Contrary to expectations, the airline industry performed better overall in 1998 than in any other year this decade. US and European major carriers have learnt to maintain a wide margin between unit costs and revenues. Some airlines in the Asia Pacific are finally making a recovery.

US airlines enjoy best year

Expectations of a recession in the past year may have been due, in part, to the very real prospects of such an event occurring in the Asia Pacific region. Of course, many also thought that a recession was just about due (most economies having had it so good since 1994). In fact, the majority of the world's biggest airlines have actually experienced extremely strong results in 1998. For example, this was the best ever year for airlines in the US. However, there are also signs that 1999 will cause problems for a few airlines. Profits are expected to dip since traffic growth is expected to slow down as economic growth cools.

North America

Except for Northwest, which suffered a pilot strike for several months, all major US carriers maintained a positive difference between unit revenues and costs. This was about 1.0 cent for all airlines and operating profits have been healthy as a result *(see table, page 12)*.

In terms of difference between unit revenues and costs, US Airways had by far the highest result, not only of US carriers, but of all major carriers around the globe. The airline's operating profits of $1.014 billion on a revenue of $8.688 billion and traffic of 56,723 million available seat miles (ASMs) generated a difference between unit revenues and costs of 1.8 cents per ASM *(see table, page 12)*. This is a virtually unprecedented occurrence in the industry. Moreover, it is especially impressive for US Airways.

The airline has steadily increased its operating profit for the past four years after having made losses each year prior to this. In addition to unit revenues, US Airways also reduced unit costs.

One of the factors in US Airways' success has been its high unit revenues. Passenger unit revenues were 12.4 cents in 1998. This compares with less than 10.0 cents achieved by all other airlines. Total unit revenues were 15.3 cents per ASM. Not only does US Airways have the highest unit revenues of all north American airlines, it also has higher unit revenues than many European and Asia Pacific carriers.

US Airways achieved an operating profit of 11.7% of revenue in 1998. It also had a margin of 1.8 cents between unit revenues and costs, the largest of any US carrier.

SUMMARY OF US AND EUROPEAN AIRLINE FINANCIAL RESULTS YEAR END 1998

Airline	Alaska	America West	AMR Corp	Continental	Delta
Passenger revenue $m	1,410	1,859	14,695	6,804	13,212
Total revenue $ m	1,898	2,023	17,449	7,951	14,399
Operating costs $m	1,687	1,811	15,513	1,817	12,596
Operating profit $m	211	213	1,936	701	1,803
RPMs-mm	12,427	16,374	111,743	53,910	103,344
ASMs-mm	18,622	24,307	159,768	74,727	142,154
C pax revenue/ASM	9.4	7.6	9.9	9.1	9.3
C total revenue/ASM	10.2	8.3	10.9	10.6	10.1
C costs/ASM	9.1	7.4	9.7	9.7	8.9
Difference pax revenue & costs/ASM	0.3	0.2	0.2	(0.6)	0.4
Difference C revenue & costs/ASM	1.1	0.9	1.2	0.9	1.3

Airline	Northwest	Southwest	United	US Airways	Austrian
Passenger revenue $m	7,607	3,964	15,519	7,021	1,249
Total revenue $ m	9,045	4,164	17,561	8,688	1,668
Operating costs $m	9,134	3,480	16,082	7,675	1,579
Operating profit $m	(90)	684	1,479	1,014	90
RPMs-mm	66,738	31,420	120,340	41,254	5,128
ASMs-mm	91,311	47,544	171,892	56,723	7,764
C pax revenue/ASM	8.3	8.3	9.0	12.4	16.09
C total revenue/ASM	9.9	8.8	10.2	15.3	21.49
C costs/ASM	10.0	7.3	9.4	13.5	20.33
Difference pax revenue & costs/ASM	(1.7)	1.0	(0.3)	(1.2)	(4.24)
Difference C revenue & costs/ASM	(0.1)	1.4	0.9	1.8	1.15

Airline	British Airways	KLM	Lufthansa	Swissair	Virgin Express
Passenger revenue $m	11,237	4,151	8,437	4,430	277
Total revenue $ m	14,259	6,816	13,111	8,272	294
Operating costs $m	13,428	6,402	12,008	7,782	293
Operating profit $m	832	414	1,103	490	1
RPMs-mm	74,286	35,929	44,371	17,693	2,258
ASMs-mm	104,156	46,879	60,472	24,654	2,935
C pax revenue/ASM	10.79	8.86	13.95	17.97	9.45
C total revenue/ASM	13.69	14.54	21.68	33.55	10.03
C costs/ASM	12.89	13.66	19.86	31.56	9.99
Difference pax revenue & costs/ASM	(2.10)	(4.80)	(5.91)	(13.59)	(0.54)
Difference C revenue & costs/ASM	0.80	0.88	1.82	1.99	0.04

Source: Merrill Lynch

SUMMARY OF ASIA PACIFIC AND MIDDLE EASTERN AIRLINE FINANCIAL RESULTS YEAR END 1998

Airline	Emirates*	Air New Zealand	All Nippon Airways	Cathay Pacific	Japan Airlines
Passenger Revenue $m	884	1,225	5,975	2,387	7,041
Total revenue $m	1,114	1,699	7,002	3,425	9,382
Operating costs $m	1,043	1,601	6,997	3,424	9,144
Operating profit $m	71	98	5	1	238
RPMs-mm	7,116	12,185	34,052	24,695	48,916
ASMs-mm	10,171	18,017	53,129	37,222	72,469
C pax revenue/ASM	8.7	6.8	11.2	6.4	9.7
C total revenue/ASM	11.0	9.4	13.2	9.2	12.9
C costs/ASM	10.3	8.9	13.2	9.2	12.6
Difference pax revenue & costs/ASM	(1.6)	(2.1)	(1.9)	(2.8)	(2.9)
Difference C revenue & costs/ASM	0.7	0.5	0.0	0.0	0.3

Airline	SIA	Qantas	Malaysian	China Eastern	China Southern
Passenger Revenue $m	3,056		3,041	803	1,298
Total revenue $m	4,579	5,246	4,172	1,006	1,440
Operating costs $m	3,988	4,871	4,757	957	1,385
Operating profit $m	591	375	(585)	49	55
RPMs-mm	35,142	39,026	18,443	7,015	11,580
ASMs-mm	52,301	54,682	27,639	11,542	19,305
C pax revenue/ASM	5.8		11.0	7.0	6.7
C total revenue/ASM	8.8	9.6	15.1	8.7	7.5
C costs/ASM	7.6	8.9	17.2	8.3	7.2
Difference pax revenue & costs/ASM	(1.8)		(6.2)	(1.3)	(0.5)
Difference C revenue & costs/ASM	1.1	0.7	(2.1)	0.4	0.3

Source: Merrill Lynch
****Source: annual report***

AMR Corp and Delta turned in the largest operating profits of $1.936 billion and $1.803 billion, respectively in 1998. Again, this level of performance has been rare. Both airlines have reported annual operating profits in excess of $1.0 billion in the past three or four years and have managed steadily to increase operating profits.

AMR Corp also managed to widen the gap between its unit revenues and costs. The airline group achieved a 1.2 cents difference in unit revenues and costs *(see table, page 12)*.

American strengthened its position after acquiring Reno Air and Business Express. It also formed the One World alliance with British Airways, Cathay Pacific, Canadian and Japan Airlines, as well as several other major carriers. Finally it formed additional marketing alliances with US Airways and Alaska.

AMR Corp is the second largest global carrier and generates revenues of about $1.75 billion by its computer reservation system (CRS) Sabre. This system is used by many other carriers to book seats and is a substantial profit generator for AMR Corp.

Delta also had a stunning year after operating profits jumped by about $200 million to $1.8 billion. A higher proportion of Delta's revenue is from passenger operations. Despite its operating profits being $100 million less and unit revenues being 0.8 cents lower than AMR Corp's, Delta's unit costs were almost 1.0 cent less than AMR Corp's.

Delta managed a 1.3 cents gap between unit revenues and costs *(see table, page 12)*, the third highest of US airlines analysed here.

All other airlines had similarly high margins. The strategy of focussing on costs and operating margins rather than market share has paid off. As always the US's best performer was Southwest. The airline dominates each of its markets more than any other airline and has an average share of 80% in its top 25 markets. Southwest has become the US's seventh largest airline and has introduced electronic ticketing across its whole system. Despite being cautious about the results that may follow this move, 68% of the airline's sales are now via electronic ticketing.

Southwest's unit revenues and cost margin was 1.4 cents, putting it second, but still 0.4 cents behind, US Airways. While most other operators had high unit revenue and cost margins in the region of 1.0 cents, they achieved poorer results between 0.2 and 0.5 cents on passenger revenues alone. Southwest is a far stronger performer in passenger revenue terms and had a 1.0 cents margin over costs in 1998.

Commensurate with its strategy, Southwest had a unit cost level of 7.3 cents per ASM. This compares with 9.0 cents plus for most other US airlines. The only exception is full-service airline America West, which had a cost performance of 7.4 cents, almost identical to that of Southwest.

Europe

Austrian made its second consecutive annual operating profit after several years of substantial losses. Austrian's performance has been transformed since it joined an alliance with Swissair, Sabena, Delta and Air France. The airline also has codeshares with All Nippon Airways and Air China. The margin between unit revenues and costs has doubled in the past year.

Lufthansa was the strongest performing European carrier in 1998, with an operating profit of $1.1 billion *(see table, page 12)*. The Lufthansa group is substantial and passenger revenues only accounted for 64% of total revenues. The remaining 36%, $4.674 billion, was generated by Lufthansa Cargo, Lufthansa Cityline, Lufthansa Technik and other services, such as catering.

Lufthansa is also part of the Star alliance. Lufthansa has great revenue generating power. Unit passenger revenues of 13.95 cents are one of the highest of all airlines analysed here and the highest of all European carriers. Total unit revenues for the group are 21.68 cents, again the highest of all airlines studied here.

Lufthansa has also managed to maintain a wide margin of 1.82 cents between unit revenues and costs, generating its high operating profit in 1998. This is in large part due to Lufthansa's many other activities in the group, as well as the benefits in traffic it has gained from being a major partner in the Star alliance with United and Thai.

British Airways is the second strongest European airline, having been removed from top position by Lufthansa in recent years. BA turned over an operating profit of $832 million in 1998 and achieved unit revenues of 13.69 cents per ASM *(see table, page 12)*. Margin between unit revenues and costs was 0.80 cents per ASM, 1.0 cent less than Lufthansa. BA, of course, has fewer additional subsidiaries to the airline, than has Lufthansa.

Operating profits were down in 1998 over 1997, which, in turn, was down over its 1996 record performance. BA's falling performance has been blamed on the decreasing proportion of passengers using business and first-class services.

A high proportion of premium fare paying passengers has been key in BA's strong profit performance for more than a decade. Premium passengers have been eroded in recent years as the no-frills concept has begun to take hold in Europe. This is especially the case in the UK, with no-frills competitors easyJet and Ryanair growing rapidly since 1996. In response, BA launched its own low-cost subsidiary Go in 1997. It is too early to see what the overall effect of this will be on BA's profitability. BA has also experienced a continuous increase in competition on its long-haul network.

BA has been toppled from number one position as most profitable European airline. Increased competition has decreased premium fare passengers

The eroding profits could also be counterbalanced by a strategic alliance with American, but this is still awaiting approval.

KLM is another carrier that has experienced improved performance since becoming part of a strategic alliance. The carrier's operating profit performance increased by 744% over the year ending 1997 to 1998. Revenues jumped 29% by $1.533 billion.

Both KLM and Northwest have experienced substantial improvements in traffic with the power of their alliance re-directing traffic and increasing passenger numbers on their trans-Atlantic routes at unprecedented levels.

KLM's revenue passenger-mile traffic also rose 2.9%. This saw unit revenues rise 22.8%, an unprecedented

SIA increased porfits in 1998 after a dip in 1997. The airline has the widest margin between unit revenues and costs in the region and was barely affected by the Asia Pacific crisis.

achievement by most airlines' standards. Unit costs also rose, however, by 16.5%. This widened the gap between unit revenues and costs from 0.12 cents per ASM to 0.88 cents. Operating profit for the year ending 31 March 1997 leapt from $56 million to $414 million for the year ending 1998. Forecasts for 1999 are for a levelling of traffic and revenue growth as the initial effects of alliance plateaus.

No-frills airline Virgin Express, which began operations in 1996, achieved disappointing results. Its low-cost strategy, which was adopted in a similar way to Southwest, has achieved low unit costs of 9.99 cents per ASM. Although this is about 2.7 cents higher than its US counterpart, it is also in the order of 5.0 cents or more lower than European majors.

Despite the advantageous factor of being based in Brussels and having a passenger load factor of about 76%, Virgin Express has suffered because of an apparent lack of pilots. Unit revenues have failed to deliver a high margin between them and unit costs.

Asia Pacific and Middle East

Emirates is an impressive performer. The carrier has gone from strength to strength. The airline is still relatively small, with annual revenues of just $1.114 billion.

With a strong load factor of 70%, unit passenger revenues are 8.7 cents per ASM and total revenues 11.0 cents per ASM *(see table, page 13)*. The Emirates Group has several other activities, including maintenance division Dnata and Mercator.

The airline has a margin of 0.7 cents per ASM between unit revenue and cost, although this includes other group activities. This is comparable with US and European carriers and is better than most Asia Pacific airlines.

Japan Airlines (JAL) and All Nippon (ANA) managed to generate operating profits in 1998. ANA's performance was superior to JAL's for several years, but ANA's $ performance plummeted in the year ending 31 March 1998.

The Yen weakened during 1998, improving revenues earned from international sales for both airlines. The $: Yen exchange rate differences between 1997 and 1998 exaggerate the fall in $ performance during that period by a few percentage points.

ANA's passenger load factors were unchanged in 1998. Both traffic and capacity grew. Operating costs rose, but $ unit costs fell by 1.3 cents per ASM. About 0.2 cents of this was due to the weakening of the Yen since 1997. The airline's Yen unit cost still fell, since capacity grew at a higher rate than costs.

ANA's problems were caused by a fall in unit revenues, which tumbled 1.6 cents. About 0.6 cents of the figure was attributable to the weakening Yen, reducing the gap between unit revenues and costs to almost zero. The major factor in this was a lower rate of revenue growth compared to rise in costs.

JAL's problems of the past seven years were reversed in 1998 with a welcome jump in operating profits of $200 million to $238 million. Capacity grew faster than revenue, but costs were maintained. Unit revenues fell, but the gap between them and unit costs widened from 0.1 to 0.3 cents.

Cathay Pacific continued on a downward spiral, after Hong Kong's handover to China. Revenues dropped $530 million, while costs could only be lowered by $200 million. Operations and capacity are being slashed, but yields and unit revenues are suffering, with traffic in decline.

Singapore Airlines' (SIA) performance stood out from all other carriers in the region. While all other airlines have been wavering in the Asia Pacific crisis revenues have continued to grow.

SIA has not been totally immune to the economic problems of the region, since traffic in 1998 hardly changed from 1997. Despite this factor revenues improved, with a small fall in unit revenues by 0.1 cents to 8.8 cents. Costs also rose, but as the airline increased network capacity, unit costs fell faster than unit revenues. Nevertheless, the airline managed to keep the rise in unit costs under control and maintain the wide margin SIA has always enjoyed between unit revenues and costs.

This factor increased operating profits by $60 million to $591 million. The airline's operating profits in 1997 were down on the previous year, as it coped with the toughest year of the downturn in its region. The past year has allowed SIA to regain its profitable status, with an impressive ability to control unit costs.

In contrast, Malaysian Airline System's performance suffered. The airline increased traffic, revenue and unit revenues, but unit costs leapt by 3.3 cents per ASM. Capacity increased marginally while the airline has recently taken delivery of a large number of new widebodies. Some have now been deferred.

Capacity rose faster than traffic for China Eastern and China Southern. Despite double-digit growth in past years, China's carriers are now seeing capacity increases outstrip traffic growth. New aircraft deliveries have been deferred to stem mounting losses. The margin between unit revenues and losses slid in 1998. AC