

JOHN F. BROWN COMPANY EMAIL NEWSLETTER

Consultants to the Airport Industry

28 May 2002

✧ FINANCIAL STATE OF THE AVIATION INDUSTRY

US AIRWAYS AND CONTINENTAL IN CODE-SHARE TALKS

Summarized from Reuters, 5-23-02; and the New York Times, 5-23-02:

Continental Airlines CEO Gordon Bethune confirmed that his airline and US Airways were in negotiations over a code-share deal. One analyst said the success of the strategy depends on growth plans at US Airways, which has been seeking a code-share partner to extend its route structure. "I think it could be advantageous if US Airways' strategy is to get smaller," said Jim Corridore, an analyst at Standard & Poor's. "If they're going to try and get bigger, it's not in Continental's interest to work with them, because they would be in a lot of the same markets. Continental can use US Airways for a lot of the niche markets on the East Coast."

US AIRWAYS SEEKS CONCESSIONS, THREATENS GOING BUST

Summarized from Reuters, 5-16-02; USA Today, 5-17-02; and the Washington Post, 5-22-02:

US Airways said it will apply for almost \$1 billion in federal loan guarantees, and warned politicians that the airline would go bankrupt this summer if the federal loan program were suspended, as has been proposed in the House. The airline is also attempting to secure almost \$1 billion in wage concessions from its unions and \$200 million in payment reductions from its creditors and suppliers. The carrier is asking its pilots to allow the addition of 150 regional jets, over and above the increase from 70 to 140 pilots approved last April.

CARTY PROPOSES LABOR ARBITRATION, OPPOSES MORE BAG MATCHING

Summarized from the Dallas Morning News, 5-16-02; Reuters, 5-20-02; and Aviation Now/Aviation Daily, 5-21-02:

Donald Carty, AMR chairman, advocates a "last best offer" approach to arbitrate stalled labor-management negotiations. "The beauty of that approach is that it forces both sides to the center, and avoids a scenario in which all the bargaining leverage belongs to the party that can impose a strike that neither the company nor the traveling public can afford," he said. American Airlines pilots, last August, rejected just such a proposal. Dave Eitel, chairman of the pilot union's San Francisco division, said changes to the negotiation process are not needed. "It is not labor costs killing this industry," he said. "It is the pricing model." Carty also spoke out against Congressional plans to extend the bag matching program to connecting flights. "In off-schedule operating conditions, imposing positive bag matches on connecting flights will cause absolute paralysis in airports," he said.

APPROACHING THE LIMITS OF SCOPE CLAUSES

Summarized from Aviation Now/Aviation Daily, 5-14-02 and 5-20-02:

The Regional Airline Association is making a case with legislators that scope clauses could cause the loss of airline service to small communities. Scope clauses often limit the amount of flying regional airlines can do based on the amount of flying done by the major airline. Thanks to cutbacks in service by the majors, regionals are approaching the scope-clause limits faster than anticipated. In response, airlines can reduce available seat-miles, remove seats, drop markets, remove code-shares, and/or sell off subsidiary regionals. American Eagle recently cut back its schedule so that American Airlines did not violate the scope clause it has with its mainline pilots.

United and Delta could face similar dilemmas. RAA argues that as regionals purchase more RJs, turboprops will be phased out in order to use the RJs and remain within scope clause limitations. Some routes and communities can only be served sensibly by turboprops, and those places will suffer when turboprops are taken out of service. Related to the scope clause issue is the belief by some Comair pilots that the Air Line Pilots Association, the union for both Delta's regional and mainline pilots, has an inherent conflict of interest when it negotiates scope clauses in labor contracts for mainline pilots.

EROSION OF HUB ECONOMICS

Summarized from the Wall Street Journal, 5-22-02:

Wall Street Journal travel editor Scott McCartney warns that traditional connecting hubs will experience erosion of their economics as airlines restructure the way they do business. He points to the increase in point-to-point service, reasoning that bypassing of hubs will result in fewer connecting passengers, especially high-fare business travelers, and a subsequent decrease in capacity from hubs as airports end up depending more heavily upon origin and destination traffic. Lower capacity means poorer hub economics. McCartney quoted a former airline chief as saying, "Hubs will only persevere if they can serve thin spokes with small planes." McCartney said one type of restructuring could involve the implementation of rolling hubs. Under the current inherently inefficient system, he explained, aircraft wait for connecting passengers, which decreases utility and, ultimately, the bottom line. At a rolling hub, passengers wait for connecting aircraft, which increases aircraft utility and lowers per unit costs.

SOUTHWEST UPBEAT ABOUT LUSCIOUS OPPORTUNITIES

Summarized from Reuters, 5-16-02:

While other major carriers continue to struggle with September 11 and recession-induced losses, Southwest, having just posted its 29th straight profitable year, is eyeing domestic expansion. Southwest's low-cost business model and lower reliance on business travelers has offered it a cushion against hard times. "Our business is built to withstand that kind of pressure on margins," says Chief Financial Officer Gary Kelly. "We can make money without raising prices." He added that 35 percent to 40 percent of Southwest's passengers pay full fare, generating 55 percent of the carrier's total revenue and net income. While Southwest recently announced plans for its first transcontinental flight, from BWI to LAX, international expansion is likely not in the cards. Founder and chairman Herb Kelleher recently told shareholders he would much prefer to focus on "luscious and lucrative domestic opportunities." The airline plans to take delivery of 14 aircraft in 2003. The carrier's growth in 2002 (measured in available seat miles) is projected at 5 percent. Kelly said the airline analyzes brand new routes by checking what other carriers fly and the average fare. Then, Southwest forecasts the increase in traffic resulting from the initiation of Southwest service and decides whether to serve that route.

MAJOR INTEREST IN MEXICO CITY'S NEXT AIRPORT

Summarized from Dow Jones Newswire, 5-21-02:

Some 25 companies have expressed interest in bidding on the master plan for Mexico City's new airport, according to ASA, Mexico's airport administration. ASA plans to announce the winning bidder in the second half of next year. The \$2.3 billion airport, which will require private funds to cover 75 percent of the cost, will be located on Texcoco, a dry lakebed east of the capital.

MEXICAN AIRLINES PRIVATIZATION PROCEEDS WITH BANK SELECTION SOON

Summarized from the Dallas Morning News, 5-23-02:

Mexico-owned airlines AeroMexico SA and Compania Mexicana de Aviacion SA expect to have a banking advisor by June, paving the way for their public tender auction later next month. Financial analysts expect U.S. airlines, such as Continental and American, are the most likely bidders. The two Mexican airlines are owned by a single holding company, Cintra SA, which the Mexican government took control of in 1995 as a result of the massive devaluation of the peso. AeroMexico is a member of the Delta Air Lines Sky Team and Mexicana is part of United's Star Alliance. Together, the two Mexican airlines control almost 80 percent of domestic traffic and serve destinations in the U.S., Canada, South America, and Europe.

✈ AIR CARGO

AIR CARGO ON THE RISE

Summarized from WorldACD, 5-17-02:

The Bank of Tokyo-Mitsubishi (BTM) reported a 3.4 percent increase in the U.S. air cargo trade index for March, the first rise in five months. The index had experienced four months of declines totaling 4.7 percent. "March tends to bring a seasonal upturn, but the magnitude of this gain was solid and bodes well for the air cargo industry," said Michael Niemira, senior economist at BTM in New York.

✈ AIR TRAFFIC

TRAVELER TOLERANCE INCREASES

Summarized from the Wall Street Journal, 5-20-02:

Consumers are more satisfied with air travel than they have been in the past five years, according to a University of Michigan survey. Economists attribute the increase to a rise in passenger tolerance. "People just want to get from here to there safely; the rest doesn't really matter as much any more," Philadelphia economist Joel Naroff said.