

# JOHN F. BROWN COMPANY EMAIL NEWSLETTER

*Consultants to the Airport Industry*

26 April 2002

## ✈ THE AIRLINES

### FINANCIAL STATE OF THE AIR CARRIERS

Summarized from Reuters as reported by Yahoo!, 4-15-02; the Wall Street Journal, 4-15-02; the Associated Press as reported by Yahoo!, 4-17-02 and 4-19-02; the Financial Times, 4-17-02; and the Chicago Tribune, 4-19-02:

Losses were common as US air carriers announced their first quarter results, though in many cases losses were not as severe as expected by Wall Street. Considered together, quarterly airline losses topped \$2.4 billion. Traditionally, though, the first quarter is weak for airlines and losses are not unusual. Analysts explain Southwest's continued profitability by noting its lack of dependence on business travel. On a carrier-by-carrier basis, highlights are as follows:

|              | <u>Net Loss</u> <sup>1</sup> | <u>Revenue</u> |
|--------------|------------------------------|----------------|
| American     | \$575 million                | \$4.1 billion  |
| United       | \$510 million                | \$3.3 billion  |
| Delta        | \$397 million                | \$3.1 billion  |
| America West | \$358 million                | \$460 million  |
| US Airways   | \$269 million                | \$1.7 billion  |
| Northwest    | \$171 million                | \$2.2 billion  |
| Continental  | \$166 million                | \$2.0 billion  |
| Alaska       | \$34 million                 | \$497 million  |

  

|           | <u>Net Gain</u> | <u>Revenue</u> |
|-----------|-----------------|----------------|
| Southwest | \$21 million    | \$1.3 billion  |

<sup>1</sup> Includes special items.

### VIEW FROM AMERICAN: SLOW BUSINESS RECOVERY, "CHANGES" IMMINENT

Summarized from the Financial Times, 4-17-02; the Associated Press as reported by Yahoo!, 4-17-02; and Airline Monitor Weekly, 4-23-02:

Regarding the journey back to aviation normalcy, AMR CEO Don Carty states, "There is no question that our business overall is improving and there are a number of particularly encouraging signs with regard to our day-to-day operations. But the facts are that business travel, which historically constitutes a major portion of our business, is not rebounding the way leisure travel is, and average fares are down because of heavy discounting." Carty has hinted that American will completely review its business model and undergo fundamental operational changes, but has been tight-lipped about details.

### VIEW FROM DELTA'S MULLIN: SUPPLY STILL EXCEEDING DEMAND

Summarized from the Atlanta Journal and Constitution, 4-17-02; and Airline Monitor Weekly, 4-23-02:

Regarding Delta's business recovery, CEO Leo Mullin explains, "Advance bookings are coming back, but it is not swift. It is consistent with an economy that is ambling along. What brings back pricing power to any industry is demand and supply lines crossing. That crossing point is still out

there in the future. We hope it comes back in the mid- to late summer, but until then there will be substantial discounting as we try to put the last passenger on board.” The business travel slump is most notable in Delta’s East Coast shuttle between Boston, New York, and Washington. In the first quarter, traffic on the shuttle fell 28 percent – greater than four times the airline’s overall decline.

#### **VIEW FROM DELTA’S REID: RAILWAY LABOR ACT CREATES IMBALANCE**

Summarized from Maintenance, Repair & Overhaul Conference Keynote Address by Frederick Reid, Delta President and COO, 4-10-02; and Airline Monitor Weekly, 4-23-02:

Regarding the relationship between labor and management, Delta President and COO Frederick Reid explained, “The soaring cost of labor in our industry is the direct result, I believe, of the unbalanced relationship between unions and companies, created by the Railway Labor Act. Left unchanged, this imbalance will set our industry on a course of certain decline. Because of the way negotiations are structured under the Railway Labor Act, an unequal distribution of power exists between organized labor and management. Any labor group has the power to bring an airline to a complete halt, depriving the public of a critical engine for economic well-being.” Reid also discussed how difficult it is for an airline to absorb a strike as an industry with no stored inventory, as well as the impossibility of covering the cost of invested capital if airlines lack the pricing power to recoup rapidly rising employee costs. Delta, he said, will be taking a “disciplined, conservative approach to capacity,” not bringing idle aircraft back into service too quickly.

#### **VIEW FROM BRITISH AIRWAYS: FREE GLOBAL COMPETITION NEEDED**

Summarized from British Airways press release, 4-17-02:

British Airways’ CEO Rod Eddington urged governments to abandon protectionism and normalize the airline industry in a recent speech. He commented, “It is not appropriate for governments to use the current situation to get into the business of propping up failing businesses, and thus distorting competition across the entire market. Our industry is stuck in a time warp of regulation and protectionism, which is odd for the very industry that makes free trade between nations a possibility. We are hardly a role model for our customers.” He further added that the current regulatory environment should allow airlines to establish seamless global networks on a free competition basis, which is the prerequisite for a healthy and efficient industry.

#### **VIEW FROM CONTINENTAL: SLOW RECOVERY, OIL PRICE UNCERTAINTY**

Summarized from the Wall Street Journal, 4-15-02:

Regarding a return to “reliable profitability,” Continental CEO Gordon Bethune has expectations for next year rather than this one. He also makes no promises for the traditionally stronger second and third quarters. Volatile oil prices are expected to be particularly challenging to deal with, and a fare increase is likely imminent on account of them. “There are some guys who are never going to make it” back to profitability, Bethune concedes. “I have expectations for next year.

#### **VIEW FROM UNITED: LACK OF BUSINESS TRAVELERS POSES PROBLEMS**

Summarized from Business Week, 4-18-02:

Of all the major U.S. carriers, United may be facing the most dire situation. Its heavy dependence on the business traveler, and its bad labor relations, have resulted in United posting the biggest losses in the industry. According to United President Rono Dutta, “All of us are in many ways too weak to compete against one another. We try to, but eventually we retreat to our respective corners of the market. Consolidation is inevitable.” Dutta mentions that bankruptcy is no longer seen as likely, but the carrier may need to apply for federal loan guarantees by the June 28

deadline. However, United's poor labor relations could jeopardize its ability to secure those guarantees, according to Standard & Poor's analyst Phil Baggaley.

### **VIEW FROM US AIRWAYS: MORE RJs**

Summarized from Airline Monitor Weekly, 04-23-02; and USA Today, 04-19-02:

US Airways posted its worst quarterly loss in a decade, racking up a \$269 million deficit for the first quarter, compared to a \$171 million loss in last year's first quarter. David Siegel, the airline's president and CEO, said he plans to alter the company's cost structure, increase the number of regional jets operated, address the airline's lack of alliance partners, and apply for a government-backed loan. US Airways has the highest cost structure among US airlines and would be only the second major airline to apply for loan guarantees (America West being the other). Part of the airline's difficulty results from having few unencumbered assets. The carrier's cash position has fallen from \$1.1 billion in December to \$561 million as of March 31. One analyst expects the airline to run out of cash by the end of the summer.

## **✈ FINANCIAL STATE OF THE AVIATION INDUSTRY**

### **NETJETS EXPANDS**

Summarized from the Wall Street Journal, 4-23-02:

NetJets, a jet-sharing program run by Executive Jet, Inc., itself a unit of Warren Buffet's Berkshire Hathaway, Inc., is the largest player in the fractional-ownership market. This is surprising, given that Buffet once "swore off" investment in the aviation industry after losses on a large stake in US Airways a few years ago. NetJets currently operates 350 Cessnas, Gulfstreams, and similar seven to 19 seat jets with 2,500 owners who own at least 1/16<sup>th</sup> of a jet. The company has been adding planes to its fleet at a rate unmatched by any other carrier: between seven and nine aircraft each month. Although the cost of NetJets ownership far exceeds airfare on commercial airlines, the program has attracted the niche that shuns commercial airlines due to security concerns and long waiting lines, but can't afford jets on an individual basis. This travel segment was once estimated by United Airlines to be the most lucrative one to commercial airlines, representing 9 percent of passengers who account for 46 percent of all revenues. Some label this indicative of an "hourglass" trend in the aviation market in which consumers gravitate toward the most high-end and low-end products, vacating the middle ground.

### **EXPEDIA BEATS ESTIMATES**

Summarized from the Wall Street Journal, 4-23-02:

Online travel firm Expedia, Inc. reported a profit for the first quarter of 46 cents per share, almost doubling the market consensus of 26 cents. Expedia is benefiting from a migration of travel purchasers to the Web from traditional travel agents as well as rebounding leisure travel after the September 11 terrorist attack.

### **CONCESSIONAIRES FACING WORSENING SITUATION**

Summarized from USA Today, 4-15-02:

Sales in the \$6 billion airport concession industry declined more than 40 percent for some airports in the last quarter of 2001, according to a recent report by concession companies. Labeling the situation "economically disastrous," the companies foresee the closing of "a large number" of stores and restaurants in the near future. HMS Host, CA One Services, and Anton Airfood, among others, predict they together will lose \$854 million in revenue this year because of the September 11 attacks, according to ACI-NA.

## **AIRFARE DROPS ON BUSINESS ROUTES**

Summarized from USA Today, 4-22-02:

An exclusive study by USA Today found significantly lower discount airfares, even on prime business routes. In many cases the discounted fares could save business travelers 35 percent to 90 percent. However, all the fares were non-refundable, requiring one to two weeks advance purchase and imposing a \$100 fee for changing travel dates. Increasingly, corporations are using discount carriers to cut airfare spending, or are planning ahead and being flexible in order to take advantage of special deals.

## **COMPETITION INTENSIFIES OVER NEW AMERICA WEST FARES**

Summarized from the Wall Street Journal, 4-22-02:

Several major carriers are slashing airfares on America West's prime routes as retaliation after America West adopted a new fare structure on March 25. The new structure, cutting prices on unrestricted tickets and eliminating Saturday-night stays, came as major carriers failed for a second time to lift domestic fares. Northwest, Delta, and Continental cut walk-up fares to unprecedented levels at all three hubs of America West: Phoenix, Las Vegas, and Columbus. Despite the retaliation, America West still has the price advantage on most of the 2,300 North American markets it serves.

## **✧ AVIATION SECURITY**

### **RIDGE PUSHES "TRUSTED FLIERS" PROGRAM**

Summarized from Washington Post, 4-23-02:

Homeland Security Director Tom Ridge made one of the strongest pushes yet for a "trusted fliers" program, predicting that passengers will voluntarily pay a fee to receive background checks in exchange for security cards to speed them through security checkpoints. His comments received mixed feedback from the airline industry and other government agencies. Ridge believes that the government could concentrate on the high-risk segment of travelers by implementing the trusted fliers program.

### **EMPLOYEES OF AIRPORT CONTRACTORS ARRESTED**

Summarized from Reuters Securities, 4-23-02; and New York Times, 4-24-02:

The Justice Department announced on Tuesday that more than 100 employees of contractors at Washington, DC-area airports were arrested on charges of supplying false information in job applications, using fake Social Security information, and other immigration violations. None were linked to terrorism; however, four were fugitives with outstanding state warrants. So far, the national security sweep has rounded up more than 350 in a dozen large airports in recent months.

## **✧ AIR TRAFFIC**

### **MARCH PASSENGER TRAFFIC BOOSTED BY SPRING HOLIDAY TRAVEL**

Summarized from Air Transport Association press releases, 4-16-02 and 4-24-02:

The Air Transport Association (ATA) reported that system-wide revenue passenger miles (RPMs) declined 8.9 percent and available seat miles (ASMs) declined 11.8 percent in March 2002 relative to the corresponding month of 2001. As a consequence, load factors improved to 76.7 percent. Passenger enplanements were down 10.2 percent, even considering that spring

holidays fell in March this year as compared to April last year, which made the comparison more favorable than it otherwise would have been. Fares in March were down significantly as well, with domestic fares falling 13.2 percent and international fares decreasing 8.5 percent relative to March 2001.

### **BUSINESS TRAVEL RECOVERY IN QUESTION**

Summarized from Reuters, 4-23-02; and Denver Rocky Mountain News, 4-23-02:

According to a survey conducted by the Business Travel Coalition, an advocacy group for corporate travel interests, corporations cut airfare spending by 16.5 percent in 2001 and more than half were planning further cuts in 2002. Three-quarters of the 184 companies surveyed consider the cuts to be permanent. Corporations were planning to use cheaper nonrefundable tickets, use discount carriers, fly to secondary airports, and use video and teleconferencing to reduce airfare spending, which is a further blow to major carriers. "The myth that the business traveler is inelastic has been debunked," said Kevin Mitchell of the Business Travel Coalition. "The business traveler is not going to pay \$2,500 to fly from the mountains to the sea."

### **HEATHROW FACING INCREASED COMPETITION**

Summarized from the New York Times, 4-23-02:

Although Heathrow Airport remains the undisputed gateway to Europe with more than 60 million passengers annually, it is facing increasing competition from other airports, especially Charles de Gaulle Airport. Most Americans are still loyal to Heathrow as a gateway primary due to the English language advantage. Heathrow is, however, very restricted physically, with only two runways and a peak capacity of only around 85 aircraft movements per hour. British planning authorities recently approved a construction plan of a fifth terminal to be completed in 2007 that will increase capacity to 90 million passengers per year; however, an airline executive commented that airport capacity would still fall short when faced with potential triple passengers in 2030.

### **U.S., JAPAN SIGN ACCORD TO BOOST TOURISM**

Summarized from the Los Angeles Times, 4-22-02:

The United States and Japan signed a pact to establish panels promoting tourism on Monday. Japanese visitors spend \$10 billion in the United States annually with \$1.2 billion in California alone. After the September 11 terrorist attacks, Japanese visitors decreased significantly, as did U.S. visitors to Japan. The pact aims to increase travelers by 20 percent in the next five years, an optimistic goal compared to the 3 percent growth rate forecast by the Department of Commerce.

### **"THE EL TORO AIRPORT IS DEAD"**

Summarized from El Toro Reuse Planning Authority (ETRPA) press release, 4-23-02:

The Navy has issued a Record of Decision selecting a non-aviation reuse plan for the closed El Toro Marine Base in Orange County, California. After nine years of debate and uncertainty, ETRPA executive director Paul Eckles welcomed the decision, proclaiming, "The El Toro airport is dead."

## ✈ RENTAL CAR INDUSTRY

### **RENTAL CAR COMPANIES CONSIDERING MILEAGE CAP**

Summarized from the Wall Street Journal, 4-24-02:

Security concerns and lengthy lines at airports have been driving travelers to the rental car market, which has raised discussions among rental car companies whether unlimited mileage should be abandoned. Under unlimited mileage, increasing daily mileage will incur faster depreciation of rental cars at the same revenue level. Hertz has recently observed an increasing average rental period, as one- and two-day rentals have fallen off. (Hertz won't say how much.) Avis has noticed the same thing, with average rental lengths up by 1 to 3 percent. Although both ANC Rental and Dollar Rent A Car System have had internal discussions on mileage capping, its implementation still requires wider industry acceptance.

### **JOHN F. BROWN COMPANY ANNOUNCES THE AIR CARGO TEAM (ACT)**

To bring added service to airports and third party developers, the John F. Brown Company has established the "Air Cargo Team" staffed by highly experienced air cargo personnel.

John F. Brown Company's in-house expertise in market assessment, development of marketing plans, and the creation and management of selection processes for third party development, is now complemented with air cargo marketing. Using an approach unlike anything the industry has seen before ACT is results oriented and operated and staffed by some of the industry's most knowledgeable experts. What truly sets ACT apart is a unique compensation system that helps our clients to identify and address their target markets efficiently and extremely cost-effectively. For more information, call Dan Muscatello at (513) 321-6080 or via email at [dmuscatello@johnfbrown.com](mailto:dmuscatello@johnfbrown.com).