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Earnings

No earnings reports this week

Is it Wrong to Go Long?

A look at the dangers and risks of longhaul flying, for LCCs or anyone else for that matter

If WestJet eventually tries to fly longhaul (see page two), it will attempt to achieve something that no airline in the history of the world has ever done.

From ATA to Zoom, dozens of airlines over the decades have tried to make money flying low-cost longhaul. Air Berlin tried. Gol tried. Plenty of less respectable outfits like Oasis Hong Kong tried. And today, AirAsia X—the low-cost cousin of one of the world's most profitable shorthaul airlines—is trying. All of them have proven how tough low-cost longhaul flying can be.

But wait: what about Jetstar? Isn't it the grand exception to all this? True, it's the most profitable part of Qantas. But even if people around the world think primarily of its sexy longhaul routes like Auckland-Singapore, it's in essence mostly a shorthaul carrier: 65% of its ASKs are on routes less than 2,400 miles that are flown almost entirely with narrowbody aircraft. The equivalent figure for Qantas-branded service is just 43% shorthaul. Like most airlines, Qantas doesn't disclose profitability on a market-by-market basis. But for all of Jetstar's legitimately alluring low-cost practices, is it possible the most important reason it's more profitable than the rest of Qantas might be simply that it's a shorter-haul carrier?

See also:
• Shorter haul, taller profits? p. 12

As it happens, it's actually disproportionately difficult to make money on longhaul, period—low-cost or not.

Scour the list of the world's most profitable airlines year in and year out—think AirAsia, Allegiant, Copa and Ryanair, for example, the only airlines that have ranked among the world's 10 most profitable by operating margin in all of the past three years. Add Alaska, Spirit and WestJet, which are often near the top too, and you have an eclectic group of carriers with widely varying business models but one thing in common: not a single widebody in their fleets. Other frequent profit leaders like LAN and Turkish that (like Jetstar) might seem like longhaul airlines actually butter their bread with shorthaul: average stage lengths of less than 1,000 and 1,200 miles, respectively (see chart, page 12). That's less than even some all-narrowbody carriers—nothing like the 2,700-mile average stage length of Singapore Airlines, or Virgin Atlantic's 4,400.

CONTINUED ON p. 12

Pushing Back: Inside This Issue

As the winter holidays approach, the airline world is waiting—waiting for the outcome of talks involving Virgin Atlantic, Delta, Singapore Airlines and perhaps Air France/KLM. And waiting for the outcome of talks involving US Airways, American and American's creditors.

Conclusions to both dramas might be near. At American, pilots ratified their new contract, and creditors are actively evaluating a formal US Airways takeover proposal.

As for Delta, talks on overseas acquisitions didn't preclude it from reaching a less sexy but important deal to buy large regional jets from Bombardier. In an age of expensive jet fuel, 50-seat regional jets are about as wanted as rats, and no airline is working harder to expunge them than Delta.

For Lufthansa, the question is how to expunge losses on shorthaul routes. Its answer: a beefed-up, re-branded Germanwings. With BA/Iberia buying full control of Vueling and Air France/KLM expanding Transavia, Europe's Big Three are betting big on low-fare flying.

On the longhaul front, meanwhile, Lufthansa will follow the pack and install premium economy seats, just as WestJet is doing back in Canada. And speaking of WestJet, it's starting to turn heads with talk of eventual widebody flying.

Back in Europe, Avianca's parent company is getting closer to buying TAP Portugal, while British Airways is taking advantage of its newly acquired British Midland slots at Heathrow to expand its Asia presence—it's now flying to Seoul.❍

“ Verbulence

Your highest cost isn't fuel. It's the cost of an empty seat.

—Azul EVP Trey Urbahn, explaining why Azul uses smaller jets than the narrowbodies used by rivals ”

Is **Virgin Atlantic** founder Richard Branson just days away from surrendering control? *The Sunday Times*, which a week earlier first reported **Delta**'s interest in the 40% stake held by **Singapore Airlines**—and **Air France/KLM**'s interest in at least part of Richard Branson's 51%—says yes. Singapore itself acknowledged in a stock exchange filing that it is "in discussions with interested parties" about selling its stake. On *Bloomberg TV*, meanwhile, Virgin founder Richard Branson didn't explicitly acknowledge anything but did say that if Delta were to buy Singapore's stake, Virgin would have to approve, and he hinted it likely *would* approve given the airline's need for feed (which Delta and its partners could provide more effectively than Singapore). *The Times*' latest report says "three-way talks"—for now between Virgin, Delta and Singapore —could lead to a deal "within days." Singapore Airlines purchased its Virgin Atlantic stake back in 1999 for about $900m, presumably far more than what Delta would pay today. An interesting side note to the 1999 deal: Singapore won the right to block other airlines from using the Virgin name on international flights, which is why **Virgin Blue** had to use names like **V Australia** and **Pacific Blue** for its non-domestic flying. But when Singapore and **Virgin Blue** formed an alliance, the latter was able to change the entire group's name to **Virgin Australia**. Separately, Virgin Atlantic has hired **Aer Lingus** to operate 24 U.K. shorthaul flights per day, using four Virgin-painted A320s, into London Heathrow to replace the **British Midland** feed it lost.

Meanwhile **US Airways**, as expected, formally proposed the even bigger acquisition of **American**, according to several reports. Under the offer to American's creditors, those creditors would reportedly own 70% of the combined company, with US Airways shareholders owning the remaining 30%. This implies a valuation of American not much less than **Delta**'s current $8.6b market capitalization and more than **United**'s $6.8b (see page four). Some reports, though, point to American holding out for as much as 80% for its creditors, a figure it's hard to imagine US Airways shareholders accepting. The long courtship by US Airways is now nearing its conclusion, with American's labor contracts now secured (see page seven) and creditors ready to make their decision between the merger proposal and a standalone plan. American's creditor committee consists of three unions, which have publicly stated their support for the merger, as well as Boeing, Hewlett-Packard, the PBGC (the government pension insurer) and groups representing unsecured bondholders. These bondholders will be the swing voters that US Airways must convince.

A number of airlines are holding investor day events this month, during which management typically provides a thorough review of company strategies. **WestJet** held one last week, in which spoke of planning a new regional airline called **Encore**, installing premium seats (while densifying B737-800 configurations), providing inflight wireless connectivity, chasing more corporate traffic, pursuing more airline partnerships, upgrading its internet booking engine (to enable more self-service options and more merchandising), lobbying Ottawa for airport cost relief, using home-based reservation agents, leveraging its loyalty program, debuting a new pricing approach with three fare brands ("economy," "flex" and "plus") and growing mainline ASMs about 7% to 8% in 2013. Most intriguing, though, is WestJet's potential interest in widebodies. Though it's only in very early discussions with Boeing and Airbus, management noted with wide eyes that **Air Canada** currently has the $10b longhaul market from Canada largely to itself. More relevant to the here and now, however, was a more nervous recognition that Air Canada is becoming a less bloated competitor after signing new labor agreements and announcing a new international low-cost carrier. WestJet estimates its cost advantage will now be between 10% and 15%, half what it once was.

At the other end of the Americas, **Gol** held an investor day as well, highlighting four demons wreaking havoc on its ability to restore profitability: a slowing Brazilian economy (GDP grew less than 1% in Q3), a weaker Brazilian currency, expensive fuel (made more expensive by the weaker currency) and exorbitant fees at Brazil's main airports. In response, Gol is downsizing its workforce, developing its Smiles loyalty program, looking for new airline partners, expanding inflight sales and mothballing its newly acquired **Webjet** subsidiary, which management says was still worth buying for the airport slots, executive talent and ideas it contributed (and although this went unsaid, surely for making a competitor disappear). And although unlike **WestJet** it won't evaluate widebodies—Gol tried that before, with unhappy memories—it does apparently have **Copa** envy. More specifically, it will experiment with new flights to Santo Domingo in the Dominican Republic, envisioning it as a possible hub between the Americas. It might do so, moreover, in conjunction with **Delta**, which invested $100m into Gol and now owns 3% of it. During the past decade, yields in Brazil have plummeted 60%, thanks in large part to the efficiency of airlines like Gol and **TAM**, which replaced a previous generation of rag-tag carriers like **Varig**, **VASP** and **Transbrazil**. Lower fares, in turn, triggered air traffic growth of 15% a year on average, or roughly four times the rate of GDP growth. But this trajectory has suddenly come to a halt, with Gol and TAM now reversing course and cutting capacity to push up yields. And that's indeed what's happening, to a degree that makes Gol confident of profits in 2013.

At a **Hawaiian Airlines** investor day event, management spoke glowingly about its push into Asia and Australasia and how it has turned a once-struggling carrier into one of the country's fastest growing and most profitable—its Q3 operating margin was 13%, same as Allegiant's. By revenue, Hawaiian is now 65% larger than it was just three years ago, having launched new routes to Japan, Korea, Australia, New York and—soon—New Zealand and Taiwan (see page eight). It still sees lots of other new destination opportunities as well: Hong Kong is one possibility. Only 47% of Hawaiian's revenue is now sourced from U.S. mainland markets, down from 62% three years ago, meaning a more diversified income stream. It's also looking to serve smaller Hawaiian cities with turboprops and has a long list of partner airlines that provide it feed for inter-island hops. In many ways, its business model is unique, with densely configured widebodies, no first-class upgrades for elite fliers (it prefers to sell those seats) but free meals for economy-class passengers. Yet it is vulnerable to competition because it doesn't have a large local traffic base of its own. In other words, most of its passengers are inbound from cities where rivals hold marketing sway. Plus foreign exchange rates are hugely influential for its Asian business, with success in Japan notably dependent on Japanese tourists taking advantage of a strong yen/weak dollar scenario.

Some tour operators, notably in Europe, have gotten away with low-cost longhaul flying by filling planes with tour groups booked through large travel agencies. But unsurprisingly (see cover story), the air service itself doesn't generate the profits. That appears to be true for **TUI**, whose tour package business is doing well but whose one airline that operates as a regular scheduled airline is not. That would be **Corsair**, which despite ongoing restructuring efforts suffered a roughly $20m underlying operating loss in the 12 months to September. TUI's other airlines, including **Thomsonfly**, **TUIfly**, **Jetairfly**, **Arkefly** and **Jet4You**, are part of integrated tour operators.

Not again: To the disgust of airlines everywhere, and to the disgust of anyone recognizing aviation's potential to ignite economic growth, the U.K. announced its intention to again raise the APD—the air passenger duty, otherwise known as the EST, the economic suicide tax. Not stopping there, in the theatre of the absurd, it's also increasing government funding for marketing the U.K. as a tourist destination. In other words, the U.K. is pushing up the already high cost of visiting the country to fund a campaign urging people to visit the country. The U.K. government genuinely needs revenue to correct a bad fiscal position. But the APD, even before the latest hike, is a giant depressant for air travel and tourism, which are both important engines of economic growth.

A newly released IATA forecast sees global airline traffic rising at 5.3% a year on average from now through 2016, led by growth from China, the former Soviet Union and other emerging markets. The U.S., for its part, will still be the world's largest airline market in 2016, but traffic will grow just 3% a year domestically and 4% internationally. The fastest growing country markets, ranked by expected annual growth, are forecast to be Kazakhstan (20%), Uzbekistan (11%), Sudan (9%), Uruguay (9%), Azerbaijan (9%), Ukraine (9%), Cambodia (9%), Chile (9%), Panama (9%) and Russia (8%).

AirWaves

Noteworthy Airline Coverage From Other Media

Good news: **Air India** is expected to lose just $790m in the 12 months that end in March 2013, according to company estimates seen by *Mint*, an Indian newspaper. That's substantially less than the $1.5b it lost last year or the $1.3b it lost the year before that (calculated at current exchange rates). Despite a pilot strike, and despite lingering inefficiencies, Air India is surely benefiting from **Kingfisher**'s demise, and did reduce staffing from 35,000 to 29,000, according to the report. India's civil aviation minister told parliament last week that Air India still doesn't make money in most markets and can't even cover the cost of fuel alone on some routes. But at least it's improving.

Korea's *Joong Ang Daily*, talking to **Delta**'s general manager for the region, says the U.S. carrier might grow its presence at Seoul Incheon, perhaps even switching some flights from its Tokyo hub. In Seoul, of course, Delta has SkyTeam partner **Korean Air**. Tokyo is a larger market but has no local SkyTeam carrier. (And though not discussed in the article, any further liberalization at Tokyo Haneda would also be a threat to Delta's Narita hub, whereas Seoul has just one major airport.) Delta and Korean Air won antitrust immunity for their alliance 10 years ago but haven't done much with it—at least not yet.

Particularly if you're not all that tall and even if you're not all that plump, you might soon find yourself focusing less on economy-class legroom and more on elbow room. *Australian Business Traveler* notes that new-generation seats (with thinner backs) can mean a bit more legroom, even if airlines technically reduce pitch (the distance between rows) a bit. But ever more airlines, not just **AirAsia X** but also higher-end carriers like **BA** and even **Etihad**, have squeezed passengers by adding an extra seat across per row on their widebodies.

Who We Are and How to Reach Us

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Fleet Sheet

Aircraft Developments

- It's not as sexy as romancing Virgins abroad, but **Delta** is working tirelessly to make its dull but important regional business the best it can be. And that means replacing toxic 50-seat regional jets—it treats these like a bad rash—with more economical planes. To that end, it's buying 40 CRJ-900s, which have lower unit costs than the reviled 50-seaters and also feature the two-class configurations that premium passengers appreciate. Delta also obtained options for 30 additional units and—as part of the deal—Bombardier must help it get rid of 50 unwanted CRJ-200 50-seaters. The deal was a win for Bombardier and a disappointment for Embraer, which also competed for the order. The new planes will start arriving in the second half of 2013, when B717s from **Southwest** will also start arriving—these will replace larger RJs and Northwest's old DC-9s. New B737-900ERs will start arriving then too.
- ILFC, by some measures the world's largest leasing company—and by all measures at least No. 1 or No. 2 alongside GECAS—has a new controlling shareholder. Its parent company AIG reached a deal to sell a 90% to a consortium of Chinese financial institutions.
- **China Southern** ordered 10 additional A330-300s, another instance of Asian carriers going wild for this plane. Deliveries will run from 2014 to 2016. Also in China, an unnamed airline signed a purchase agreement for seven CRJ-700s.
- Airlines around the world are excited about A350s too—but not the smallest version of the plane. **Qatar Airways** converted all 20 of its -800 orders to larger versions. It still has 80 A350s on order but instead of 20 -800s, 40 -900s and 20 -1000s, it now plans 43 -900s and 37 -1000s. **Aeroflot** and **US Airways** are now the two biggest customers for the -800, which is looking ever less likely to ever be built. The -1000 has firm orders from Qatar, **Cathay Pacific**, **Emirates**, **Etihad** and **Asiana**. And the most popular -900 has firm orders from more than 20 airlines, with Qatar, Emirates, Cathay, **TAM**, **United** and **Singapore Airlines** placing the biggest orders.
- Back on the topic of A330s, some of which A350s will eventually replace, **Iraqi Airways** took delivery of its first unit, a -200 model. The carrier will use the midsized widebody to serve the U.K., Germany and Austria from its Baghdad base.
- **United** took delivery of another B737-900ER last week—not by itself a huge event. But it happened to be the 377th B737 delivered by Boeing this year, breaking an annual record previously established in 2010. Thanks to the newly offered MAX series, B737 orders are also more numerous than ever before, with Boeing having surpassed its previous 2007 high back in October. The manufacturer has now sold 1,031 B737s this year, well above the 846 it sold in 2007.
- **Icelandair**, currently one of Europe's most profitable airlines, placed an order for 12 B737-MAXs, including eight 153-seat MAX 8s and four 172-seat MAX 9s. It also took purchase rights for an additional 12 units. Icelandair currently flies only B757s, a larger plane with 183 seats and one that will remain a staple of its fleet for many years—the first B737-MAX won't arrive until 2018. When they do come, however, their versatility will prove highly useful, given their ability to reach points in both North America and continental Europe from Reykjavik.

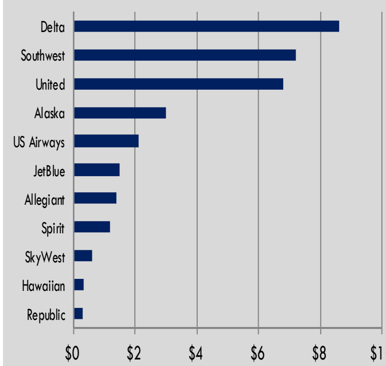
SkyMoney

Airline Finance

- **Avianca**'s parent company, Synergy Group, made a formal takeover offer for **TAP Portugal**, with most of the proceeds reportedly designated not to Portugal's heavily indebted government but to pay off TAP's debt and recapitalize the company. Synergy was the only bidder, giving it leverage to offer a lower price. A decision on whether to accept the offer is expected before the end of the month. But how could a Brazilian company buy control of a European one? To comply with foreign ownership restrictions, Synergy's founder was able to obtain Polish citizenship.
- In unrelated news, **Delta** CEO Richard Anderson was seen, before meeting with Richard Branson, applying for Slovakian citizenship. Okay, just kidding.

What They're Worth

Market caps (in $b) for U.S. carriers



JetGreen

Environment, Conservation & Fuel

- **British Airways** and others have been trialing a polymer coating designed to reduce friction on the skin of an aircraft and thus reduce fuel consumption. So how much fuel can be saved? Apparently, about half of a percent. Speaking last week at the Marketforce/IEA "Future of Air Transport" conference in London, Jonathon Counsell, BA's head of environment, said applying the coating to an A318 flying between London's City Airport and New York JFK yielded a 0.4% fuel savings. That's less than the 1% to 2% savings the manufacturer was touting when the trials began, but airlines will take it. In fact Counsell called it a "huge…massive, significant" savings. And he's right. He says that if the coating were applied to BA's entire fleet, it would avoid 50,000 metric tons of carbon dioxide emissions per year. In financial terms, 0.4% would have shaved about $47m of the 2011 fuel bill at **Delta**, for example. Not bad for a coating so thin that it requires "about a jam jar" to cover a narrow body plane. BA is now trialing the coating on a B777. If it continues to deliver fuel savings, Counsell says BA will probably apply it across the fleet.
- Climate talks in Doha ended last week with very little progress toward a meaningful climate change treaty. But other international climate talks are being held this week. The International Civil Aviation Organization's (ICAO) so-called "high-level group" will have its first of many meetings to discuss a framework for a global plan to address aviation's greenhouse gas emissions. Environmentalists and European climate commissioners (who suspended the E.U. Emissions Trading System, ostensibly because of the progress they've seen with the high-level group) are hoping a framework for a plan can be agreed upon at the next ICAO Assembly in September 2013. The high-level group is a committee of officials from 17 countries: Australia, Belgium, Brazil, Canada, China, India, France, Japan, Mexico, Nigeria, Russia, Saudi Arabia, Singapore, Uganda, the United Arab Emirates, the U.K. and the U.S. Importantly, that list includes the world's biggest aviation markets but ones in very different stages of development—and therefore with very different positions on how to curb the emissions of the world's airlines. This week's meeting could be the beginning of a wild ride.

AirBuzz

Marketing, Price, Promotion & Alliances

- In conjunction with its decision to double down on **Germanwings**, **Lufthansa** is rebranding it with a new aircraft livery, new logo and new marketing pitch. Passengers will have three fare options: "basic," "smart" and "best," with each offering different perks, amenities and levels of flexibility. The best fare, for its part, includes access to Lufthansa's airport lounges and awards double Miles & More miles. The revamp will take effect in July. When all is said and done, the new Germanwings will have about 90 airplanes, many transferred from mainline Lufthansa. Its assignment will be all shorthaul flying that doesn't touch Frankfurt or Munich.

Courtesy Lufthansa

Lufthansa's new Air Berlin killer

- **Lufthansa** is improving its mainline longhaul service too, doing something that many others have already done. In time, it will outfit its entire longhaul fleet with a premium economy section. It hasn't disclosed any details, some of which are still under development. Will it be highly differentiated from economy, like most European airlines (but not **KLM**)? Or will it—like most U.S. carriers and KLM—be standard economy seats with extra legroom and perhaps some extra recline but no extra width?
- The new African airline **Fastjet**—watched with great expectations due to the pedigree of its financial backers (i.e., **easyJet** founder Stelios Haji-Ioannou)—said it's negotiating to buy the assets of South Africa's bankrupt LCC **1Time**. It's also said to be talking with **Emirates** about some sort of marketing partnership.
- **Singapore Airlines** might or might not wind up selling its 49% stake in **Virgin Atlantic**. But don't forget: it recently bought 10% of **Virgin Australia**. And now it wants to work with **Virgin America**. It recently filed a U.S. DOT application to put its "SQ" flight code on about 20 Virgin America markets from San Francisco and Los Angeles.
- Despite Hurricane Sandy, **United**, during November, achieved its best monthly operating performance of 2012. And to thank its "co-workers," as it calls employees, management awarded a $100 bonus to eligible front-line workers. For domestic flights, United's on-time arrival rate was 86%. For international flights it was 81%. At **Delta**, 91% of November flights arrived on time, while for **US Airways**, the figure was 88%.
- **Azul**'s commercial EVP Trey Urbahn explained the rationale behind merging with **Trip**, a deal that combined Brazil's No. 3 and No. 4 airlines by size. Urbahn, speaking to *Airline Weekly* last week in London at the Marketforce/IEA "Future of Air Transport" conference, said Azul's initial plans were to list its shares publicly. But that proved impossible when the Brazilian stock market faltered. So the merger fortified its market presence in the face of difficult economic, infrastructure and forex challenges. Urbahn did say demand has rebounded strongly of late, after a period of weakness earlier this year. (Azul also suffered an $8m loss this year when its home airport was closed for 45 hours due to a cargo plane mishap). Speaking publicly at the conference, he also noted strong merger synergies so far and said just 8% of routes directly overlap with **TAM** and/or **Gol**. Like **JetBlue**, an earlier brainchild of Azul founder David Neeleman, Azul offers leather seats and inflight satellite televisions, doesn't overbook and has no middle seats on its E-Jets (it also flies ATRs). And most importantly, just as JetBlue's key network coup was setting up shop at domestically underserved New York JFK, Azul's masterstroke was setting up shop at underserved Viracopos-Campinas airport not far from Sao Paulo. Campinas is now the busiest hub in the nation measured by nonstop destinations offered by a single airline. Azul believes the Brazilian market remains underpenetrated and is currently taking about two planes per month, earning what it claims are 40% unit-revenue premiums above TAM and Gol. (It does, of course, fly smaller planes with higher units costs.) "We are not," Urbahn added, "a low-cost airline."
- At the same event last week in London, **Etihad** CEO James Hogan revealed nothing about rumored plans to buy a stake in India's **Jet Airways**. But he did say there was much more to come to further tighten Etihad's new alliance with **Air France/KLM** and its longer-running but more rudimentary one with **Alitalia**. Etihad also wants to do more with **Aer Lingus** and more generally believes strongly in the potential for joint procurement, joint fleet management, shared training and shared maintenance with its partner airlines, many of which it partly owns. Its closest partner, of course, is **Air Berlin**, where it seems to essentially be running the show—after all, it did rescue the carrier from oblivion. In the meantime, Etihad is growing organically too, sensing enormous opportunities in east-west traffic flows, many involving India and China with their 2b-plus people combined. As Hogan likes to say, Etihad has none of the "legacy airline baggage" burdening many of its rivals. Last year it earned its first annual profit: $14m net. It expects to have $10b in revenues by 2017 and will next year add flights to Washington, Ho Chi Minh City and Sao Paulo. Separately, Etihad announced a new Panasonic-powered "Wi-Fly" connectivity offering for passengers.
- **Spirit Airlines** CEO Ben Baldanza gave a presentation of his own last week, in this case at the INVESTFlorida investor conference near Fort Lauderdale. He repeated his mantra that for Spirit, "price *is* the product,"—i.e., if it's cheap, it's giving customers what they value most. He said the targeted consumer is anyone that pays for his or her own airline tickets—this excludes managed travelers but does include some small business fliers. While most U.S. airlines keep capacity steady, Spirit is growing rapidly to chase what it considers at least 140 airplanes worth of opportunity, up from 44 today. Remarkably, it now serves more domestic destinations from Dallas DFW than it does from its home airport Fort Lauderdale (where many of its routes are international). Baldanza added that he laughs every time he's watching a football game and sees a **Southwest** ad touting that bags fly free, knowing that its average fare is $68 more than what Spirit charges.

The Backend

Sales, Distribution, Tourism & Corporate Travel

- **Finnair** agreed to sell its ancillary products through Sabre, just as it already does through Amadeus. Sabre-using travel agents can already book checked bags for their Finnair-flying customers, and will soon be able to book prepaid preferred seats as well. As a carrier specializing in longhaul business travel to and from Asia, Finnair is especially dependent on travel agencies.
- **Virgin Australia** signed a full content distribution agreement with Amadeus, while the less esteemed **Pakistan International Airlines** did the same with Travelport. For Virgin, the move is particularly important now that it's chasing corporate travelers. Recall that it will soon install the SabreSonic reservation system as well.
- Priceline said the average roundtrip U.S. domestic airfares this Christmas holiday season, based on a recent two-week sample of tickets purchased on its website, is $469. That's up 4% y/y, though shoppers paid less than average if they booked earlier—$444 if booked a month ago and $430 if booked in early October.
- The World Travel and Tourism Council says international tourist demand remains "impressively resilient" despite tough global economic conditions. But y/y growth has indeed slowed, and international tourist arrivals will likely rise just 3% for all of 2012. For the first nine months of the year, arrivals grew 4% y/y, with North Africa up 10% as travelers returned after 2011's unrest—the Middle East region, however, is down 1%. The Asia-Pacific region saw a 7% increase, Latin America was up 6%, sub-Saharan Africa was up 4% and Europe and North America were each up 3%.

Steady but Uncertain: Q3 2012 East Asian airline earnings

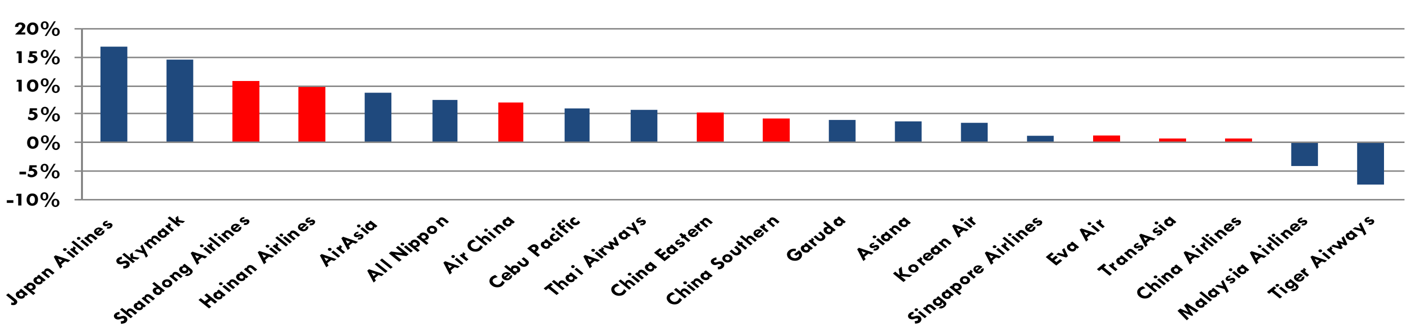
Most profit margins still good during what's for most carriers a peak season; last year's collective margins were a bit better though
Some carriers improving y/y while others—notably those based in mainland China—are regressing (see "difference" column)

All Nippon still enjoying strong local currency, new B787s, new JVs and so on; not doing quite as well as its archrival JAL, but margins up y/y
China Southern, like all Chinese carriers, not doing as well this year as last; expanding more aggressively abroad than other two Big Three peers
Air China still the profit champion among the Big Three but revenues growing more slowly; all eyes on China's economy
Japan Airlines riding high post bankruptcy but facing some headwinds including sluggish domestic market and revenue loss from China routes
China Eastern still much improved from several years ago, before it merged with Shanghai Airlines; faces threat from ambitious Spring Airlines
Singapore Airlines not profiting like it once was as pax yields slump and cargo losses deepen; just bought into one Virgin; will it sell another?
Korean Air would have done better save for cargo weakness, but results did improve y/y; will it ever do something more with Delta?
Thai Airways enjoys a strong Q3, which is off peak in the ASEAN region; Thailand a gargantuan tourist market but a competitive one
Asiana growing pax revenues, especially to Europe, North America and Japan, but cargo revenues weak; cargo about 25% of its total revenues
Hainan Airlines still prints money on many domestic routes where fare competition is muted; having less luck on international routes
China Airlines didn't do as well as it should during peak summer season, weighed down by cargo weakness; visa waivers should help U.S. routes
Malaysia Airlines improving but not fast enough; getting hammered in all directions by AirAsia; maybe new A380s and oneworld will help
EVA Air doing a bit better than its larger rival China Airlines but still feeling the cargo slump; will soon join the Star Alliance
Garuda continues its ascent to respectability among Asia's business travelers; Indonesia white hot with growth but rivals like Lion Air growing too
AirAsia making good money and growing all over the place; Indonesia now one of its best markets, but Malaysia still where most of the action is
Shandong Airlines a consistently profitable unit of Air China; operates a lot of routes with heavy business and government traffic
Skymark remains highly profitable, but its all-domestic network is under assault by LCCs; hopes for salvation in A330 and A380 longhaul service
Cebu Pacific now facing competition from AirAsia Philippines and a recapitalized PAL, will also try its luck with A330 longhaul flying
Tiger Airways still reeling from 2011's grounding in Australia, where it will now team with Virgin; Singapore alone had positive 4% op. margin
TransAsia making a bit of money challenging its two larger rivals; big to mainland China and Japan; might fly to Australia/Mideast with A330s

Airline (ranked by revenue)	Revenues (in m)	Expenses (in m)	Operating profit (in m)	Op. profit ex special items (in m)	Net profit (in m)	Net profit ex special items (in m)	Op. margin ex si	Net margin ex si	Revenue y/y	Expenses y/y	Difference
All Nippon	$5,216	$4,398	$818	$818	$461	$747	**16%**	14%	10%	4%	6 pts
China Southern	$4,737	$4,276	$461	$461	$419	$419	**10%**	9%	9%	16%	-7 pts
Air China	$4,563	$3,913	$650	$650	$557	$557	**14%**	12%	2%	6%	-4 pts
Japan Airlines	$4,421	$3,393	$1,028	$1,028	$897	$897	**23%**	20%	1%	4%	-3 pts
China Eastern	$3,988	$3,597	$391	$391	$435	$435	**10%**	11%	3%	7%	-4 pts
Singapore Airlines	$3,162	$3,103	$59	$59	$88	$88	**2%**	3%	3%	4%	-1 pt
Korean Air	$3,001	$2,725	$276	$276	$300	$113	**9%**	4%	3%	0%	3 pts
Thai Airways	$1,691	$1,575	$116	$116	$60	$69	**7%**	4%	5%	2%	3 pts
Asiana	$1,331	$1,246	$85	$85	$71	$35	**6%**	3%	7%	12%	-5 pts
Hainan Airlines	$1,307	$1,113	$193	$193	$191	$191	**15%**	15%	5%	18%	-13 pts
China Airlines	$1,167	$1,108	$59	$59	$47	$47	**5%**	4%	1%	-1%	2 pts
Malaysia Airlines	$1,121	$1,119	$1	$1	$13	($20)	**0%**	-2%	-2%	-7%	5 pts
EVA Air	$955	$901	$54	$54	$52	$52	**6%**	5%	5%	3%	2 pts
Garuda	$921	$835	$86	$86	$62	$62	**9%**	7%	9%	9%	flat
AirAsia*	$669	$556	$113	$69	$65	$33	**10%**	5%	11%	9%	2 pts
Shandong Airlines	$531	$429	$102	$102	$108	$108	**19%**	20%	12%	13%	-1 pt
Skymark	$345	$261	$84	$84	$51	$51	**24%**	15%	15%	24%	-9 pts
Cebu Pacific	$194	$190	$4	$4	$13	$1	**2%**	0%	5%	5%	flat
Tiger Airways	$164	$174	($10)	($10)	($15)	($15)	**-6%**	-9%	79%	38%	41 pts
TransAsia	$86	$84	$2	$2	$4	$4	**2%**	4%	5%	16%	-11 pts
Regional total	**$39,569**	**$34,994**	**$4,575**	**$4,531**	**$3,878**	**$3,873**	**11%**	**10%**	**x**	**x**	**x**

How did they do for the first nine months of the year?

Operating profit margin (ex special items) from January through September. (Airlines in greater China are in red.)



Source: *Airline Weekly* analysis of company reports. *AirAsia's results include all subsidiaries and joint ventures. Figures converted to US$ at current exchange rates

State of the Unions

Workforce Developments

- A year after filing for bankruptcy, **American** has a long-term consensual, concessionary contract in place with its pilots. Nearly three quarters of those voting on a tentative deal said “yes,” laying one of the final planks in a 12-month restructuring that also involved new contracts with all other labor groups, a reduction in debt, the renegotiation of aircraft and real estate leases, concessions from suppliers, the addition and subtraction of several routes and job cuts. The new six-year pilot agreement, by the way—ratified after an earlier tentative deal was voted down over the summer—is the first new American pilot contract since prior to 9/11. So where does American stand one year after bankruptcy? Happily, it’s making money again. Less happily, as of last quarter it still wasn’t making as much money as its peers. But that was with its pilots still working under pre-bankruptcy terms most of the quarter and then staging an expensive work slowdown. Addressing American’s workforce last week, CEO Tom Horton trumpeted the new B777-300ERs, A319s and A320s on the way and a brand overhaul coming soon. He also said “we expect to have a conclusion on [the **US Airways** merger proposal] soon.” The Allied Pilots union, for its part, said it “continues to support a merger with US Airways as the best path to a stronger, more competitive American Airlines that will in turn enhance our pilots’ long-term career prospects.”
- Strikes at **Iberia** remain scheduled to start this week. **British Airways**, meanwhile, is looking to buy out 400 of its own most senior flight attendants. In other words, it wants them to retire early, with the intention of lowering average seniority. That usually involves severance packages that sometimes include travel privileges.
- **easyJet** pilots represented by the BALPA union said the carrier’s success is “built on the use of cheap contract labor.” This sudden verbal broadside follows news of a big bonus payout to CEO Carolyn McCall. Although the union credits her with leading easyJet’s impressive performance, they questioned the fairness of such compensation while the company uses contract pilots with lower pay and inferior terms. ALPA wants only pilots actually employed by easyJet to fly easyJet planes.

The Landing Strip

Airport Developments

- There’s no shortage of reasons why **Delta**’s Atlanta hub is not just the busiest airport in the world but also one of the most lucrative and powerful. Its geographic position is excellent for all kinds of busy traffic flows, its costs are low, its layout is loved by travelers, it’s the only airport in town, it has few competing nearby hubs and so on. Well now Porsche, the large German car builder, has broken ground on its new North American headquarters next to the airport. A large number of foreign auto makers have their North American facilities in the U.S. southeast, making them natural Delta customers. Porsche’s executives won’t even have to take a connecting flight.
- In an incident that might or might not really be about bigger geopolitical matters, the Maldives, a popular tourist destination, took control of its main airport from India’s GMR Infrastructure. GMR had a contract to build and operate the airport. The Maldivian government suddenly seized the airport and canceled the visas of GMR’s staff, including non-Indian executives. Officials denied allegations that China, looking to throw its weight around in the Maldives, was behind the move. A previous government, since ousted, had originally signed the contract with GMR.

Mainland China’s Busiest Airports

Ranked by 2011 passenger volumes

Rank	Airport	Passengers
1	Beijing	79m
2	Guangzhou	45m
3	Shanghai PVG	41m
4	Shanghai SHA	33m
5	Chengdu	29m
6	Shenzhen	28m
7	Kunming	22m
8	Xian	21m
9	Chongqing	19m
10	Hangzhou	18m

Who's Flying Where

- Last week saw the debut of several prominent international routes, including a new **British Airways** flight to Seoul, a new **Japan Airlines** flight to San Diego, a new **Emirates** flight to Lyon and a new **Alitalia** flight to Abu Dhabi. The BA service perhaps marks the start of an Asian offensive designed to make its network there competitive with **Lufthansa**, **Air France/KLM** and **Finnair**—BA's partner **American**, remember, will itself start Seoul flights in May. For JAL, San Diego becomes its seventh U.S. destination and is made economically feasible by the airline's new B787s. Lyon, a city famed for its food, becomes the third French city for Emirates, which also dines in Paris and Nice. And the significance of Abu Dhabi to Alitalia—it will fly there from Rome—lies in its partnership with **Etihad**, which itself flies from Abu Dhabi to Milan. That partnership might deepen along with Etihad's partnership with Air France/KLM, which in turn is a part owner and partner of Alitalia.
- Like its neighborhood rival **Emirates**, **Qatar Airways** also started a new route to Europe last week. It's now flying to Warsaw, the capital of Poland where Emirates itself will start flying in February. One after another, the major cities of Europe are falling into the orbit of Gulf carrier networks, giving their residents excellent access to hundreds of destinations in the Middle East, Africa, the Indian subcontinent, the ASEAN region and Australasia. No wonder Europe's longhaul airlines feel besieged, although they're still largely immune to Gulf carrier attacks on journeys connecting Europe to northeast Asia and the Americas—connecting via the Middle East just doesn't make geographical sense for that.
- Which is not to say that Gulf carriers don't have business in markets like northeast Asia. True enough, they're not flying many Europeans there. But they are flying many Africans and even South Americans there. So it's no surprise that **Qatar Airways**, not content with the five new cities it's already announced for 2013 (Gassim, Najaf, Salalah, Phnom Penh and Chicago), will now put Chengdu in China on its route map come March. Flights will operate three times per week using A330s, joining service to five other cities in greater China: Beijing, Shanghai, Guangzhou, Chongqing and Hong Kong.
- **Turkish Airlines** will this week step into two more African cities, linking Istanbul to Niamey in the Central African Republic, with onward service to Nouakchott in Mauritania. The two Saharan desert nations are among the world's poorest, with minuscule amounts of tourism and business travel. But some people—economic development officials and aid workers, for example—have to get there somehow and will pay a premium to do so. Mauritania, it's important to note, does have some offshore oil activity too, although it's hardly a major global energy supplier.
- Iran is most definitely a major global energy supplier, international sanctions on its exports notwithstanding. It also shares a border with Turkey, which makes **Turkish Airlines** all the more eager to develop a network there. Later this month, it will start Istanbul flights to Kermanshah and Isfahan, each twice per week. You can see how Turkish is focusing less on flight frequency and more on adding new points to its network, which makes sense for remote markets where any service by a reputable airline, however infrequent, is a welcome development for travelers.
- Turkey's main low-cost carrier **Pegasus Airlines** is also expanding and will make Belgrade in Serbia its first new destination of 2013. Istanbul SAW flights start in February. Don't forget that the parent company of Pegasus owns 12% of **Air Berlin**, although it's largely a passive shareholder that takes a back seat to **Etihad** and its heftier 29% stake. Separately, Pegasus told the *Khaleej Times* that its new Dubai flights are doing well and that it wants to add more Gulf routes including Doha, Kuwait and Bahrain if it can secure flight rights. It also wants to expand in the former Soviet region and will soon announce a new plane order.
- In the U.S. market, **Spirit** concluded that Washington Reagan airport doesn't fit its business model, so it's handing back slots to the U.S. DOT, which regulates entry there. Without hesitation, three carriers jumped at the chance to apply for the slots. One was **Southwest**, which wants to fly to Houston Hobby. Another was **US Airways**, which wants to fly to Oklahoma City. (To sweeten the deal, it also promised Oklahoma City flights from its big Charlotte hub, which it somewhat surprisingly doesn't yet offer, if it gets the DCA slots.) The third was **JetBlue**, which wants to fly to Jacksonville. The DOT will choose the winner based on its assessment of which route would prove most beneficial to the flying public.
- Apparently, Denver and Houston IAH airports, on the other hand, do fit the **Spirit** business model. The ancillary-heavy LCC will add one new destination from each: Detroit from Denver and Orlando from Houston. Spirit is also moving up the start date for new Philadelphia and Minneapolis flights from Dallas-Fort Worth, as well as for some new Myrtle Beach flights.
- Taiwan nationals can now visit the U.S. without a visa, so **Hawaiian Airlines** responded by announcing new thrice-weekly A330 service connecting Taipei with Honolulu. Hawaiian was impressed by the surge in U.S. tourism that followed Korea's designation as a visa waver country, which made a winner out of its Seoul-Honolulu flights. It hopes to repeat the pattern with its newly announced Taipei service.
- Out of the longhaul game for three years, **CSA Czech** will jump back in with new A330 flights to Seoul. If that sounds a bit odd, it is: an airline with one longhaul destination from Prague, and it's a secondary Asian market rather than, say, New York or even Tokyo. The motivation seems to stem from a relationship that CSA has with **Etihad**, which it wants to replicate with SkyTeam partner **Korean Air**. The Czech carrier recently opened Abu Dhabi service and says it's going well thanks to the Etihad cooperation. Korean Air is occasionally named as a possible investor in CSA, which its government owners are trying to dump. **Qatar Airways** is also bandied about as a possible suitor.
- On **CSA**'s shorthaul front, Latvia's **airBaltic** is attacking with three weekly flights to Prague, marketing connections to Scandinavia and the former Soviet region, the latter a rare market where **CSA** has some modest competitive strength. airBaltic itself has had its share of struggles but did earn a solid $7m net profit in the peak third quarter. And while it's reducing capacity on some routes, it plans six new destinations for next summer.
- Spain's **Vueling**, which already has a base in Rome, will now open one in Florence. The LCC, seeking to diversify away from its economically battered home country, will boost its presence in only marginally better-off Italy with new Florence flights to London Heathrow, Copenhagen, Berlin and Hamburg. It already serves the resplendent renaissance city from Barcelona, Madrid and Paris Orly. But for all its recent expansion, Vueling is shuttering its Toulouse base, where fighting with **easyJet** and **Air France** has been too intense.
- When not at war with **Vueling** in France, **easyJet** is spending most of its time on what's by far its largest market: the U.K. And within the U.K., its newest and fastest growing base is London Southend, which it will start connecting to Newquay in southern England next summer.

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Who's Flying Where

CONTINUED FROM p. 8

- In the American west, **Allegiant** will fly to its Phoenix Mesa leisure base from Provo, Utah, home to Brigham Young University. The airline's only other destination in Utah is Ogden. It does not, in other words, fly to Salt Lake City, where **Delta** and **Southwest** have a large presence.
- **Ethiopian Airlines** is trying to replicate the international joint venture strategy pioneered by **LAN** and reproduced with success by **AirAsia** and **Jetstar**. It already owns 25% of **African Sky**, or **ASKY**, which flies from Lome, Togo, and which just last week announced service to Senegal—finally. It badly wanted to serve Dakar, one of western Africa's busiest markets, but until now was blocked by protectionist shenanigans. ASKY's new Dakar flights will operate three times per week from Lome via Bamako in Mali. In the meantime, the remarkable Ethiopian has its eyes now set upon Malawi, Zambia and perhaps other underserved markets.
- It would probably love to launch an airline in Nigeria too, but even just thinking about the bureaucratic hurdles gives pain to the brain. That was on display this autumn when **Arik Air**, a local airline based in Lagos, had a large number of its planes temporarily grounded as airline officials argued with government officials about who owed how much to whom. Nevertheless, things are calm at the moment, and Arik is now offering new twice weekly Lagos service to Kinshasa via Douala using B737-700s.
- **AirAsia** seems to have its eyes on India. CEO Tony Fernandes, who visited Mumbai last week and speaks glowingly about India's potential, tweeted a remark about being "done in ASEAN" but "will focus on larger joint ventures." While hard to conclude anything from that, there's been plenty of market chatter about AirAsia investing in an airline like **SpiceJet**, which has said it was shopping a stake in itself. Again, nothing to suggest an AirAsia India is imminent, but plenty of clues hinting that Fernandes spends a lot of time thinking about the market.
- **Vietnam Airlines** began flying from Ho Chi Minh City—some still call it "Saigon"—to Jakarta using A321s. Come to think of it, the fact that neither Vietnam Airlines nor **Garuda** had flown this route—a route connecting two of the most important cities in the ASEAN region—is remarkable. One airline recently entered though, and Vietnam Airlines will have to contend with it: **AirAsia Indonesia**.
- As for **Garuda**, it switched its Dubai service—which it used as a stopover for onward journeys to Amsterdam—to Abu Dhabi instead. Why? Because like so many other airlines these days, Garuda signed a partnership deal with **Etihad**. Separately, Garuda is eagerly awaiting its first B777-300ERs next year, which will enable it to serve Moscow and Los Angeles, each slated to launch in 2014. It will also re-enter the Auckland market with A330-300s next year (man, do Asian carriers love that aircraft) and assign its **Citilink** unit to operate regional domestic routes with turboprops. It's evaluating both Q400s and ATRs. The winners will be based in Batam (just south of Singapore) and Lombok (east of Bali).
- **SpiceJet** is again venturing abroad, announcing new service from Delhi to both Guangzhou in China and Riyadh in Saudi Arabia. Not to neglect its home market though, it also starts a new Delhi-Udaipur route this week.

Around the World

A Look at the World's Airlines, Including Endweek Equity Prices

Airline	Share Price	Change from last week	Change from last year	Comment
United	20.51	1%	-1%	Hainan Airlines planning to compete with United and American on Beijing-Chicago route
Delta	10.11	1%	19%	Will hold an investor day event Wednesday; Southwest will hold one Friday
American	0.57	14%	-12%	Eagle, its regional carrier, says costs are down by almost $75m; ground handling revenue up
US Airways	12.77	-1%	127%	Nov. pax RASM flat y/y; Southwest up 1%, Delta up 3% on strong corp./Thanksgiving demand
Southwest	9.81	3%	16%	CEO Gary Kelly succeeds Delta's Richard Anderson as chairman of the A4A lobby group
Alaska	42.50	-1%	22%	A4A on a renewed lobbying push to promote lower taxes and other aviation-friendly policies
JetBlue	5.24	2%	4%	Battling Delta on Caribbean routes from New York JFK; Delta now boosting service to Aruba
Virgin America	(not publicly traded)			Announces marketing deal with YouTube for inflight programming
Hawaiian	6.21	0%	3%	Longest route it flies is Honolulu-Manila; Australia flights actually shorter
Spirit	17.14	2%	8%	Opened its new Dallas DFW crew base last week; continues to recruit flight attendants
Allegiant	73.25	-1%	41%	Seeing a "slightly weaker fare environment" for Dec.; total RASM down 5%-6% y/y in Nov.
SkyWest	11.56	0%	-6%	Flight attendants at Delta's Compass subsidiary clamoring for new contract
Republic/Frontier	5.68	-2%	44%	Southwest gets DOT to give AirTran Frontier's flight rights for Denver-Los Cabos
Air Canada	1.75	-2%	61%	Rival Porter says advance bookings, yields strengthening; sees "strong early trends" for winter
WestJet	19.58	4%	76%	Has just 10% of the managed travel segment in Canada; believes it can get much more
Aeromexico	19.30	-3%	-18%	LCC rival VivaAerobus seeking to quadruple in size by 2020 (*CNN Expansión*)
LAN/TAM	16.94	1%	-6%	TAM's domestic load factor rose 14 points y/y in Nov. as it cut ASK capacity 5%
Gol	5.08	6%	-42%	Weaker local currency a nightmare for fuel costs, leasing costs and maintenance costs
Copa	95.99	1%	54%	December and January holiday season one of its most profitable periods of the year
AviancaTaca	4450	2%	29%	Florida trade delegation arrives in Colombia to, among other things, urge new Avianca flights
Emirates	(not publicly traded)			Arab Air Carriers Organization (AACO) member RPK traffic up 11% y/y through October
Air Arabia	0.74	3%	20%	Increasing frequencies to Pakistan, putting more pressure on Pakistan International Airlines
Turkish Airlines	5.84	11%	154%	CEO tells *Reuters*: Lufthansa talks positive, announcement could come early next year
Kenya Airways	10.75	-10%	-43%	Has new co-branded credit card with Barclays
South African Air.	(not publicly traded)			Ethiopian flying B787s on Addis-Jo'burg; marketing China, India and Mideast connections
Jet Airways	531	1%	125%	Trying to find new homes for five B777s currently leased to Thai Airways until next year
Aeroflot	103.34	2%	-10%	Ready to launch an LCC but only if Russia changes outdated regulations
Crude oil futures (WTI, for delivery next month; source New York Mercantile exchange)	$86	-3%	-14%	U.S. crude oil production at its highest level since 1998. Largest producers by state are Texas, North Dakota, California, Alaska, Oklahoma and New Mexico (source: U.S. Energy Information Administration)

Some stocks traded on multiple exchanges; not intended for trading purposes

Around the World

A Look at the World's Airlines, Including Endweek Equity Prices

Airline	Share Price	Change from last week	Change from last year	Comment
Lufthansa	13.38	5%	45%	Already runs a joint venture leisure airline with Turkish Airlines called Sun Express
Air France/KLM	7.11	1%	69%	Has carried more than 3m passengers on A380s since putting plane in service in Nov. 2009
BA/Iberia	171	1%	12%	Premium RPK traffic up 5% y/y in Nov., outpacing the 3% growth in non-premium RPKs
SAS	8.20	18%	-1%	Secured $125m loan backed by three of its A330-300s; separately, seeing "good" demand
Alitalia	(not publicly traded)			All B767s and MD-80s now gone from its fleet; flying just A319/20/21s, A330s, B777s now
Finnair	2.39	8%	-4%	"In November," it said, "we saw continuing strong development in our traffic performance"
Aer Lingus	1.09	0%	58%	Atlantic traffic and loads surge y/y in Nov. but shorthaul traffic depressed by strike threats
Virgin Atlantic	(not publicly traded)			*The Sunday Times* reports an imminent marketing deal with Aer Lingus; stay tuned
easyJet	732	2%	93%	*Times* of London reports that Egyptian tourism officials want it to serve Cairo from London
Ryanair	4.85	2%	26%	Adding eight new routes from Glasgow and Edinburgh
Air Berlin	1.37	-2%	-46%	Might sell its TopBonus frequent flier plan to Etihad, its largest shareholder
Norwegian	144.00	6%	134%	RASK up 5% y/y in Nov. on 6% higher yields; strong results considering 23% ASK growth
Vueling	7.15	0%	73%	Doing quite a lot of new Heathrow flying; Florence will be its first non-Spanish LHR route
Aegean	1.72	1%	21%	Encouraging tourists to visit islands like Crete in the winter, not just the summer
Japan Airlines	3790	0%	x	LCC rival Peach, like Delta's old LCC unit Song, specifically targeting female passengers
All Nippon	177	0%	-21%	Expanding codeshare relationship with India's Jet Airways
Korean Air	44250	-2%	-8%	Rumored to be among the interested for a stake in CSA Czech; Qatar another potential suitor
Cathay Pacific	13.64	0%	4%	Hong Kong Airlines trying to negotiate its way out of an ill-advised A380 order (*Dow Jones*)
Air China	5.55	7%	-5%	China to allow connecting pax via Beijing to spend up to three days in the city without a visa
China Eastern	2.75	4%	-4%	Will fly to Sydney from Nanjing, a relatively wealthy city in the Shanghai region (*Xinhua*)
China Southern	3.60	4%	-9%	Partner Xiamen Airlines, which happens to be highly profitable, working closely with KLM
Singapore Airlines	6.85	2%	19%	Jetstar's Singapore operation adding capacity to Bangkok and Penang
Malaysia Airlines	0.83	-5%	-37%	Regional rival Vietnam Airlines to codeshare with Israel's El Al
AirAsia	2.76	-3%	-25%	AirAsia X to add seven planes in '13; key markets: China, Korea, Japan, Australia, Taiwan
Thai Airways	21.60	-1%	-4%	Nok Air currently serves just two int'l points: Penang in Malaysia and Vientiane in Laos
Cebu Pacific	62.80	0%	-7%	Major storm causes major flight disruptions in the Philippines last week
Qantas	1.35	2%	-15%	Abandoning plans for inflight Wi-Fi after trial shows low uptake rate
Virgin Australia	0.44	0%	29%	Tiger Airways Australia chief leaving for arch-enemy Jetstar
Air New Zealand	1.07	5%	53%	Hong Kong-London Heathrow flights, as previously announced, will stop in March

Some stocks traded on multiple exchanges; not intended for trading purposes

Flyer Beware: Longhaul markets can be tough for all carriers—and especially for LCCs

CONTINUED FROM p. 1

Those two airlines, as it happens—the latter 49% owned by the former—do have a history of profitability. And Emirates, too, with its roughly 2,900 mile average stage length—the third longest among all major airlines—shows it's still possible to earn nice profits on longhaul. But all three of these enjoy exceptional advantages, be it strong government support, a booming home economy or artificial supply constraints at London Heathrow. For most airlines, even as the world globalizes and demand for longhaul air service increases over time, profiting from it has become ever more difficult. The more recent struggles of Singapore Airlines and Virgin Atlantic (and the questionable merits of the former's new Scoot unit) attest to that.

Like so much else in the airline business, higher fuel costs are the chief reason for all this. All flights—long and short alike—consume fuel. But fuel is a much bigger piece of the overall cost pie on longhaul, where conversely other costs, particularly costs on the ground, matter less. No airline will say it doesn't care about airport costs, but listen carefully and notice that longer-haul carriers talk about them a lot less than shorter-haul ones. Longhaul inherently has lower unit costs but also lower unit revenues than shorthaul: after the costly exercise of selling seats, boarding a flight and getting it in the air, the airplane flies more revenue-generating miles without stopping, meaning unit costs fall. But passengers generally won't pay twice as much to fly twice as far, meaning unit revenues fall too. When fuel is expensive, this typically fixed-cost industry becomes more of a variable-cost industry, and chances are unit revenues will decrease more than unit costs: passengers still won't pay twice as much to travel twice as far, but now more than ever, it can cost nearly twice as much to fly an airplane twice as far.

And that, in turn, explains why LCCs in particular find longhaul so difficult. LCCs usually have lower costs than their legacy competitors for any stage length, but an LCC's biggest cost advantages are usually on the ground. That's true even for LCCs that have rather low crew costs or high seat densities. Low distribution costs, efficient ground handling, outsourced maintenance, alternative (read: cheaper) airports, no lounges, quicker aircraft turn times… ever since Southwest invented the model 40 years ago, successful LCCs have won the game by getting a big lead before the flight ever pushes back from the gate. Their customers almost always pay less than they would pay for a competing legacy airline flight, but that's okay as long as the cost advantage is greater than the revenue disadvantage.

Those cost advantages on the ground really add up for ultra-shorthaul airlines like Southwest, Ryanair and easyJet, which have average stage lengths of less than 700 miles. One aircraft might make a half dozen flights in a day. Turn the plane around 15 minutes more quickly than your competitor each time, and that might mean another 90 minutes of revenue-generating time in the air. Other efficiencies on the ground multiply similarly. But the advantage is lost on longhaul, where an aircraft might only make at most two turns a day.

Ryanair CFO Howard Millar said in late 2011 that the carrier decided against flying longhaul for the foreseeable future, after flirting with the idea, partly because by far the two most important costs on longhaul are aircraft ownership and fuel, and no one has an inherent advantage in those areas. So "unless you get very cheap fuel or very cheap aircraft, it's going to be hard to differentiate your costs from Lufthansa or Air France," he said. The other efficiencies—more productive workers, etc.—are still there, but they just don't matter as much as on shorthaul.

Mattering more on longhaul, meanwhile, are the traits that give LCCs their revenue disadvantages. These days, most corporations don't mind telling their employees to suck it up and fly easyJet from London to Lyon, but they're less likely to send them across the Atlantic with a similar lack of comfort. That's just one reason why easyJet thrives while Zoom Airlines—like Laker Airways, People Express and so many others before—failed. Revenue-generating tools like robust frequent flier plans, alliances, intricate connecting itineraries, multiple distribution channels, multiple classes of service, expensive and varied marketing strategies to appeal to culturally diverse client bases and on and on… they all matter most on longhaul, and they're all complex and costly activities on which LCCs generally don't focus.

Given all that, it's not so hard after all to understand why AirAsia's shorthaul unit can produce profit margins exceeding 20% while longhaul AirAsia X struggles to break even. Yes, things are surely improving as it replaces highly inefficient A340s with A330s and trades very long European routes for shorter ones to Asia. Still, the fact remains that both AirAsia X and shorthaul AirAsia have cost advantages and revenue disadvantages versus their legacy competitors, but the advantages carry the day on shorthaul whereas the disadvantages weigh most on longhaul. (Note, by the way, that in the U.S., Southwest and JetBlue—despite the latter's rather nice inflight product—have struggled when they've tried flying longish-haul transcontinental routes. And that Virgin America—with an average stage length of more than 1,500 miles, very long for a narrow-body carrier—has struggled badly, period.)

More generally, shorthaul routes involve higher traffic volumes where building a sustainable frequency advantage is possible: it's unlikely anyone will rival Southwest's 25 flights each day, each way between Dallas and Houston anytime soon. Most longhaul routes, by contrast, entail just a few daily frequencies at most, meaning any rival entering with a mere flight or two can decimate yields overnight. Longhaul markets are often more sensitive to macro-economic shocks too. They're more difficult to stimulate. They involve more complex crew scheduling. There are often overflight fees to pay and foreign bureaucracies to deal with. Widebody planes require lots of capital.

It's for these reasons and more, by the way, why any honest analysis of Norwegian's longhaul chances would have to conclude that the surprise would be if it *does* succeed, rather than if it does not. Yes, it has state-of-the-art B787s and a wealthy home market going for it. But that home market is small, Norwegian (unlike AirAsia) hasn't even proven it can consistently generate solid shorthaul profits and it now faces a leaner SAS, with its more robust network feed and Star Alliance membership and so forth.

WestJet, on the other hand, has indeed proven itself as one of the world's most successful airlines. And to be clear, it remains far from committed to flying longhaul—it simply said it's considering it for later this decade. Its cautiousness for now shouldn't surprise anyone.

Someone might someday operate a successful low-cost longhaul operation. But it would be a first.❍

Shorter haul, taller profits?

A look at the world's 25 largest airlines

Virgin Atlantic, not among the 25 largest listed below, has the longest average stage length of all (4,411 miles) and had a negative 1.5% operating margin for 2011.

Airline*	ASMs this week in b	Average stage length	2011 operating profit margin**
United	4.45	1,375	6%
Delta	4.05	1,103	6%
American	3.25	1,228	-2%
Air France/KLM	3.10	1,561	-1%
Emirates	3.10	2,857	4%
Lufthansa	3.06	1,148	3%
BA/Iberia	2.71	1,646	3%
Southwest	2.40	692	5%
Air China	1.94	927	6%
Qantas	1.65	1,357	3%
Singapore	1.63	2,706	3%
Cathay Pacific	1.60	2,066	5%
China Southern	1.60	884	4%
LAN/TAM	1.56	960	7%
US Airways	1.53	793	3%
China Eastern	1.45	807	4%
Turkish Airlines	1.21	1,174	1%
Air Canada	1.16	1,379	2%
All Nippon	1.14	762	6%
Qatar Airways	1.12	2,291	(not disclosed)
Korean Air	1.11	1,692	4%
Thai Airways	1.06	1,890	-3%
Japan Airlines	0.98	1,045	14%
Ryanair	0.92	679	15%
JetBlue	0.75	1,132	7%

Source: **Diio Mi,** company reports and *Airline Weekly* analysis. *Including wholly owned subsidiary airlines. **Calendar year 2011 or closest period for airlines that don't report that period.