN EIDEM
CLAUS LINDEGAARD	RALF FRICK	INGVAR LILLETUN

JAN CARLZON
President and Chief
Executive Officer

SAS GROUP CONSOLIDATED STATEMENT OF INCOME

MSEK	**Oct. 1-Dec. 31 86/87 15 mths**	Oct. 1-Sept. 30 86/87[1] 12 mths	Oct. 1-Sept. 30 85/86 12 mths
Traffic revenue – Note 1	**17760**	14152	13456
Other operating revenue – Note 2	**12164**	9718	8129
OPERATING REVENUE	**29924**	23870	21585
Operating expense	**27407**	21524	19369
OPERATING INCOME BEFORE DEPRECIATION	**2517**	2346	2216
Depreciation – Note 3	**1380**	1126	863
OPERATING INCOME AFTER DEPRECIATION	**1137**	1220	1353
Gain on the sale of equipment, etc. – Note 4	**394**	313	34
Dividend income – Note 5	**10**	10	8
Interest income, net – Note 6	**84**	56	113
Other financial items – Note 7	**73**	64	7
INCOME BEFORE EXTRAORDINARY INCOME AND EXPENSE	**1698**	1663	1515
Extraordinary income and expense	**–**	–	–
INCOME BEFORE ALLOCATIONS AND TAXES	**1698**	1663	1515
Allocations in the subsidiaries, net – Note 8	**–155**	–[2]	–84
INCOME BEFORE SUBSIDIARIES' TAXES	**1543**	–	1431
Taxes payable by subsidiaries – Note 9	**–100**	–	–105
Minority interests	**2**	–	1
INCOME BEFORE TAXES RELATING TO THE CONSORTIUM[3]	**1445**	–	1327

[1] Not audited by SAS auditors.
[2] Allocations and taxes not applicable to 12-month interim figures.
[3] Taxes payable by its parent companies in Denmark, Norway and Sweden.

SAS GROUP CONSOLIDATED BALANCE SHEET

MSEK ASSETS	Dec. 31 1987	Sept. 30 1986
CURRENT ASSETS		
Liquid funds – Note 10	**5 107**	3 582
Accounts receivable – Note 11	**2 396**	2 614
Prepaid expense and accrued income	**693**	582
Other accounts receivable	**1 005**	823
Expendable spare parts and inventory – Note 12	**517**	433
Prepayments to suppliers	**81**	78
Total current assets	**9 799**	8 112
NON-CURRENT ASSETS		
Restricted accounts – Note 13	**36**	34
Stocks and participations	**155**	137
Bonds and other securities	**50**	50
Other long-term accounts receivable	**266**	199
Goodwill and capitalized development costs – Note 15	**104**	95
Long-term prepayments to suppliers – Note 17	**455**	450
Fixed assets – Note 18		
Construction in progress	**723**	238
Aircraft	**4 731**	4 711
Spare engines and spare parts	**394**	476
Maintenance and aircraft servicing equipment	**148**	117
Other equipment and vehicles	**1 381**	1 165
Buildings and improvements	**1 118**	943
Land and improvements	**220**	154
Total non-current assets	**9 781**	8 769
TOTAL ASSETS	**19 580**	16 881
ASSETS PLEDGED, ETC. – Note 26	**567**	734

MSEK LIABILITIES AND EQUITY	Dec. 31 1987	Sept. 30 1986
CURRENT LIABILITIES		
Accounts payable	**1 003**	1 055
Taxes payable – Note 9	**85**	100
Accrued expense and prepaid income	**2 267**	2 028
Unearned transportation revenue, net – Note 19	**1 180**	1 364
Current portion of long-term debt	**265**	548
Other current liabilities – Note 20	**1 673**	1 323
Prepayments from customers	**379**	311
Total current liabilities	**6 852**	6 729
LONG-TERM DEBT		
Bond loans – Note 21	**3 242**	2 751
Other loans – Note 22	**1 328**	1 495
Other long-term debt	**263**	160
Provision for pension liabilities – Note 23	**65**	57
Total long-term debt	**4 898**	4 463
SUBORDINATED DEBENTURE LOAN – Note 24	**904**	843
MINORITY INTEREST	**15**	16
RESERVES – Note 8	**872**	1 059
EQUITY – Note 25		
Capital	**4 276**	2 276
Legal reserve	**99**	64
Revaluation reserve	**17**	20
Retained earnings	**202**	84
Net income for the period	**1 445**	1 327
Total equity	**6 039**	3 771
TOTAL LIABILITIES AND EQUITY	**19 580**	16 881
CONTINGENT LIABILITIES – Note 27	**410**	296

SAS CONSORTIUM STATEMENT OF INCOME

MSEK	**Oct. 1-Dec. 31 86/87 15 mths**	Oct. 1-Sept. 30 86/87[1] 12 mths	Oct. 1-Sept. 30 85/86 12 mths
Traffic revenue – Note 1	**17592**	14032	13456
Other operating revenue – Note 2	**4428**	3539	3039
OPERATING REVENUE	**22020**	17571	16495
Operating expense	**20118**	15818	14723
OPERATING INCOME BEFORE DEPRECIATIION	**1902**	1753	1772
Depreciation – Note 3	**1060**	874	690
OPERATING INCOME AFTER DEPRECIATION	**842**	879	1082
Gain on the sale of equipment, etc. – Note 4	**341**	286	–10
Dividend income – Note 5	**47**	47	30
Interest income, net – Note 6	**78**	59	115
Other financial items – Note 7	**68**	60	–20
INCOME BEFORE EXTRAORDINARY INCOME AND EXPENSE	**1376**	1331	1197
Extraordinary income and expense	**–**	–	–
INCOME BEFORE ALLOCATIONS AND TAXES[2]	**1376**	1331	1197

[1] Not audited by SAS auditors.
[2] Allocations are made and taxes payable by the parent companies.

SAS CONSORTIUM BALANCE SHEET

MSEK ASSETS	Dec. 31 1987	Sept. 30 1986
CURRENT ASSETS		
Liquid funds – Note 10	**3965**	2551
Due from subsidiaries	**177**	91
Accounts receivable – Note 11	**1396**	1786
Prepaid expense and accrued income	**603**	481
Other accounts receivable	**740**	672
Expendable spare parts and inventory – Note 12	**341**	286
Prepayments to suppliers	**16**	12
Total current assets	**7238**	5879
NON-CURRENT ASSETS		
Stocks and participations in subsidiaries – Note 14	**326**	333
Other stocks and participations – Note 14	**127**	114
Bonds and other securities	**8**	9
Long-term accounts receivable, subsidiaries – Note 16	**325**	190
Other long-term accounts receivable	**177**	142
Long-term prepayments to suppliers – Note 17	**455**	450
Fixed assets – Note 18		
Construction in progress	**615**	150
Aircraft	**4731**	4711
Spare engines and spare parts	**394**	476
Maintenance and aircraft servicing equipment	**148**	117
Other equipment and vehicles	**719**	626
Buildings and improvements	**292**	263
Land and improvements	**57**	51
Total non-current assets	**8374**	7632
TOTAL ASSETS	**15612**	13511
ASSETS PLEDGED, ETC. – Note 26	**29**	26

MSEK LIABILITIES AND EQUITY	Dec. 31 1987	Sept. 30 1986
CURRENT LIABILITIES		
Accounts payable, subsidiaries	**186**	84
Accounts payable, suppliers	**597**	673
Accrued expense and prepaid income	**1814**	1669
Unearned transportation revenue, net – Note 19	**1180**	1364
Current portion of long-term debt	**55**	362
Other current liabilities – Note 20	**802**	631
Prepayments from customers	**7**	13
Total current liabilities	**4641**	4796
LONG-TERM DEBT		
Bond loans – Note 21	**3242**	2751
Other loans – Note 22	**696**	849
Other long-term debt	**112**	103
Total long-term debt	**4050**	3703
SUBORDINATED DEBENTURE LOAN – Note 24	**904**	843
RESERVES – Note 8	**365**	696
EQUITY – Note 25		
Capital		
DDL	**1222**	650
DNL	**1222**	650
ABA	**1832**	976
Total capital	**4276**	2276
Net income for the period	**1376**	1197
Total equity	**5652**	3473
TOTAL LIABILITIES AND EQUITY	**15612**	13511
CONTINGENT LIABILITIES – Note 27	**535**	509

STATEMENTS OF CHANGES IN FINANCIAL POSITION

MSEK	SAS Group **Oct. 1-Dec. 31 86/87 15 mths**	 Oct. 1-Sept. 30 85/86 12 mths	SAS Consortium **Oct. 1-Dec. 31 86/87 15 mths**	 Oct. 1-Sept. 30 85/86 12 mths
THE YEAR'S OPERATIONS				
Income before allocations and taxes	**1698**	1515	**1376**	1197
Depreciation	**1380**	863	**1060**	690
Gain on the sale of equipment, etc.	**−394**	−30	**−341**	–
Other – net	**−33**	−143	**67**	19
Subtotal	**2651**	2205	**2162**	1906
Payments made to the parent companies	**−350**	−280	**−350**	−280
Funds provided by the year's operations	**2301**	1925	**1812**	1626
Increase in				
inventories (−)	**−54**	−20	**−25**	15
current receivables (−)	**−95**	−569	**110**	−403
current liabilities (+)	**407**	289	**152**	93
Change in working capital	**258**	−300	**237**	−295
Net financing from the year's operations	**2559**	1625	**2049**	1331
INVESTMENTS				
Aircraft	**−1539**	−2731	**−1539**	−2731
Spare parts	**−155**	−230	**−155**	−230
Buildings, improvements and other equipment	**−1770**	−1149	**−1068**	−655
Stocks and participations	**−29**	−18	**−32**	−117
Total investments	**−3493**	−4128	**−2794**	−3733
Change in advance payments for flight equipment, increase (−), decrease (+)	**−5**	365	**−5**	365
Sale of equipment, etc.	**1070**	45	**1013**	–
Net investments	**−2428**	−3718	**−1786**	−3368
Financing surplus/deficit	**131**	−2093	**263**	−2037
EXTERNAL FINANCING				
Long-term receivables, net	**−107**	−9	**−170**	−75
Repayment of long-term debt	**−1594**	−867	**−1273**	−787
Borrowings	**2040**	2869	**1544**	2611
Capital infusion from parent companies	**1050**	–	**1050**	–
Change in minority interest	**5**	6	**–**	–
External financing, net	**1394**	1999	**1151**	1749
INCREASE IN LIQUID FUNDS (Cash, bank balances and short-term investments)	**1525**	−94	**1414**	−288
Liquid funds at beginning of the year	**3582**	3676	**2551**	2839
Liquid funds at year-end	**5107**	3582	**3965**	2551

NOTES TO THE FINANCIAL STATEMENTS

SIGNIFICANT VALUATION AND ACCOUNTING PRINCIPLES

Principles of consolidation

SAS's parent companies decided to change the Group's fiscal period to conform to the calendar year. As a result, the 1986/87 fiscal year of the SAS Consortium and the SAS Group, which normally would have ended on September 30, 1987, was extended to December 31, 1987, thus covering a period of 15 months. Consequently, the fiscal periods 1986/87 and 1985/86 cannot be accurately compared. To enable meaningful comparisons with 1985/86 and previous years, the Annual Report has been supplemented with the Consolidated Statement of Income and figures from the SAS Group's interim report for the twelve-month period October 1, 1986 to September 30, 1987. The interim report has not been audited by SAS auditors.

Unless stated otherwise, diagrams showing trends are based on figures for the twelve-month period.

The financial statements of the SAS Group are stated in millions of Swedish kronor (MSEK) unless otherwise indicated.

The consolidated financial statements of the SAS Group include the SAS Consortium, its wholly owned subsidiaries and those partly owned companies in which the Consortium has a controlling interest. Those wholly owned subsidiaries that are closely connected with the business of the Consortium are directly included in the accounts of the Consortium. For further information see Note 14, the specification of stocks and participations as of December 31, 1987.

The accounts of Scanair, another consortium owned by the parent companies of the SAS Consortium, are not included in the consolidated accounts of the SAS Group.

Equity accounting is not applied in the financial statements of the SAS Group, but shares in income and capital in SAS affiliated companies (where the ownership is between 20 and 50 percent) are reported separately in the Annual Report.

Companies acquired during the financial year are included in the Consolidated Statement of Income for the period during which they belonged to the SAS Group.

The consolidated financial statements are prepared in accordance with the purchase method of accounting, which means that taxed equity in the subsidiaries is included in the Group's equity only to the extent that it was earned after the date of acquisition. The equity in a subsidiary at the time of acquisition, including 50 percent of acquired untaxed reserves, is eliminated against the acquisition value of the corresponding stocks in the accounts of the Consortium.

The financial statements of subsidiaries in currencies other than Swedish kronor are, for the purposes of consolidation, translated into Swedish kronor using the current-rate method. Assets and liabilities are thus translated to Swedish kronor at year-end rates of exchange, while income for the year is translated at the average annual rate of exchange. SAS's share of such translation differences is transferred directly to the equity of the SAS Group. Translation differences relating to minority interest in subsidiaries are entered under the heading "Minority interest" in the Consolidated Balance Sheet.

Monetary assets and liabilities in currencies other than Swedish kronor

Monetary assets and liabilities in currencies other than Swedish kronor are translated at year-end market rates of exchange. When the rate of exchange on the payment date is secured by a forward contract, translation is carried out at the rate of exchange of the forward contract currency.

In cases where a loan has been the object of a currency-rate swap (where, in principle, interest expenses and repayments are paid in a currency other than the original one – a swap currency), the loan is stated after translation to the swap currency's year-end rate of exchange.

Effective 1986/87, unrealized exchange gains on long-term debt are offset against unrealized exchange losses on long-term debt. Excess losses are charged to income, while excess gains are credited to a foreign exchange account among reserves in the Balance Sheet.

Unrealized exchange gains on long-term receivables are reported as income to the extent in which they are offset by exchange losses on long-term loans arranged in the same currency. Other unrealized exchange gains on long-term receivables are credited to a foreign exchange account. Unrealized exchange losses are charged to income.

Unrealized currency gains that offset earlier unrealized currency losses are reported as income under exchange rate differences.

Prepayments in flight equipment are accounted for at the rate of exchange on the date of payment.

Unrealized exchange gains and losses on translations to Swedish kronor of foreign, short-term monetary assets and liabilities are credited/charged in full to income and reported as foreign exchange rate differences.

Exchange rates to SEK for some of SAS's prinicipal currencies are:

		Year-end rate		Average rate	
Currency		**Dec. 31 1987**	Sept. 30 1986	**1986/87 15 mths**	1985/86 12 mths
Denmark	DKK 100	**94.95**	90.50	**92.54**	85.70
Norway	NOK 100	**93.20**	94.05	**93.75**	98.94
USA	USD	**5.83**	6.91	**6.49**	7.40
Great Britain	GBP	**10.86**	9.98	**10.21**	10.83
Switzerland	CHF 100	**452.07**	421.40	**423.29**	383.00
West Germany	DEM 100	**366.10**	341.10	**350.61**	316.23
Japan	JPY 100	**4.74**	4.49	**4.36**	4.04
European Currency Unit	ECU	**7.55**	7.14	**7.28**	6.85

Expendable spare parts and inventory

Expendable spare parts and inventory are stated at the lower of cost or market value. An appropriate deduction for obsolescence has been made.

Expendable spare parts included under this heading comprise two-thirds of the total stock of such parts. The remaining one-third is reported and accounted for as fixed assets.

Fixed assets and depreciation

Fixed assets are stated in the Balance Sheet at cost less accumulated depreciation.

Flight equipment and other fixed assets are depreciated according to plan based on their estimated economic lives.

New flight equipment (aircraft and engines, including spare parts) is depreciated as follows:

Type of aircraft	Depreciation period	Residual value
Douglas DC−10	12 years	10%
Douglas DC−8	10 years	10%
Douglas DC−9−80	14 years	10%
Douglas DC−9	10 years	10%

Major modifications and improvements in fixed assets are capitalized and are depreciated over their estimated economic lives.

Maintenance and aircraft servicing equipment and other equipment and vehicles are depreciated over five years. The annual depreciation of buildings varies between 2 and 20 percent. Goodwill and development costs are amortized over 5 to 10 years.

Improvements to the Group's own and rented premises are, in principle, depreciated over their estimated useful lives.

Traffic revenue

Ticket sales are reported as traffic revenue only upon completion of the air travel in question.

The value of tickets sold but not yet used is reported as unearned transportation revenue among current liabilities. This item is reduced either when SAS or another airline completes the transportation or after the ticketholder has requested a refund.

A reserve against the unearned transportation revenue liability, based on statistical estimates, is assessed annually. This reserve corresponds to that portion of tickets sold that is estimated to remain unused.

In principle, the estimated reserve against the unearned transportation revenue liability at year-end is reported as revenue the following year.

Maintenance costs

Routine aircraft maintenance and repairs are charged to income as incurred.

Due to the structure of SAS's fleet, with a predominance of DC-9s, maintenance costs are spread relatively evenly over time. Thus, no provisions are made for future maintenance costs with respect to owned aircraft and other assets.

Extraordinary income and expense

Effective 1986/87, only items which have no clear connection with the Company's normal operations will be reported as extraordinary items. In addition, the nature of the items shall be such that they are not expected to occur frequently or regularly, or amount to substantial sums.

Gain on the sale of equipment, etc., is shown in the Statement of Income between income after depreciation and financial income and expense. Such items have a direct connection to the company's normal operations and often contribute to various financing operations. The extent of these items and their effect on income can vary considerably from year to year and is thereby reported separately, to allow an accurate assessment to be made of operating income.

Reclassifications

Certain items in the Statement of Income and the Balance Sheet were reclassified effective 1986/87. For the sake of comparison, the 1985/86 figures have been changed correspondingly.

International Accounting Standards, IAS

Effective 1988, international accounting practice, in conformance with the recommendations of the International Accounting Standards Committee, will be applied when preparing the SAS Group's financial reports.

Definitions of financial terms and ratios used in the Annual Report

Gross profit margin. Operating income before depreciation as a ratio of operating revenue.

Gross profit margin GOP. Operating income before depreciation and real estate costs (rental, insurance, tax) as a ratio of operating revenue. (Used by SAS International Hotels).

Net profit margin. Income before extraordinary items, but excluding gain on the sale of equipment, etc., as a ratio of operating revenue.

Pre-tax return on capital employed. Operating income after depreciation plus financial income as a ratio of average capital employed. Capital employed equals total assets less noninterest-bearing liabilities.

Ratio of risk-bearing capital. Equity plus untaxed reserves and minority interest as a ratio of total assets.

Net financing from operations. Funds provided internally including change in working capital.

Note 1 – Traffic revenue

SAS Consortium	86/87 15 mths	86/87 12 mths	85/86 12 mths
Traffic revenue:			
Passenger	**15113**	12080	11430
Freight	**1607**	1280	1501
Mail	**315**	241	291
Other	**557**	503	234
Total	**17592**	14032	13456

The SAS Group's traffic revenue also includes freight revenue from Air de Cologne in the amount of 168 MSEK.

Traffic revenue in 1986/87 includes a reversal of unnecessary reserve funds, totaling 201 MSEK, from the reserve under the unearned transportation revenue liability (see note 19).

Note 2 – Other operating revenue

Other operating revenue of the SAS Group includes 4,428 MSEK in the Consortium from inflight and airport sales, and leasing of excess capacity, among other things. Other operating revenue also includes 9,303 MSEK in subsidiaries. After group eliminations (1,567), other operating revenue totaled 12,164 MSEK.

Note 3 – Depreciation

SAS Group	86/87 15 mths	86/87 12 mths	85/86 12 mths
Goodwill and development costs	**18**	13	6
Aircraft	**573**	513	385
Spare engines and spare parts	**160**	106	81
Maintenance and aircraft servicing equipment	**48**	36	28
Other equipment and vehicles	**480**	379	287
Buildings and improvements	**101**	79	76
Total	**1380**	1126	863

SAS Consortium	86/87 15 mths	86/87 12 mths	85/86 12 mths
Aircraft	**573**	513	385
Spare engines and spare parts	**160**	106	81
Maintenance and aircraft servicing equipment	**48**	36	28
Other equipment and vehicles	**255**	198	162
Buildings and improvements	**24**	21	34
Total	**1060**	874	690

Based on a re-estimation of the economic lives of aircraft, the depreciation plan for two secondhand DC-10s purchased in 1986/87 was extended from 5 to 10 years. This reduced depreciation by 57 MSEK compared to the original plan. The aircraft will be sold in 1988 at prices in excess of their book value.

Note 4 – Gain on the sale of equipment, etc.

SAS Group	86/87 15 mths	86/87 12 mths	85/86 12 mths
Flight equipment	**351**	270	–
Hotel property	**21**	21	–
Buildings	**–**	–	29
Stocks	**13**	13	–
Other items	**9**	9	5
Total	**394**	313	34

SAS Consortium	86/87 15 mths	86/87 12 mths	85/86 12 mths
Flight equipment	**351**	270	–
Stocks	**–7**	13	–
Other items	**–3**	3	–10
Total	**341**	286	–10

Gain on the sale of equipment includes 12 MSEK from the sale of six DC-8s to the sister consortium Scanair. Capital gain on this sale has been eliminated in SAS's and Scanair's common parent companies. This item also includes a gain of 13 MSEK from the sale of stock in TMG in Sweden.

Figures for the Consortium include the intra-group sale of the stock in Olson & Wright. Other items include 4 MSEK for the writedown of stock in TMG Norway, plus a shareholder's contribution of 2 MSEK to Air de Cologne.

Note 5 – Dividends

SAS Consortium	86/87 15 mths	86/87 12 mths	85/86 12 mths
Dividends from:			
SAS Service Partner A/S	**13**	13	8
SAS International Hotels A/S	**14**	14	5
Vingresor AB	**10**	10	7
InterSAS BV	**–**	–	2
Dividends from subsidiaries	**37**	37	22
Dividends from Linjeflyg AB	**7**	7	5
Dividends from others	**3**	3	3
Total	**47**	47	30

Dividends from subsidiaries, approved by their respective annual meetings, represent distributions for the income of the fiscal years 1985/86 and 1984/85, respectively. Dividends are thus not anticipated in the Statement of Income.

Note 6 – Interest, net

SAS Group	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
Interest income	**882**	656	665
Interest expense	**−798**	−600	−552
Total	**84**	56	113

SAS Consortium	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
Interest from subsidiaries	**21**	17	10
Other interest income	**619**	483	531
Total interest income	**640**	500	541
Interest to subsidiaries	**−5**	−1	–
Other interest expense	**−557**	−440	−426
Total interest expense	**−562**	−441	−426
Total	**78**	59	115

Capital gains on disposals of bonds are reported as interest income and, for 1986/87 (15 months), amounted to 52 MSEK. The corresponding figure for 1986/87 (12 months) was 44 MSEK, compared with 90 MSEK in 1985/86. Cash received, totaling 61 MSEK, in connection with interest-rate swaps, were also reported as interest income in 1985/86. No corresponding payments were received in 1986/87.

Note 7 – Other financial items

SAS Group	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
Exchange rate gains on long-term debt	**116**	101	2
Other exchange differences	**−20**	−20	65
Exchange rate differences, net	**96**	81	67
Issue expenses on loans	**−10**	−10	−54
Other	**−13**	−7	−6
Subtotal	**−23**	−17	−60
Total	**73**	64	7

SAS Consortium	**86/87 15 mths**	86/87 12 mths	85/86 12 mths
Exchange rate gains/losses on long-term debt	**109**	96	−26
Other exchange differences	**−20**	−20	65
Exchange rate differences, net	**89**	76	39
Issue expenses on loans	**−10**	−10	−54
Other	**−11**	−6	−5
Subtotal	**−21**	−16	−59
Total	**68**	60	−20

For 1986/87 (15 months), unrealized exchange rate gains on long-term debt in the Consortium amounting to 126 MSEK were offset against unrealized exchange rate losses on long-term debt. The amount similarly offset in 1986/87 (12 months) was 6 MSEK and in 1985/86, 142 MSEK. On December 31, 1987 the foreign exchange reserve in the Consortium totaled 365 MSEK (see Note 8).

Note 8 – Reserves

SAS Group	Inventory reserve	Depreciation reserve, flight equipment	Foreign exchange reserve	Accumulated supplementary depreciation	Investment reserve	Other reserves	Total
Untaxed reserves, 30/9 -85	41	498	79	136	47	96	897
Allocations 85/86	4			18	24	34	80[3]
Other changes 85/86	−33	−25	149	3	−7	−5	82
Untaxed reserves, 30/9 -86	12	473	228	157	64	125	1059
Allocations 86/87	0			72	−6	82	148[3]
Other changes 86/87	0	−473[1]	136[2]	−6		8	−335
Untaxed reserves, 12/31/87	**12**	**–**	**364**	**223**	**58**	**215**	**872**

SAS Consortium	Inventory reserve	Depreciation reserve, flight equipment	Foreign exchange reserve	Accumulated supplementary depreciation	Investment reserve	Other reserves	Total
Untaxed reserves, 30/9 -85	33	498	78				609
Allocations 85/86		33	180				213
Reversals 85/86	−33	−58	−35				−126
Untaxed reserves, 30/9 -86		473	223				696
Allocations 86/87		8	328				336
Reversals 86/87[1]		−481[1]	−186[2]				−667
Untaxed reserves, 12/31/87		**–**	**365**				**365**

[1] Includes allocation of 103 MSEK on Sept. 30, 1986, for Airbus A300 aircraft. In connection with the sale of these aircraft in 1986/87, this reserve was dissolved and transferred directly to the Consortium's capital account (note 25). Sale of other aircraft have reduced the depreciation reserve by 137 MSEK, net. The remainder of this reserve has been transferred to accumulated depreciation of aircraft and spare parts (note 28).
[2] Of which 126 MSEK was offset against unrealized exchange rate gains on long-term debt.
[3] Allocations include transfer of 7 MSEK (4) to pension premium reserve in 1986/87, reported among Other Current Liabilities.

Note 9 – Subsidiaries' taxes
The Statement of Income and Balance Sheet of the SAS Group includes only taxes payable by subsidiaries, since the tax liability in Denmark, Norway and Sweden relating to the activities of the Consortium lies with its parent companies.

Taxes payable by the Consortium abroad are included in operating expense in the amount of 4 MSEK (6).

Note 10 – Liquid funds

	SAS Group Dec. 31 1987	SAS Group Sept. 30 1986	SAS Consortium Dec. 31 1987	SAS Consortium Sept. 30 1986
Cash and bank accounts	**522**	434	**125**	131
Short-term investments	**4585**	3148	**3840**	2420
Total	**5107**	3582	**3965**	2551

The liquid funds are in many different currencies and are stated after deductions for currency risks.

The balance of the liquid funds of the Consortium includes 49 MSEK (31) in a restricted tax deduction account in Norway.

On December 31, 1987 short-term investments consisted primarily of government securities and housing bonds. Short-term investments are reported at the lower of cost or market value.

Open interest arbitrage transactions are reported net and amounted to 285 MSEK on December 31, 1987. No corresponding transactions existed on September 30, 1986.

Note 11 – Accounts receivable
Accounts receivable are stated after provisions for uncertain receivables and currency risks.

Note 12 – Expendable spare parts and inventory

	SAS Group Dec. 31 1987	SAS Group Sept. 30 1986	SAS Consortium Dec. 31 1987	SAS Consortium Sept. 30 1986
Expendable spare parts, flight equipment	**274**	224	**274**	224
Expendable spare parts, other	**46**	47	**46**	47
Inventory	**197**	162	**21**	15
Total	**517**	433	**341**	286

Note 13 – Restricted accounts

SAS Group	Dec. 31 1987	Sept. 30 1986
Development reserve	**6**	7
Special investment reserve	**0**	3
Investment reserve	**29**	23
Regional development reserve	**1**	1
Total	**36**	34

Note 14 – Stocks and participations

SAS Consortium	Number of shares	Percent holding	Par value in 000s		Book value MSEK
Subsidiaries directly included in the accounts of the Consortium					
SAS Cargo Center A/S, Copenhagen	48	100	DKK	300	0.2
Scandinavian Airlines System of North America Inc., New York	1 750	100	USD	175	0.9
SAS France S.A., Paris	5 000	100	FRF	500	0.5
Other companies					0.0
Total					1.6
Subsidiaries					
SAS International Hotels A/S, Oslo	50 000	100	NOK	50 000	84.5
SAS Service Partner A/S, Copenhagen	90 000	100	DKK	90 000	70.5
Vingresor AB, Stockholm	700 000	100	SEK	70 000	70.0
Diners Club Nordic A/S, Oslo	25 100	100	NOK	25 100	70.0
Scandinavian Multi Access Systems AB, Stockholm	150 000	75	SEK	15 000	15.0
MediaSäljarna AB, Stockholm	4 000	100	SEK	400	9.8
SAS Capital BV, Haag	36	100	NLG	36	0.2
Travel Management Group, Norway A/S, Oslo	50 000	100	NOK	5 000	1.1
Travel Management Group, Denmark A/S, Copenhagen	50 000	100	DKK	5 000	0.0
Danair A/S, Copenhagen	1 710	57	DKK	1 710	1.2
Air de Cologne, AdeC AB, Stockholm	30 000	100	SEK	3 000	0.0
SAS Oil Denmark A/S, Copenhagen	300	100	DKK	300	0.3
SAS Oil Sweden AB	2 000	100	SEK	200	0.2
SAS Business Consultants AB, Stockholm	500	100	SEK	50	0.1
InterSAS BV, Amsterdam	104	100	NLG	104	0.2
Business Travel Systems AB, Stockholm	500	100	SEK	50	0.1
SAS Tours AB, Stockholm	10 000	100	SEK	1 000	1.0
Other					1.8
Total stocks and participations in subsidiaries					326.0
Affiliated companies					
Linjeflyg AB, Stockholm	500 000	50	SEK	50 000	53.0
Polygon Insurance Co. Ltd., Guernsey	3 329 036	33	GBP	3 329	19.0
Scandinavian Info Link AB, Stockholm	100 000	33	SEK	1 000	10.0
Travel Management Group, Sweden AB, Stockholm	45 000	30	SEK	4 500	4.5
Arctic Hotel Corp. A/S, Narssarssuaq	4 000	29	DKK	4 000	3.1
Københavns Lufthavns Forretningscenter K/S, Copenhagen		40	DKK	4 000	3.2
Bennett Reisebureau A/S, Oslo	20 880	31	NOK	2 088	1.1
Widerøe's Flyveselskap A/S, Oslo	26 622	22	NOK	2 662	1.1
Copenhagen Excursions A/S, Copenhagen	25	23	DKK	270	0.9
Greenlandair (Grønlandsfly A/S, Godthåb)	146	25	DKK	6 000	0.4
Scanator AB, Stockholm	500	50	SEK	50	0.1
Malmö Flygfraktterminal AB, Malmö	1 455	40	SEK	146	0.0
Total affiliated companies					96.4
Helikopter Service A/S, Oslo	130 500	9	NOK	13 050	26.2
Sanitas Investment AB, Stockholm	800	5	SEK	80	0.4
Dar-es-Salaam Airport Handling Co Ltd, Dar-es-Salaam	27 000	15	TAS	2 700	1.4
Airline Tariff Publishing Company, Washington D.C.	17 737	4	USD	17	0.4
Other					2.0
Total other companies					30.4
Total other stocks and participations					126.8

The book value of stock in SAS International Hotels on Dec. 31, 1987 was written up by 35.5 MSEK. Write-downs of the book value of stock were made in the following companies: Travel Management Group, Denmark A/S, 4.3 MSEK; Diners Club Nordic A/S, 28.2 MSEK; and Air de Cologne, 3.0 MSEK.

Note 15 – Goodwill and development costs
Goodwill arising on consolidation mainly relates to Diners Club Nordic A/S 72 (82). Development costs pertain chiefly to SAS International Hotels 10 MSEK (2), and Vingresor 10 MSEK (4).

Note 16 – Long-term accounts receivable, subsidiaries

SAS Consortium	**Dec. 31 1987**	Sept. 30 1986
SMART AB	**132**	126
SAS International Hotels A/S	**105**	57
SAS Capital BV	**61**	–
SAS Oil Denmark A/S	**19**	–
Other	**8**	7
Total	**325**	190

This includes 54 MSEK receivable from SAS International Hotels A/S, which is reported as loan capital in the accounts of the subsidiary.

Note 17 – Long-term advance payments to suppliers

SAS Consortium	**Dec. 31 1987**	Sept. 30 1986
DC-9-80	**420**	250
DC-9-51	**35**	83
DC-8-63	**–**	29
Engines	**–**	88
Total	**455**	450

Note 18 – Fixed assets

	Cost		Accumulated depreciation		Book value	
SAS Group	**Dec. 31 1987**	Sept. 30 1986	**Dec. 31 1987**	Sept. 30 1986	**Dec. 31 1987**	Sept. 30 1986
Construction in progress	**724**	238	**1**	–	**723**	238
Aircraft	**7326**	7130	**2595**	2419	**4731**	4711
Spare engines and spare parts	**1075**	1056	**681**	580	**394**	476
Maintenance and aircraft servicing equipment	**416**	348	**268**	231	**148**	117
Other equipment and vehicles	**2874**	2273	**1493**	1108	**1381**	1165
Buildings and improvements	**1517**	1506	**399**	563	**1118**	943
Land and land improvements	**223**	156	**3**	2	**220**	154
Total	**14155**	12707	**5440**	4903	**8715**	7804
SAS Consortium						
Construction in progress	**615**	150			**615**	150
Aircraft	**7326**	7130	**2595**	2419	**4731**	4711
Spare engines and spare parts	**1075**	1056	**681**	580	**394**	476
Maintenance and aircraft servicing equipment	**416**	348	**268**	231	**148**	117
Other equipment and vehicles	**1618**	1340	**899**	714	**719**	626
Buildings and improvements	**377**	562	**85**	299	**292**	263
Land and land improvements	**57**	51			**57**	51
Total	**11484**	10637	**4528**	4243	**6956**	6394

Changes in the book value of aircraft were as follows:

Cost,		
September 30, 1986	7 130	
Acquisitions (gross)	1 539	
Sales (gross)	−1 343	7 326
Accumulated depreciation,		
September 30, 1986	2 419	
Depreciation 1986/87	573	
Reversal of depreciation upon sale of aircraft	−579	
Transfer from depreciation reserve	182	2 595
Book value, December 31, 1987		4 731

The insurance value of the aircraft was 10 228 MSEK on December 31, 1987. This includes the insurance value of leased aircraft in the amount of 480 MSEK.

Of the year's aircraft acquisitions, three DC-9-80 aircraft were acquired formally through leasing agreements. Full payment was made in respect of all leasing charges and the residual value at the expiry of the leasing period. The aircraft are shown as fixed assets in the Balance Sheet, totaling 399 MSEK.

The heading "Other Equipment and Vehicles" includes the Consortium's data processing and communications equipment and flight simulators at a cost of 969 MSEK (820) and 218 MSEK (120).

The cost of construction in progress in the SAS Group increased by 486 MSEK. The major portion of the increase is attributable to the Consortium. This item includes SAS's new headquarters and miscellaneous new construction in Denmark and Norway. Of costs incurred relating mainly to furnishings in leased facilities, 163 MSEK (47) was charged against operating income.

Funds remaining in the depreciation reserve on December 31, 1987 have been transferred to accumulated depreciation of aircraft and spare parts.

Accumulated supplementary depreciation, including write-downs against investment reserves, etc., relates to the following assets of the SAS Group:

SAS Group	**Dec. 31 1987**	Sept. 30 1986
Machinery and equipment	**76**	87
Buildings and improvements	**82**	67
Land improvements	**2**	3
Depreciation of aircraft contracts	**63**	–
Total	**223**	157

Write-downs against investment reserves and regional development reserves during the year amounted to 5 MSEK (11), related to machinery and equipment. These write-downs increased the balance of accumulated supplementary depreciation.

Note 19 – Unearned transportation revenue, net

The reserve against the unearned transportation revenue liability at each year-end is dissolved and reported as revenue the following year. In the accounts for the period Oct. 1, 1986 – Dec. 31, 1987, the reversal totaling 123 MSEK has proved to be too conservative. Hence, it was possible to reduce this liability by 201 MSEK. This adjustment is included in the year's traffic revenue (note 1). In addition, 61 MSEK was reversed, offsetting costs from earlier periods.

Note 20 – Other current liabilities

These include 433 MSEK (208) in overdraft facilities utilized by the Group of which 55 MSEK (50) by the Consortium.

Note 21 – Bond loans

The aggregate of SAS Consortium bond loans was 3,242 MSEK (2,751).

Loans are in the following amounts and denominations:

SAS Consortium	**Dec. 31 1987**	Sept. 30 1986
USD U.S. dollar	**1 458**	1 037
ECU European Currency Unit	**755**	714
NOK Norwegian krona	**419**	423
CHF Swiss franc	**297**	276
AUD Australian dollar[1]	**201**	238
SEK Swedish krona	**70**	90
LUF Luxemburg franc	**70**	–
	3 270	2 778
Less repayments 1988 and 1986/87, respectively	**−28**	−27
Total	**3 242**	2 751

Specification of individual loans: Amount issued	Interest rate	Tenor	Remaining debt in MSEK
80 M Swiss francs	5.500%	77/92	297
150 M Swedish kronor	10.750%	79/94	70
200 M Norwegian kronor	11.625%	84/91	186
250 M Norwegian kronor	10.125%	85/93	233
100 M European Currency Units	9.000%	85/95	755
150 M U.S. dollars	10.125%	85/95	875
50 M Australian dollars[1]	14.250%	86/89	201
100 M U.S. dollars	6.750%	87/89	583
400 M Luxemburg francs	7.375%	87/94	70
Total			3 270

[1] Through a currency swap transaction, SAS's repayment commitment has in principle been changed to USD.

Note 22 – Other loans

Other long-term loans of the SAS Group amount to 1,328 MSEK (1,495), of which the Consortium accounts for 696 MSEK (849). The loans are denominated in currencies as follows:

	SAS Group		SAS Consortium	
	Dec. 31 1987	Sept. 30 1986	**Dec. 31 1987**	Sept. 30 1986
USD U.S. dollar	**36**	1 087	**–**	957
NOK Norwegian krona	**167**	195	**1**	1
DKK Danish krone	**160**	163	**12**	14
SEK Swedish krona	**104**	141	**67**	91
JPY Japanese yen[1]	**597**	12	**583**	–
ESB Spanish peseta	**166**	84	**–**	–
DEM Deutsche mark	**60**	75	**–**	–
FRF French franc	**–**	70	**–**	70
NLG Dutch guilders	**49**	–	**49**	–
GRD Greek drachma	**87**	41	**–**	–
Other	**45**	38	**1**	3
Total	**1471**	1 906	**713**	1 136
Less repayments 1988 and 1986/87, respectively	**–143**	–411	**–17**	–287
Total	**1328**	1 495	**696**	849

[1] Through a currency swap transaction, SAS's repayment commitment has in principle been changed to USD.

The loans for the Consortium fall due for repayment as follows:

1989	15
1990	11
1991	11
1992 and thereafter	659
Total	696

Note 23 – Provision for pension liabilities

SAS Group	**Dec. 31 1987**	Sept. 30 1986
PRI	**62**	54
Other	**3**	3
Total	**65**	57

The Pension Registration Institute (PRI) is a non-profit service organization that manages employee pension plans.

Other pension liabilities are either covered by periodic premium payments or are entered as contingent liabilities under the heading "Pension Commitments".

Note 24 – Subordinated debenture loan

A perpetual 200 million Swiss franc bond loan was floated during the 1985/86 fiscal year. Every fifth year, SAS has the exclusive right to terminate the loan.

The interest rate, fixed for periods of 10 years, at present amounts to 5¾ percent per annum.

Note 25 – Equity

SAS Group	Capital	Legal reserve	Revaluation reserve	Retained earnings	Income for fiscal period	Total equity
September 30, 1986	2276	64	20	84	1 327	3771
Income 85/86	1 197			130	–1 327	
Transfer to parent companies	–350					–350
Allocation to statutory reserves		35		–35		
Change in translation difference, net				19		19
Other	1 050					1 050
Reserve transferral[1]	103		–3	4		104
Income 86/87					1 445	1 445
December 31, 1987	**4276**	**99**	**17**	**202**	**1445**	**6039**
Consortium						
September 30, 1986	2276				1 197	3473
Income 85/86	1 197				–1 197	
Transfer to parent companies	–350					–350
Other	1 050					1 050
Reserve transferral[1]	103					103
Income 86/87					1 376	1 376
December 31, 1987	**4276**				**1376**	**5652**

[1] See note 8.

Note 26 – Assets pledged

	SAS Group		SAS Consortium	
	Dec. 31 1987	Sept. 30 1986	**Dec. 31 1987**	Sept. 30 1986
Mortgages in real estate	**441**	636	**14**	16
Corporate mortgages	**43**	45	**–**	–
Receivables	**58**	36	**15**	10
Securities on deposit	**25**	17	**0**	0
Total	**567**	734	**29**	26

Note 27 – Contingent liabilities

	SAS Group		SAS Consortium	
	Dec. 31 1987	Sept. 30 1986	**Dec. 31 1987**	Sept. 30 1986
Travel guaranties	**–**	–	**295**	205
Guaranties for pension liabilities	**–**	–	**41**	35
Loan guaranties	**–**	–	**4**	92
Other contingent liabilities for subsidiaries	**–**	–	**5**	5
Total contingent liabilities for subsidiaries	**–**	–	**345**	337
Other contingent liabilities	**305**	206	**85**	82
Pension commitments	**105**	90	**105**	90
Total	**410**	296	**535**	509

In addition to these contingent liabilities, certain commitments which could reach 24 MSEK have been made in connection with the acquisition of aircraft, formally through leasing agreements (note 18).

Concering the leasing of a Boeing 747B in October 1981, the Consortium has undertaken leasing commitments until 1989. The Consortium has also undertaken certain obligations in connection with ticket sales on pay-later plans.

A lawsuit demanding app. 60 MDKK in damages has been filed against SMART AB by GNData A/S, who claim that SMART reneged on a contract. SMART AB has contested the charges.

Loans which have become the objects of currency-rate swaps are stated at the swap currency's year-end rate of exchange. In the event that the counter-party to the swap agreement does not fulfill his undertaking, SAS currency exposure reverts to the original currency of the loan.

AUDITORS' REPORT

We, the undersigned, appointed in accordance with Article 11 of the Consortium Agreement between AB Aerotransport (ABA), Det Danske Luftfartselskab A/S (DDL) and Det Norske Luftfartselskap A/S (DNL), as auditors of SCANDINAVIAN AIRLINES SYSTEM Denmark–Norway–Sweden, have examined the financial statements of the Group and the Consortium for the fiscal year October 1, 1986 to December 31, 1987.

Our audit was performed in accordance with generally accepted auditing standards. In our opinion, the financial statements present fairly the financial position of the Group and the Consortium at December 31, 1987, and the result of their operations for the year then ended based upon the accounting principles described in the section of the Annual Report entitled "Significant valuation and accounting principles."

Stockholm, April 6, 1988

ARNE BRENDSTRUP Authorized Public Accountant	BERNHARD LYNGSTAD Authorized Public Accountant	ROLAND NILSSON Authorized Public Accountant
OLE KOEFOED Authorized Public Accountant	JACOB BERGER Authorized Public Accountant	SÖREN WIKSTRÖM Aulthorized Public Accountant

FINANCIAL SUMMARY

TRAFFIC/PRODUCTION		**86/87 15 mths**	86/87 12 mths	85/86 12 mths	84/85 12 mths	83/84 12 mths	82/83 12 mths
Number of cities served		**85**	84	89	88	91	93
Kilometers flown, scheduled	(millions)	**171.7**	137.2	135.9	125.0	123.5	119.3
Total airborne hours	(000)	**274.5**	218.8	217.5	199.7	192.7	182.1
Total number of passengers carried	(000)	**15672**	12497	11708	10735	10066	9222
Available tonne kilometers, total	(millions)	**3018.7**	2427.3	2490.9	2382.2	2333.0	2331.3
Available tonne kilometers, charter		**20.9**	16.6	12.2	18.2	18.4	19.8
Available tonne kilometers, scheduled		**2997.8**	2410.7	2478.7	2364.0	2314.6	2311.5
Revenue tonne kilometers, scheduled	(millions)	**1969.3**	1571.7	1560.9	1502.1	1473.6	1431.2
Passengers and excess baggage		**1421.6**	1136.8	1096.6	1054.4	1030.8	986.0
Freight		**483.8**	385.9	409.0	396.5	390.6	393.9
Mail		**63.9**	49.0	55.3	51.2	52.2	51.3
Total load factor, scheduled	(%)	**65.7**	65.2	63.0	63.5	63.7	61.9
Available seat kilometers, scheduled	(millions)	**23463**	18799	18849	17818	17395	17037
Revenue seat kilometers, scheduled	(millions)	**16097**	12949	12471	11966	11681	11159
Cabin factor, scheduled	(%)	**68.6**	68.9	66.2	67.2	67.2	65.5
Average passenger trip length	(km)	**1030**	1039	1067	1119	1168	1219
Traffic revenue/revenue tonne km	(SEK)	**8.64**	8.60	8.41	8.15	7.66	7.17
Airline oper., expense/avail. tonne km	(SEK)	**5.47**	5.38	5.26	4.81	4.35	4.12
Revenue tonne km/employee, scheduled		**—**[3]	77200	78900	79700	83200	83 700
Rev. passenger km/employee, scheduled		**—**[3]	636100	630700	635000	659600	652500

GROUP, MSEK

INCOME STATEMENTS	**86/87 15 mths**	86/87 12 mths	85/86 12 mths	84/85 12 mths	83/84 12 mths	82/83 12 mths
Revenue	**29924**	23870	21585	19790	18005	15972
Income before depreciation	**2517**	2346	2216	1550	1599	1289
Depreciation	**1380**	1126	863	574	545	483
Gain on the sale of equipment, etc.	**394**	313	34	− 17	580	5
Financial items, net	**167**	130	128	58	− 253	−210
Income before extraordinary items	**1698**	1663	1515	1017	1381	601
Extraordinary items	**—**	—	—	—	− 413	—
Income before allocations and taxes	**1698**	1663	1515	1017	968	601

STATEMENTS OF CHANGES IN FINANCIAL POSITION	**86/87 15 mths**	86/87 12 mths	85/86 12 mths	84/85 12 mths	83/84 12 mths	82/83 12 mths
Net financing from the year's operations	**2559**	1923	1625	1398	1493	1244
Investments, total	**−3493**	−2660	−4128	−1761	−1213	−559
Sale of equipment, etc.	**1065**	784	410	− 696	907	48
Financing deficit/surplus	**131**	47	−2093	−1059	1187	733
Owner's contribution	**1050**	1050	—	—	—	—
Net borrowings	**344**	399	1999	724	299	−346
Change in liquid funds	**1525**	1496	− 94	− 335	1486	387

BALANCE SHEETS	**86/87 15 mths**	86/87 12 mths	85/86 12 mths	84/85 12 mths	83/84 12 mths	82/83 12 mths
Liquid funds	**5107**	5078	3582	3676	4013	2597
Current assets, other	**4692**	5164	4530	3610	3278	2831
Non-current assets[1]	**9781**	9587	8769	5901	4056	3654
Current liabilities	**6852**	6747	6729	6257	6105	4552
Long-term debt[2]	**5817**	5923	5322	3310	2346	2313
Equity and reserves	**6911**	7159	4830	3620	2896	2217
Total assets	**19580**	19829	16881	13187	11347	9082

RATIOS	**86/87 15 mths**	86/87 12 mths	85/86 12 mths	84/85 12 mths	83/84 12 mths	82/83 12 mths
Gross profit margin, %	**—**[3]	10	10	8	9	8
Net profit margin, %	**—**[3]	6	7	5	4	4
Return on capital employed, %	**—**[3]	16	22	21	27	24
Including sale of equipment, etc., %	**—**[3]	18	22	21	37	24
Ratio of risk-bearing capital, %	**35**	36	29	27	26	25

CONSORTIUM[4], MSEK	**86/87 15 mths**	86/87 12 mths	85/86 12 mths	84/85 12 mths	83/84 12 mths	82/83 12 mths
INCOME STATEMENTS						
Traffic revenue	**17592**	14032	13456	12572	11577	10463
Other operating revenue	**4428**	3539	3039	2862	2574	2137
Revenue	**22020**	17571	16495	15434	14151	12600
Income before depreciation	**1902**	1753	1772	1216	1356	1015
Depreciation	**1060**	874	690	447	438	399
Gain on the sale of equipment, etc.	**341**	286	– 10	2	605	3
Financial items, net	**193**	166	125	51	–192	–157
Income before extraordinary items	**1376**	1331	1197	822	1331	462
Extraordinary items	**–**	–	–	– 15	–413	–
Income before allocations and taxes	**1376**	1331	1197	807	918	462
STATEMENTS OF CHANGES IN FINANCIAL POSITION						
Net financing from the year's operations	**2049**	1447	1331	984	1233	1060
Investments in flight equipment	**–1694**	–1226	–2961	–1006	–683	–143
Investments, other	**–1100**	– 886	– 772	– 601	–328	–340
Gain on the sale of equipment, etc.	**1008**	762	365	– 750	955	35
Financing deficit/surplus	**263**	97	–2037	–1373	1177	612
Owner's contribution	**1050**	1050	–	–	–	–
Net borrowings	**101**	343	1749	770	295	–328
Change in liquid funds	**1414**	1490	– 288	– 603	1472	284
BALANCE SHEETS						
Liquid funds	**3965**	4041	2551	2839	3442	1993
Current assets, other	**3273**	3729	3328	2930	2667	2292
Non-current assets	**8374**	8287	7632	4985	3157	2883
Current liabilities	**4641**	4816	4796	4959	4976	3636
Long-term debt	**4954**	5082	4546	2630	1715	1641
Equity and reserves	**6017**	6159	4169	3165	2575	1891
Total assets	**15612**	16057	13511	10754	9266	7168
RATIOS						
Gross profit margin, %	**–**[3]	10	11	8	10	8
Net profit margin, %	**–**[3]	6	7	5	5	4
Return on capital employed, %	**–**[3]	14	21	21	29	23
Including sale of equipment, etc., %	**–**[3]	17	21	21	42	23
Ratio of risk-bearing capital, %	**39**	38	31	29	28	26

PERSONNEL (average)						
Consortium	**20588**	20465	19773	18845	17710	17101
Group	**34463**	34207	31775	29730	28526	26657

[1] Including restricted account balances.
[2] Including minority interest.
[3] Not relevant for 15-month period.
[4] The SAS Consortium includes the Group Management, SAS Airline, SAS Finance, SAS Trading and joint Group projects.

BOARD OF DIRECTORS

Upper row, from left: Jan Carlzon, President and Chief Executive Officer, Ingvar Lilletun, Ralf Frick, Per Espersen, Krister Wickman, Kaj Ikast, Bjørn Eidem. Bottom row: Curt Nicolin, Haldor Topsøe, Tor Moursund.

Haldor Topsøe, born 1913, Dr. Phil. and Eng. Chairman of SAS Board 1986/87. Danish Chairman of SAS Board since 1968, representing the private Danish owners. Also Chairman of DDL and Haldor Topsøe A/S. Member of the Boards of Jens Villadsens Fabriker A/S. Hafnia Forsikring A/S and Hafnia Invest A/S.
Personal deputy:
Flemming af Rosenborg.

Curt Nicolin, born 1921, Hon.Dr.Eng. First Vice Chairman of SAS Board 1986/87. Swedish Chairman of SAS Board since 1973, representing the private Swedish owners. Chairman of the Boards of ASEA, ESAB, Fläkt, SILA and Swedish Match. Co-chairman of the Board of ABB Asea Brown Boveri. Also, member of the Boards of Skandinaviska Enskilda Banken, Incentive, Investor, Providentia, Linjeflyg and the Royal Swedish Academy of Sciences.
Personal deputy:
Peter Wallenberg.

Tor Moursund, born 1927, Supreme Court Attorney. President of Christiania Bank og Kreditkasse. Second Vice Chairman of SAS Board 1986/87. Norwegian Chairman of SAS Board since May 1983. Chairman of DNL's Board and representative of the Norwegian government. Chairman of Christiania Bank Luxembourg.
Personal deputy:
Ragnar Christiansen.

Kaj Ikast, born 1935, Major, member of Danish Parliament. Member of SAS Board since 1987 and Vice Chairman of DDL. Member of Railway Council, Personal Traffic Council and Transportation Council.
Personal Deputy:
Jimmy Stahr.

Krister Wickman, born 1924. LL.B. and Ph.L. Member of SAS Board since 1974, representing the Swedish Government and Chairman of ABA. President of the National Swedish Pension Insurance Fund. Chairman of the Association of Swedish Authors and member of the Boards of AGA, Pharos and VPC (the Swedish Securities Register Center).
Personal deputy:
Bengt Dennis.

Bjørn Eidem, born 1942.
Supreme Court Attorney. Member of SAS Board since May, 1983, representing the private Norwegian owners. Senior Vice President of Fred. Olsen & Co. Vice Chairman of DNL. Chairman of the Board of Norges Handels- og Sjøfartstidende and Widerøe's Airlines. Member of the Boards of Ganger Rolf and Bonheur. Member of the stock exchange committee of the Oslo Stock Exchange.
Personal deputy:
Halvdan Bjørum.

Employee Representatives

Claus Lindegaard, Denmark, born 1943. Employed in the Technical Division of SAS. Member of the SAS Board since 1988. (Took Per Espersen's place on January 26, 1988.)
Deputies:
Hans Dall and Jens Tholstrup Hansen.

Ralf Frick, Sweden, born 1931. Employed in the Technical Division of SAS. Member of the SAS Board since 1986.
Deputies:
Harry Sillfors and Kenneth Andréasson.

Ingvar Lilletun, Norway, born 1938. Employed in the sales sector in Route Sector Norway. Member of SAS Board since 1979.
Deputies:
Karin Hval and Svein Vefall.

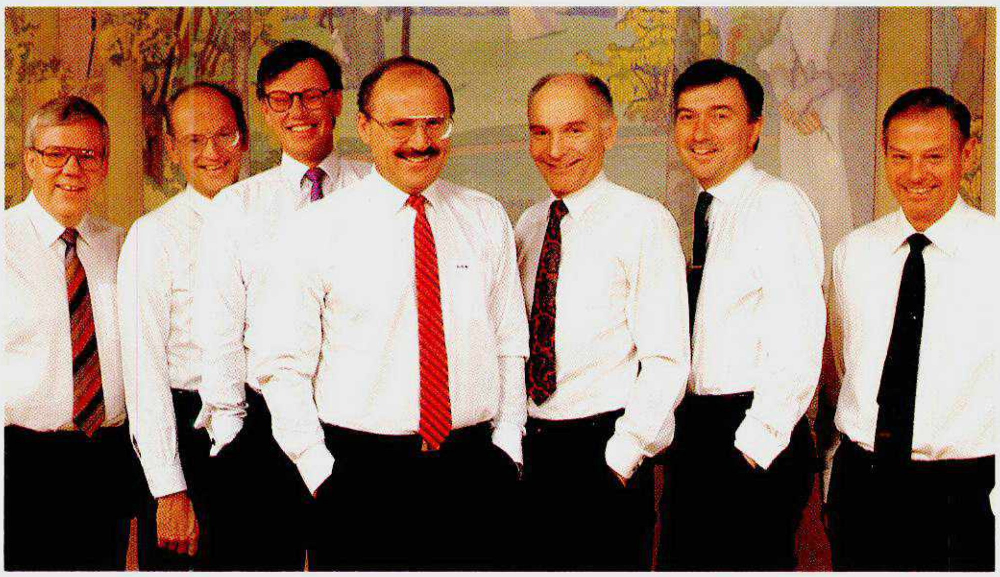
CORPORATE MANAGEMENT

GROUP MANAGEMENT
From left: Bo Ståhle, *Vice President and General Counsel;* Per-Axel Brommesson, *Executive Vice President – Sweden;* Frede Ahlgreen Eriksen, *Executive Vice President – Denmark;* Nils G. Molander, *Executive Vice President and Group Controller;* Jan Carlzon, *President and Chief Executive Officer;* Anders Claesson, *Vice President and Group Treaurer;* Helge Lindberg, *Executive Vice President – Norway.* Terje Sunde Johnsen, *Vice President, Strategic Planning;* Preben Kjær, *Vice President, Information.*

Terje Myklebust, *SAS International Hotels*
Christer Sandahl, *Vingresor*
Ivar Samrén, *SAS Service Partner*
Henrik Meldahl, *Scanair*

Peter Forssman, *Route Sector Sweden*
Ingar Skaug, *Route Sector Norway*
Lars Bergvall, *Chief Operating Officer, SAS Airline*

Göran Yxhammar, *Traffic Services Division*
Mats Mitsell, *Operations Division*
Kurt Thyregod, *Route Sector Denmark*



Sven Heiding, *Route Sector Europe*
Ulf Abrahamsson, *Technical Division*
Björn Boldt-Christmas, *Information Strategies*
Bengt A. Hägglund, *Deputy Chief Operating Officer, SAS Airline*

Kjell Fredheim, *Route Sector Intercontinental*
Per Johan Orrby, *Cargo*
Viggo Løfsgaard, *Head of Flight Operations*

ASSEMBLY OF REPRESENTATIVES

Denmark

MOGENS PAGH
Second Vice Chairman
KARL BREDAHL
FLEMMING AF ROSENBORG
NIELS FRANDSEN
JØRGEN L. HALCK
SVEND AAGE HEISELBERG
POVL HJELT
KAJ IKAST
JIMMY STAHR
HALDOR TOPSØE

Employee representatives
HANS DALL
CLAUS LINDEGAARD
JENS THOLSTRUP HANSEN

Deputies
IB JENSEN
VOLKER PAULSEN
HANS P. TANDERUP

Norway

NILS J ASTRUP
First Vice Chairman
HALVDAN BJØRUM
RAGNAR CHRISTIANSEN
BJØRN EIDEM
PER HYSING-DAHL
EINAR HØVDING
TORSTEIN LJØSTAD
TOR MOURSUND
GISLAUG MYRSET
FRED. OLSEN
OLE RØMER SANDBERG

Deputies
GRO BALAS
HELGA GITMARK
JANNIK LINDBÆK
JOHAN FR. ODFJELL

Employee representatives
KARIN HVAL
INGVAR LILLETUN
SVEIN VEFALL

Deputies
ASBJØRN HINDRUM
GUNSTEIN MOEN

Sweden

KARL-ERIK PERSSON
Chairman
BÖRJE ANDERSSON
ROLF CLARKSON
ULF DAHLSTEN
KURT HUGOSSON
NILS HÖRJEL
BO AX:SON JOHNSON
CURT NICOLIN
BO RYDIN
JAN-OLOF SELÉN
BJÖRN SVEDBERG
JAN WALLANDER
PETER WALLENBERG
KRISTER WICKMAN

Deputies
PEDER BONDE
INGEMAR ELIASSON
GUNNAR ERICSSON
GÖSTA GUNNARSSON
CARL-OLOV MUNKBERG
MONICA SUNDSTRÖM

Employee representatives
KENNETH ANDRÉASSON
RALF FRICK
HARRY SILLFORS

Deputies
BO FRIDSBERG
HANS LEVIN
BENGT RADIX

AUDITORS

ARNE BRENDSTRUP
Authorized Public Accountant
SCHØBEL & MARHOLT
member firm
Touche Ross International

OLE KOEFOED
Authorized Public Accountant
CENTRALANSTALTEN FOR REVISION
member firm
Arthur Young International

BERNHARD LYNGSTAD
Authorized Public Accountant
REVISJONSSELSKAPET FORUM
member firm
Touche Ross International

JACOB BERGER
Authorized Public Accountant
REVISJONSSELSKAPET FORUM
member firm
Touche Ross International

ROLAND NILSSON
Authorized Public Accountant
BOHLINS REVISIONSBYRÅ AB
member firm
Deloitte, Haskins & Sells International

SÖREN WIKSTRÖM
Authorized Public Accountant
TRG Revision, EINAR LARSSONS AB
member firm
Touche Ross International

ADDRESSES

Head Office

SAS
S-161 87 Stockholm
Sweden

Visitors' address:
Frösundaviks allé 1, Solna
Telephone: +46-8-797 00 00

Denmark:
SAS
Box 150
DK-2770 Kastrup
Denmark

Visitors' address:
Hedegårdsvej 88
Telephone: +45-1-50 91 11

Norway:
SAS
N-1330 Oslo Airport
Norway

Visitors' address:
Fornebuveien 38–40
Telephone: +47-2-59 60 50

Sweden:
SAS
S-161 87 Stockholm
Sweden

Visitors' address:
Frösundaviks allé 1, Solna
Telephone: +46-8-797 00 00

Telex number for SAS
in Scandinavia is
22263 SASXT DK

Subsidiaries

SAS International Hotels A/S
Postboks 325
N-1324 Lysaker
Norway
Telephone: +47-2-53 18 00

SAS Service Partner A/S
Kristen Bernikows Gade 1
DK-1105 Copenhagen K
Denmark
Telephone: +45-1-93 19 86

Vingresor AB
S-105 20 Stockholm
Sweden
Telephone: +46-8-796 67 00

Diners Club Nordic A/S
Langkai 1
N-0150 Oslo 1
Norway
Telephone: +47-2-33 43 60

MediaSäljarna AB
Klippgatan 11
S-116 35 Stockholm
Sweden
Telephone: +46-8-714 01 10

Scandinavian Multi Access Systems AB
Box 1418
S-171 27 Solna
Sweden
Telephone: +46-8-734 96 20

Affiliated Companies

Scanair
Box 20083
S-161 20 Stockholm-Bromma
Sweden
Telephone: +46-8-764 91 00

Linjeflyg AB
Box 550
S-190 45 Stockholm-Arlanda
Sweden
Telephone: +46-8-797 50 00

Travel Management Group Sweden AB
Box 5112
S-102 43 Stockholm
Sweden
Telephone: +46-8-738 03 90

Scanator AB
Box 1213
S-164 28 Kista
Sweden
Telephone: +46-8-750 79 10

Polygon Insurance Company Ltd.
P.O. Box 34
St. Peter Port, Guernsey
Channel Islands
Telephone: +44-481-281 36

Bennett Reisebureau A/S
Postboks 469
N-0105 Oslo 1
Norway
Telephone: +47-2-20 90 90

Grønlandsfly A/S
Postboks 1012
DK-3900 Godthåb
Greenland
Telephone: +299-244 88

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