



William A. Kutzke
Executive Vice President and General Counsel

November 2, 2004

Ms. Patricia Thomas
Chief, Air Carrier Fitness Division
Office of the Secretary
Department of Transportation
400 7th Street, S.W.
Washington, D.C. 20590

Ms. Vanessa Wilkins
Office of the Secretary
Department of Transportation
400 7th Street, S.W.
Washington, D.C. 20590

Re: Response to October 26 e-mail to Amy Rogers

Dear Ms. Thomas and Ms. Wilkins,

You asked for additional information on how SkyLink's pre-operating and first-year expenses were derived. The following provides that additional information.

Company Forecasts

1. Start-up (pre-operating) Expenses

SKY-402 sets forth the pre-operating expense forecast of SkyLink. This was updated by SKY-402 (Rev). The policy of the Company with respect to start-up costs is to expense these costs as they occur. SKY-402 (rev 2) reflects and the earlier Exhibits upon which it is based reflect this policy. Expenses incurred prior to certification are all treated as cash costs. Office space and furniture are rented. Computers are expensed as they are acquired. This is permitted by GAAP. All capital costs as shown in SKY-402 have been expensed.

The Salaries, Management category reflects the actual salaries and benefits of all of SkyLink's employees with the exception of line pilots and cabin crews. This category includes all employees involved in the certification process. As of today the Company has 39 full time employees in this category. The Salaries, Management category includes four station personnel who currently work at headquarters. These individuals will serve as station managers following certification. In the first quarter of 2005, SkyLink will only be operating two stations. The Flight & Cabin Crew Salaries category shows actual salaries plus benefits for line qualified pilots and line qualified flight attendants. As of today the Company has 6 full time employees in this category. Related full time management positions are included in Salaries, Management as noted category above. Aircraft, Rent & Insurance reflects the operating lease cost of one aircraft prior to certification as well as the insurance on that aircraft. This aircraft will be purchased on the date of certification. At that point, the costs of the aircraft will be included in the 2005 expenses. The Regulatory &



Legal category includes the cost of DOT filings, expenses related to the development of the Lehman Brothers Private Placement Memorandum, issuance of warrants and convertible debt, development of the aircraft operating leases and purchase documentation. The Manuals & Certification cost category includes FAA matters, the expense of preparing manuals and the expense of proving runs, including fuel and maintenance on the aircraft. Training includes initial cadre pilot training, maintenance training, ground operations training and flight attendant training. This category includes contract training and the cost of simulator time. The cost of pilot training and certain other training in this category prior to certification has decreased. This results from several considerations. First, actual training costs for initial training have come in somewhat less than forecast. Second, some training will be done on a “just in time” basis before aircraft enter service. Thus, there is somewhat more training expense shown in calendar 2005 than was the case in the initial February 2004 forecasts. Travel is the expense of travel prior to certification. This includes “road shows” for the sale of securities and travel for the purpose of acquisition of aircraft and airport facilities. It also includes the cost of hotel rooms during training events. The Administrative Offices and Airport Facilities categories are rent for space, office supplies, and every other support service necessary for an early stage company. Technology is the acquisition of office computers and servers. Initially, this category included the expenses of developing and establishing a reservation system. SkyLink had anticipated building a reservations system from the ground up. SkyLink decided that a hosted reservation system is more cost effective and requires a significantly lower up-front investment and little or no capital cost. The reservation system alone resulted in an almost \$600,000 cost saving. This results in a substantial reduction in costs in this category. All such costs and other pre-certification costs of technology have been expensed in our forecast.

SkyLink has documentation for each item. We would be pleased to have DOT meet with Ms. Jennifer Watts, CPA, our Controller, to review allocation of costs to categories and to review invoices and expense reports as needed.

As reflected in SKY-402 (Rev 2) submitted with this letter, start-up costs will come in under the level forecast in SKY-402 (Rev). In SKY-402 (Rev) SkyLink estimated costs of \$10.9 million. It is now expected that start-up costs will be \$9.5 million. This is primarily because of lower technology costs, lower salary expense, and lower certification costs. SkyLink expects to complete proving runs on January 17 in accordance with the Schedule of Events agreed with the FAA. (Originally, SkyLink planned for proving runs to be completed by mid-December). For purposes of Exhibit 402 (Rev 2), expenses that are expected to be incurred prior to January 17 are shown as start-up costs (including proving runs) in the Exhibit. Scheduled operations are to commence as quickly as the requisite permits can be obtained and all costs incurred after that date are in the revised 2005 forecast.

As noted, the primary difference between the original SKY-402, SKY-402 (rev) and the revision submitted with this letter is that, as time has passed, the data for the first, second and third quarters of 2004 have gone from forecast expenses to actual expenses. The data in the fourth quarter of 2004 is still estimated. SkyLink believes that its forecast for November and December and the first seventeen days of January before completion of proving runs are quite accurate.

2. Calendar 2005 Expenses.

- A. First quarter schedule
- B. First quarter expenses
- C. Second quarter, third quarter and fourth quarter expenses

D. Fuel Cost adjustment

E. Capital Costs

A. First quarter schedule

Your letter expressed concern about the operation of charters in the first quarter of 2005 and the manner in which the Company treated expenses and revenues for those charters pending the commencement of full, scheduled operations in the second quarter of 2005. SkyLink has reviewed this matter in some detail.

The charter plan was developed to avoid commencing scheduled service immediately upon receipt of the DOT and FAA certificates. Usually in the international market, traffic builds much more slowly and has a longer booking curve than in domestic markets. The objective was to avoid operating potentially low load factor flights in scheduled service. SkyLink believed it could sell some charters in the short term following certification and before the commencement of full scheduled service. But it is very difficult to forecast how many charters can be sold since selling cannot commence until the DOT and FAA certificates are issued.

In response to the questions raised in your letter, the Company has determined to commence scheduled service upon receipt of its certificates. The Company will plan to operate on the schedule set forth in SKY-409 for the first quarter. The Company expects to request a waiver to permit advanced sales that would permit the Company to operate additional scheduled service in March depending on market demand. The Company will have one aircraft available during the first quarter and two other aircraft completing refurbishment. Because of supplier delays with respect to interiors and seats, the Company will have these aircraft on hand before they are actually ready for service. The delivery dates for these later two aircraft, as reflected in the exhibits, have not changed nor have the entry into service dates, as reflected in the information already filed.

The Company reservation system will be ready in December 2004 but cannot be “turned on” until certification. Upon certification, it will be turned on and we will commence scheduled operations immediately. SkyLink has full expectation that it can secure the necessary landing slots for this operation. These flights will represent a “spool up” to the second quarter operation.

B. First quarter expenses

SkyLink has provided a revised exhibit showing the costs of introducing scheduled operations in the first quarter of 2005. These expenses and revenue forecasts are shown in SKY-405 (Rev) (New-Fuel Only). This exhibit shows the original DOT plan in the first five columns. The second group of five columns shows the expenses and revenues expected at \$1.10 jet fuel per gallon. The third group of five columns shows the expenses and revenues at \$1.50 jet fuel per gallon.

Expenses change in Flight Operations and Maintenance. The costs increase for Flight Operations, Flight Attendant Pay, Reserve Pay, Per Diem and Hotel and In-Flight Catering. The cost of Flight Operations Training has increased from the original forecast. Initially the Company expected to do the bulk of its training in the fourth quarter of 2004; now it anticipates more training in the first quarter of 2005. This accounts for much of the change, as explained in the start-up costs discussion above. The change in maintenance costs reflects the additional block hours flown.



Certain costs with respect to the re-forecast of the first quarter do not change in any material manner. Pilots are already employed and reflected in the costs in SKY-405 (Rev). These pilots were hired to provide sufficient crews for the proving runs and other initial operations. Insurance remains almost the same since it is based primarily on the value of the hull and expected RPM's throughout the year. General and Administrative costs remain the same. The finance staff, the dispatch staff, maintenance control and so forth do not change. The major changes that result from ACMI charter service being replaced by scheduled service, are fuel, certain aircraft and traffic servicing expense (navigation and landing fees, aircraft turn costs), catering, and engine and airframe maintenance costs that vary directly with the number of operations. Some expenses, such as promotion, distribution and sales remain essentially the same since all of this activity is directed to the full roll-out of scheduled service in the second quarter.

Revisions to SKY-405 (Rev 2) (New Fuel) are included to show the full costs of this operation.

C. Second quarter, third quarter and fourth quarter expenses

You also requested specific information on Station and other costs. To provide this information, SkyLink is providing a revised Exhibit, Sky-405 (Rev--New Fuel and other Costs). This exhibit updates costs in certain categories. This reflects that the Company is now less than 75 days from the start of scheduled operations and has been able to define its costs much more accurately than it was able to almost 10 months ago when it filed its initial exhibits.

Station Costs

Your letter requested specific information about the costs shown in Aircraft and Traffic Servicing Expense in the already filed exhibits. Exhibit SKY—405 (Rev) shows Landing and Navigation Fees, the Cost of Outsourced Below-Wing Handling (Baggage, aircraft turn costs, pushback, ground service equipment and so forth), Airport Personnel (Gate and Counter costs and personnel) and Airport and Hanger Rental (parking and other related miscellaneous costs). The original forecast for these costs was estimated based on available information.

The revised number reflects negotiated agreements with airports and signed contracts with ground handlers and is what the Company expects to pay at the airports served. The Company does not expect to incur any station costs prior to certification, except as related to specific proving runs or as forecast in the airport facilities line of the start-up expenses. As a new entrant, its costs do not reflect long-term airport leases or exclusive use gates and counters common to established airlines. Its expenses are developed and based on "turn costs," the expected cost of a single operation in and out of an airport multiplied by the number of turns. International operations are much different than domestic operations. A low fare airline in domestic operation may use a gate 8-10 times a day. It is highly likely that SkyLink will use a gate only once or twice per day and that it will not be an exclusive use gate.

The forecast is based on the navigation costs for each transatlantic crossing multiplied by the number of crossings. The landing fees are built up by multiplying the number of landings times the fees per landing. Most station expense is contracted except for a limited number of station managers previously identified.

Promotion, Distribution and Sales

The SkyLink forecast in this category has been highly refined over the last 10 months. The forecast presented with this exhibit reflects the current internal budget and the expected actual costs. While the Company still expects to spend considerable funds in the first quarter to brand and commence distribution of



its product, these expenses fall markedly in the second, third and fourth quarters based on the internet distribution strategy the Company is set to employ and the expectation that most sales will be on the Company website.

Aircraft Rentals

The Company has acquired three Boeing 767-200ER aircraft. The costs for these aircraft would not ordinarily show up in the Aircraft and Engine Rental line because they are purchased aircraft. The next five aircraft were planned to be leased. However, there are very attractive purchase options for these aircraft. To simplify the DOT exhibits it is assumed, in the revised exhibit, that all aircraft are leased, whether in fact they are leased or purchased. Thus, the line Aircraft Rentals under the Aircraft and Engine Rentals line now include the expense of eight aircraft. Given the current market, the principal and interest payments, taken together, are essentially equal to the monthly lease costs of the aircraft.

The Company did not nor has it been asked to make any deposits on the aircraft it intends to buy. Nor has it been asked for deposits on aircraft it has considered for lease. Thus, for the purposes of this exhibit, we have treated capital costs and interest costs on aircraft as a pure operating expense. (Previously, we had supplied a document that showed this relationship. That document ties to this Exhibit.) This revised line is prepared to show the DOT total aircraft expenses. The Depreciation and Amortization line have been adjusted accordingly. Net interest expense is also adjusted to reflect this restructured Exhibit.

Maintenance

Maintenance costs by category are adjusted slightly to reflect power by the hour discussions and advanced budget planning in the maintenance department.

Flight Operations

The restructured first quarter operation has slightly higher operations costs.

Summary

An Exhibit has been provided with block hours, number of aircraft, maintenance cost per block hour, station cost per turn, and total flights. This exhibit ties to the information previously provided except for the cost associated with the first quarter as a result of the commencement of scheduled, instead of charter, operations.

D. Fuel

SkyLink forecast fuel costs at \$1.10 per gallon for the year 2005. In October SkyLink provided an email to the DOT to justify its forecast. You have now asked that SkyLink provide further support for the view that it will be able to obtain fuel at \$1.10 per gallon in 2005. In the initial letter SkyLink stated its belief that crude oil prices per barrel would average of \$40 for calendar year 2005. If crude oil is in the range forecast by SkyLink, the forecast of \$1.10 is reasonable.

The Company continues to believe that average crude oil prices for calendar 2005 **will average \$40 per barrel**. This is consistent with the official **US Government** forecast of crude oil prices made in October of this year.



The \$40 per barrel estimate of crude oil was made by the Department of Energy at the Oil Price Information Service (OPIS) Supply Summit that was held in October. The Energy Information Administration of the U.S. Department of Energy stated their belief that crude oil prices for 2005 would be \$40 per barrel (see chart below). At the presentation, EIA stated “with continued strong demand growth and little surplus capacity readily available, EIA’s forecast in the short term is for continued price strength. Some forecasters see prices returning to much lower levels sooner than we do. Our forecast continues to hover near \$40 through 2005 for crude oil with product prices keeping pace in their usual manner.” Analysts at Robert W Baird supported this price per barrel in an article dated September 30, 2004. “Analysts at Robert W Baird have raised their oil price forecasts for 2004 and 2005 from \$38.50 per barrel to \$40 per barrel.”

Every airline and forecaster must look at the same data SkyLink is using and develop its plans based on expected **average** annual costs. No airline or reasonable forecaster would use the spot price of crude on or near what is seen as the high point to calculate the probable price in a forecast for calendar. In the recent days, crude oil prices have been falling as the events that precipitated the run up of crude oil have abated.

As noted, the most recent forecasts show an expectation of \$40 per barrel crude for the year 2005. That corresponds to \$1.05 a gallon for jet fuel. This is below the \$1.10 used by SkyLink. SkyLink is not in a position to challenge the U.S. Government calendar 2005 forecast. However, a separate Exhibit is provided based on the assumption that jet fuel will average \$1.50 in the calendar year 2005.

Summary

August 2005 crude oil futures are trading in the range of \$24.30 (the low) and \$49.85 (the high) a barrel (October 27, 2004 data). The mid point of this range is \$37. It seems reasonable to rely on the forecasts of experts, including the US Government, that are calling for crude in the range of \$40 in 2005. That is above the midpoint of the futures market trading range and would produce jet fuel prices below SkyLink’s forecast. It would be unfair to penalize SkyLink by using a forecast for crude oil that is well above the Government forecast to determine expected jet fuel prices that SkyLink will pay, on average, in calendar 2005.



Crude Oil Price Outlook: Higher for Some Time (Monthly Average)



* OPIS Supply Summit, October 2004, Energy Information Administration of the Department of Energy

To view the presentation:

http://www.eia.doe.gov/pub/oil_gas/petroleum/presentations/2004/opis0410/opis0410_files/frame.htm

E. Capital Costs

An exhibit line that shows capital expenditure is added. This line removes capital expenses associated with aircraft in order to show total cash outflow in calendar 2005. The aircraft capital expenses are now treated as lease expenses as described above.

F. Revised DOT reserve requirement

Based on these revisions SkyLink believes that the DOT reserve requirement would be as follows:

Total Operating Expenses	140,730
Interest	0*
Total	140,730
	/ 4
	35,183
Start-up Costs	+ 9,582
	44,765
Funds Raised	- 15,514
Remaining DOT reserve Requirement	29,251

* The interest number shown on the exhibit is \$617,000 for the year. However, that is an accrual on the convertible debt which will not be paid because it will be converted to equity.



* * * *

If you have any further questions with respect to the Exhibits, please contact either Amy Rogers or me.

Sincerely,

_____/s/_____

William A. Kutzke



SkyLink Airways
SKY-402 (Rev 2)

Start-up Costs

SkyLink Airways
Quarterly Cash Flow Requirements by Category

As Presented in SKY-402 Rev					
STARTUP COSTS (000 Unless Indicated Otherwise)	<u>2004 Q1a</u>	<u>2004 Q2a</u>	<u>2004 Q3e</u>	<u>2004 Q4e to Certification</u>	<u>2004 Total Startup Costs</u>
Salaries, Mgmt	\$91	\$329	\$981	\$1,042	\$2,443
Aircraft, Rent & Insurance	0	0	125	403	\$528
Flight & Cabin Crew Salaries	0	0	84	53	\$137
Advertising, Branding & Design	0	4	215	30	\$249
Regulatory & Legal	50	31	225	150	\$456
Manuals & Certification Costs	10	146	150	1,300	\$1,606
Travel	20	33	105	80	\$238
Training	0	0	597	364	\$961
Technology	10	40	3387	365	\$3,802
Administrative Offices	6	21	321	107	\$455
Airport Facilities	0	0	25	25	\$50
Total Startup Expenses	\$187	\$604	\$6,214	\$3,919	\$10,924
Revised as of October 30, 2004					
	<u>2004Q1a</u>	<u>2004 Q2a</u>	<u>2004 Q3a</u>	<u>2004 Q4e to Certification</u>	<u>2004 Total Startup Costs to 1/17/05</u>
Salaries, Mgmt	\$91	\$329	\$1,495	\$1,997	\$3,912
Aircraft, Rent & Insurance	0	0	0	363	\$363
Flight & Cabin Crew Salaries	0	0	0	94	\$94
Advertising, Branding & Design	0	4	108	636	\$748
Regulatory & Legal	50	31	170	110	\$361
Manuals & Certification Costs	10	146	21	245	\$422
Travel	20	33	166	185	\$404
Training	0	0	0	170	\$170
Technology	10	40	327	1790	\$2167
Administrative Offices	6	21	219	463	\$709
Airport Facilities	0	0	163	69	\$232
Total Startup Expenses	\$187	\$604	\$2,669	\$6,122	\$9,582



SkyLink Maintenance Summary

	Q1 2005	Q2 2005	Q3 2005	Q4 2005
Total Aircraft in Fleet	1	6	6	8
Total Block Hours	278	3,845	7,988	8,022
Total Flights in Month	36	502	1,068	1,078
Maintenance Cost per Block Hour	\$1,667	\$995	\$886	\$2,713
Maintenance Cost per Flight	\$12,957	\$7,619	\$6,628	\$20,188
Station Cost per Flight	\$3,885	\$3,885	\$3,885	\$11,657
Cargo Station Cost per Flight		\$424	\$424	\$424



Number of Round Trips East Coast-STN

January	2
February	4
March	12
April	Full service commences per exhibits