# US carriers: the struggle continues

**While most airlines in most regions of the world return to profitability, US airlines continue to be beset with problems. High fuel prices, overcapacity and a weak yield environment hamper the progress of most.**

This last quarter saw US airlines successively issuing the third quarterly financial report. As expected, most major airlines continued to be in a poor financial position. Apart from the continuously fierce competition, historically high oil price and hurricanes were the sources of difficulty for these companies.

## AirTran

Total operating cost increased 22% to $257.6 million. Unit costs rose 6.7% to 8.65 cents. Excluding fuel, unit cost rose by 1.9%. Revenues rose only 3.5% to $245.6 million on 14.5% more capacity as AirTran's third quarter sales were decimated by the impact of four hurricanes, especially in Florida's markets which account for 50% of the airline's traffic. The company estimates the hurricanes accounted for $8 million worth of cancellations and $7-8 million in lost bookings. Consequently, AirTran reported a September quarter loss of $12 million.

The company ended the quarter with cash and cash equivalents of $347 million, of which $8.4 million is restricted. This is about $40 million less than at the end of the June quarter.

As carriers like Delta, Independence Air and US Airways move capacity east, AirTran's December Quarter loss forecast is lowered to $35 million. The whole year's performance is lowered from breakeven to a loss of $6 million.

## America West

Revenue declined 2.3% to $579 million for the quarter. Passenger revenue fell 1.9% to $542 million, despite a 10.5% increase in traffic. Yields collapsed 11.2%, resulting in a passenger revenue per available seat-mile (RASM) decline of 9.3%. The airline attributed the RASM decline to a longer stage length, traffic weakness in the transcontinental market.

Operating expenses increased 11.6% to $605.2 million (excluding a special item). Not surprisingly, fuel expense soared 48.8% to $136.3 million as America West paid $1.18 per gallon for kerojet; 40% higher than last year.

CASM rose 3.1% to 7.9 cents (ex-special item), but ex-fuel and special item, CASM declined 3.8% to 6.12 cents.

America West's performance is one of the industry's worst as evidenced by its negative 4.6% operating margin of $63 million.

America West ended the September quarter with $488 million in cash/short-term investments (of which $72 million is restricted); about $100 million less than at the end of the June Quarter.

America West is not expected to return to profitability until next year.

## JetBlue Airways

jetBlue reported a September quarter operating profit of $23 million; a margin of 7.1%. Revenue rose 18.1% to $323.2 million, while passenger sales rose a similar 17.8% to $311.6 million on 33.3% more capacity. Load factor fell 2.8 points to 84.9%.

The huge increase in capacity, an increase in average stage length and competitive pressures all had a depressing effect on yield and unit revenue. Yield fell 8.8% on a 2.7% increase in trip length, while passenger unit revenue declined 11.6% on a stage length increase of 3.7%. Passenger unit revenue declined 11.6% as a result.

Operating expenses rose 36.6% to $300.2 million, while unit costs increased 1.6% to 6.0 cents. jetBlue's results translated into a 7.1% operating margin, 12.6 points lower than its impressive performance of 19.7% a year ago. However, this operating margin was a respectable performance in light of the hurricane impact, which resulted in 2% of its flights being cancelled this quarter.

The company ended the quarter with $516.7 million in cash and short-term investments, about $33 million less than at the end of June.

Although estimates for jetBlue have been trending down for most of the year, the company is well-positioned to take advantage of growth opportunities that may arise from competitor contraction.

## Frontier Airlines

Frontier reported a September quarter loss of $22.5 million (excluding special charges). Total operating revenue increased 29.5% to $214.4 million. Mainline passenger revenue increased 17.6% to $188.2 million on a 38.5% increase in capacity. Mainline passenger unit revenue decreased 15.3% to 7.84 cents as mainline yields fell 11.2% and load factors declined 3.7 points to 72.9%.

The lower-than-expected loss was a function of good cost control. Excluding special items, total operating costs increased 46.9% to $210.8 million. Excluding fuel and special items, mainline unit cost fell 12.8% to 5.98 cents. Costs benefited from a 12% improvement in mainline aircraft utilisation and a 12.8% increase in stage length. Fuel expense increased as Frontier paid an average fuel price of $1.41 per gallon; 39.6% higher than a year ago.

Frontier reported a positive 1.7% operating margin, which is unfavourable versus last year's 13.5% margin, but nonetheless an improvement. The carrier ended the quarter with $160.1 million in unrestricted cash, or $33.5 million less than at the end of the June quarter.

Frontier intends to accelerate retirement of its 737s by four months, which will result in an all-Airbus fleet by April 2005. There is no indication what this means for 2005's capacity growth.

## ExpressJet

ExpressJet reported a September quarter operating profit of $52 million and operating margin of 13.4%, similar to the third quarter performance last year.

Operating revenue increased 12% to $385.7 million. Operating expenses were $334 million, up 12.6% from a year ago.

The carrier continues to see efficiency improvements due to its all-jet fleet, which resulted in a unit cost decrease of 5.1% compared to a year ago.

Express Jet's operating performance is evidence of the earnings stability afforded under fixed-fee contracts.


*Following an impressive recovery after 11th September with a simplified fare structure, America West generated a negative operating margin of 4.6%, and is not expected to return to profitability until 2005.*

ExpressJet has completed the majority of its negotiations with its partner, Continental, on 2005 rates. The target operating margin is expected to remain unchanged at 10%, although the margin band is expected to narrow from 11.5%-8.5% to 10.5%-8.5%. As a result, and not unexpected, operating margins are likely to approach the 10% level.

## WestJet Airlines

WestJet reported a September quarter operating profit of C$53 million.

Passenger and charter revenue increased 21.7% to $309 million on a capacity increase of 26.9%. Load factor for the quarter was essentially flat at 76.6%, while passenger yield fell 6% to 15.37 cents. Consequently, passenger unit revenue declined 5.8%. However, both yield and unit revenue were depressed by the 16% increase in average stage length to 788 miles.

Expenses increased 27.7% to $256 million. On a unit basis, cost was 0.7% higher than a year ago; but excluding fuel CASM fell 5.6%. While the longer stage length and increased efficiencies of new aircraft helped to lower cost, these benefits were more than offset by record fuel prices.

Despite the tough environment, WestJet reported a 17.1% operating margin which is likely to be one of the industry's best performances. WestJet ended the quarter with C$228 million in cash and cash equivalents, C$36 million less than at the end of the June quarter.

## AMR Corporation

AMR reported total revenue of $4.76 billion, 3.4% higher than a year ago on 3.5% capacity growth. Passenger unit revenue declined 2.5% from a year ago as a 4.8% drop in yield overshadowed a 1.9 point increase in loads.

American's passenger RASM under-performed the industry's RASM for the quarter which fell 1.5%. Revenues from the Caribbean were depressed due to the impact of four hurricanes.

Total operating cost of $4.81 billion was 7.7% higher than a year ago, while unit costs rose marginally by 2.7% to 9.68 cents. Excluding fuel and special items, unit costs declined 5.1%. This was a step in the right direction, as the company continues to lower controllable costs.

High fuel prices resulted in a $342 million higher fuel expense compared to a year ago, almost entirely driven by the 48% increase in jet fuel.

The carrier's operating margin for the quarter declined to negative 0.9% from a positive 3.1% from a year ago.

AMR ended the quarter with $3.6 billion in cash and short-term investments, of which $481 million is restricted. This is roughly $300 million lower than at the end of the June quarter.

AMR's loss during its seasonally strong September quarter is clearly a disappointment. Nonetheless, its ample cash position and willingness to continue to make the tough decisions should ensure that it will be one of the survivors.

AMR announced it will withdraw the equivalent of 15 aircraft: fourteen MD-80s and one 757-200. This, together with the retirement of its entire Fokker 100 fleet, will result in a 5% reduction in domestic capacity for the January-March Quarter 2005. However, domestic capacity for the rest of the year will be similar, rather than down like the March quarter as American will be adding back seats to its aircraft to a higher density layout. The rationale for the denser seating configuration is that American is losing potential revenue, particularly in markets where it competes with low-cost carriers. In fact, American estimates that it has garnered $60 million of incremental revenue from adding back seats to its A300-600s and 757s.

American Eagle will not take delivery of the last 18 Embraer regional jets that were scheduled to be delivered between July 2005 and February 2006. AMR did give up 18 put rights (as part of its original agreement with Embraer) in exchange for not taking these aircraft.

AMR is currently in negotiations with its banks to refinance a fully drawn $834 million bank credit facility which matures December 31, 2005. AMR expects it will most likely have to add to the collateral pool currently backing the line of credit – at present, 67 of its aircraft are unencumbered.

## Southwest Airlines

Southwest reported September quarter total revenue of $1.674 billion, a 7.8% increase. Total operating expenses were $ 1.483 billion, an increase 8.4%.

Revenue growth was in line with a 7% increase in capacity. The carrier reported a record 72.7% load factor, 2.2 points higher than a year ago, while domestic yield fell 2.8% to 11.38 cents. This resulted in an essentially flat passenger unit revenue.

Total operating cost increased 8.4% to $1.48 billion, while unit cost increased only 1.3% to 7.61 cents despite a 10% increase in the price of jet fuel.

The hurricane impact to revenue was about $15-$20 million for the quarter. Also, unit cost excluding fuel, which was flat for the quarter, would have registered a year-over-year decline without the adverse impact of the hurricanes.

Southwest's September quarter operating margin was 11.4%, similar to last year's 11.9%.

The carrier ended the quarter with $1.9 billion of cash and has an unsecured line of credit of $575 million (fully available).

Southwest is well on its way to lowering its costs in many ways. The


*WestJet made a C$53 million operating profit; equal to a margin of 17%. This is one of the industry's best performances.*

carrier revealed a larger fuel hedge position. Energy-saving initiatives, for example, aircraft winglets, resulted in a 2% reduction in fuel burn per block hour, despite record passenger load factors. Also, the carrier's head count per aircraft was 74, the lowest level in 15 years.

## Alaska Air Group

Group total revenue grew 10.2% to $774 million for the quarter. The key drivers were 5.6% more capacity at Alaska and 18.4% more capacity at its regional partner, Horizon. Alaska Air's unit revenue increased 3.7%, a function of lower yield (2.2%) entirely offset by a 3.5 point increase in load factor to 76%.

Turning to cost, group operating expenses grew 11% to $692 million (excluding special items). Alaska's unit cost, ex-fuel and special items, fell 6% to 7.35 cents.

The group's operating margin for the quarter was $82 million, equal to 10.6%, just slightly lower than last year's 11.2% operating margin. This was despite seeing about a 46.6% increase in the fuel price ($1.40 per gallon for jet fuel).

Alaska ended the quarter with $879 million of cash on hand; $14 million higher than at the end of the June quarter.

Alaska's margin performance is likely to be one of the best among the network carriers, due in part to the company's more seasonal service area (monthly revenues to/from the State of Alaska can be more than double compared to what they are during the winter months), and also its relentless focus on reducing costs.

Alaska has now reported nine consecutive quarters of unit cost reduction; and it is maintaining its 2005 CASM ex-fuel goal of 7.25 cents.

However, given the industry-wide restructuring as well as record fuel prices, Alaska indicated that it may pursue an even lower CASM goal in order to remain competitive and achieve sustainable profitability.

The major risks to Alaska are that industry fundamentals will more be challenging down the road and it may not meet its cost reduction goals for 2005.

## SkyWest

Total operating revenue for the quarter increased 33.7% to $308.3 million. Revenue growth was driven by 30.4% more capacity as SkyWest added 27 regional jets in the last 12 months.

Total operating costs increased 38.4% to $270 million. Costs also included a $0.9 million expense related to a long-term engine service agreement for its CRJ-700s. On a unit basis, costs increased 6.3% to 13.5 cents. Excluding fuel, unit costs fell 2.9% to 10 cents (fuel expense, for the most part, is picked-up by SkyWest's major airline partners).

SkyWest's results was an operating profit of $38 million; a 12.3% operating margin. This is three points lower than last year's 15.3% operating margin, but likely to be among the industry leaders.

The company ended the quarter with $498 million in cash and marketable securities, which was $20 million higher than the previous quarter. Also, SkyWest reached an agreement with Delta on reimbursement rates for 2004. Next on the agenda is to reach agreement on a contract extension.

As a result of Delta's downsizing its DFW hub, SkyWest will re-deploy seven CRJ-200s back to its Salt Lake City hub where Delta is enhancing its position.

SkyWest reported that United favours a higher mix of 70-seater aircraft over 50-seaters and this carrier was looking to address United's need.

SkyWest was able to tap the leveraged lease market, financing four 70-seat CRJ-700s. This is a market which is only open to the industry's best credits further underscoring SkyWest's relatively strong financial position.

The carrier expects to take delivery of five CRJ-700s in the remainder of 2004, and 27 deliveries are expected in 2005.

## Northwest Airlines

Better top-line performance was the principle driver behind Northwest's narrower loss for the quarter. Northwest's revenue showed significant growth, up 13.4% to $3.05 billion as passenger RASM increased 6.8% on 2.3% more capacity. This was substantial, since industry passenger RASM for the quarter fell 1.5%.

Unit cost increased 9.6% to 10.24 cents, but most of this was driven by higher fuel prices. Excluding fuel, unit costs increased only 1.1%.

The company generated a $79 million operating profit which translated into a 2.6% operating margin; 2.8 points worse than last year's 5.4% margin.

Northwest's recent tentative agreement with its pilot to reduce its annual costs by $265 million should help mitigate the company's cost pressure.

The company ended the quarter with $2.5 billion in unrestricted cash, roughly $300 million less than that the end of the June quarter.

Northwest's RASM performance compares very favourably to the industry's 1.5% decline in system unit revenue for the quarter. Part of the passenger RASM strength reflected Northwest's large Asia-Pacific operation, which is experiencing a nice rebound after the negative impact of SARS.

Northwest's outperformance on the unit revenue is because it has been growing capacity more slowly than the rest of the industry, its hubs have seen less encroachment by low-cost carriers than its competitors' hubs, and Northwest derives a smaller percentage of revenue from its domestic network. AC