Asia Pacific carriers experience rapid post-SARS traffic recovery

Comparison of RPMs generated by Asia Pacific carriers with the same months in 2002 reveals the effect of SARS, but the rate of recovery following the end of the outbreak.

The continued recovery in passenger numbers for Asia Pacific carriers has continued in the past few months, with airlines reporting a returning of traffic following the SARS outbreak earlier this year to coincide with the European summer. However, total RPMs have not fully recovered, and are still down on the same period last year *(see chart, this page)*. The chart shows that the largest drop in traffic was in May, with carriers first beginning to recover in June. Data published by Cathay Pacific, Dragonair and other carriers shows that the recovery in revenue-passenger miles (RPMS) is continuing.

Cathay's traffic increased in July and August, as witnessed by the increase in RPMs, coming to within 3% of its August 2002 totals; and so representing an almost full recovery.

Dragonair, which was one of the worst affected by the SARS downturn, has added back all its capacity, and is traffic had fully recovered to the same level as the previous year by July.

China Southern, which was the worst hit in respect of passengers, has rebounded and by July was 24% down on its relative position last year. This compares to peak loss in May of almost 80% of its usual traffic.

The speed with which carrier RPMs are returning suggest the market has rebounded swiftly from where it was in April and May, when the outbreak was at its peak.

Cathay, China Southern and Dragonair's rebound are the most dramatic, and there is no reason to assume that the other carriers would not fully recover in the same way. The Chinese carriers: China Southern, Air China and China Eastern, which along with Dragonair, were the most severely affected, have all recovered well.

The RPMs generated by the airlines suggest that capacity is also be reintroduced. In the months from March to June airlines responded to the severe downturn in traffic by grounding much of their fleet. China Southern cut its available seat-mile (ASM) capacity the most, and had effected a reduction of 76% by May.

Air China, Dragonair and Cathay were the next seriously affected, and had cut their ASMs by 57%, 55%, and 42% in May, compared to may 2002.

Carriers are adding back ASMs into the system; matching the growth in passenger numbers with a similar growth in seat capacity.

By August Cathay's ASMs were down by just 6% down on the same period in 2002, while China Southern was down 39% and Dragonair down 10%.

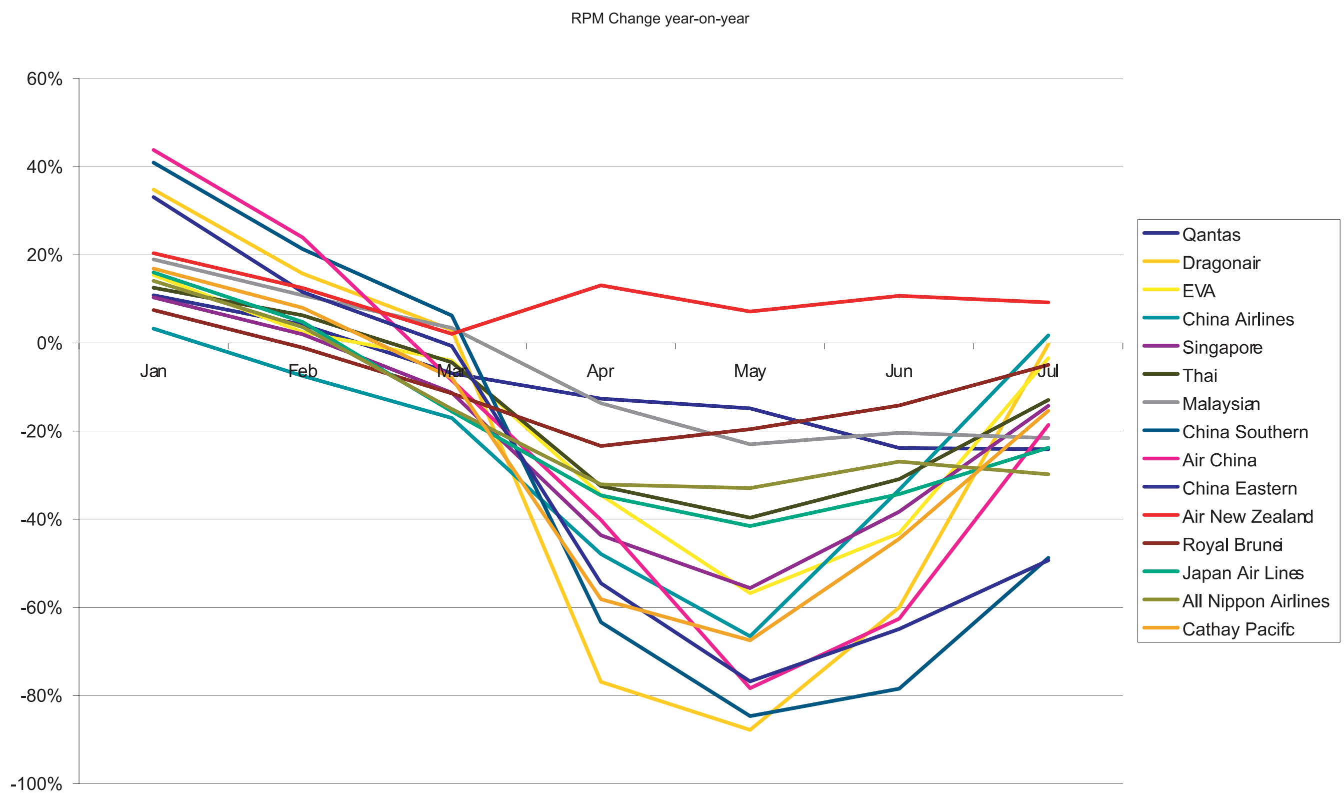
This suggests that on a passenger level the industry is returning to normal, with traffic returning to previous levels. However, the volume that returning traffic is influenced by cost cutting may have an impact on yield. Yield is still expected to be below last year's levels as passengers continue to purchase heavily discounted tickets. There is likely to be lag between traffic recovery and yield recovery.

Indications are that this situation should improve in September when special promotions tail off and passenger numbers push yields back up.

The overall profitability of Asia Pacific airlines varies, with those airlines most exposed to the SARS outbreak like Singapore Airlines and Cathay issuing profit warnings, while other carriers less exposed make profits.

Profit announcements in the Asia Pacific region, including Air New Zealand's $94 million half-year result, are in contrast to the current environment.

Continuing aircraft orders, in combination with the return of passenger volumes and scheduled service, supports the view of the Asia Pacific as a region with one of the highest growth levels. The SARS threat is now removed, and airlines are returning to normal.



US recovery

The emerging recovery in the US aviation industry continues, with major airlines posting improved results. US Airways' successful emergence from Chapter 11 bankruptcy has allowed the Arlington-based carrier to place new aircraft orders as it goes about streamlining itself. US Airways has also begun to repay its staff the salary reduction that it instituted last year. US Airways' improving condition mirrors the US market condition in general, with carriers posting improved financial results in recent months. The upturn in the industry is also reflected in the increased volume of aircraft orders that are being placed.

Aircraft orders are gathering pace, with AirTran ordering 737s to complement its 717 fleet; Frontier has begun to take delivery of its first two A318s, the carrier has 5 more on order; while jetBlue has ordered 100 Embraer ERJ-190s to add to its previously all A320 fleet. The move by jetBlue caused mixed reaction, but the market has kept faith with their performance and their stock has not suffered. Overall, aircraft orders are reflecting the improved optimism in the industry. With an upswing in the US stock markets, combined with increased global stability, airlines are beginning to approach profitability.

Frontier has been the top performer in the low-cost category. Its traffic continues to grow and the carrier has just placed an order for 15 more A319s with options for a further 23. Frontier's revenue per available seat-mile (RASM) increased by 30% in July, while August RASM is estimated to increase by about 20%. Frontier has benefited from United's preoccupation with its reorganisation, and has continued to erode traffic from the major at its Denver hub.

Of the major airlines, Continental and American appear in the best condition, while Delta and United continue to struggle. United, still in Chapter 11 bankruptcy protection, is reorganising its cost base. While its second quarter loss of $476 million was high, it should be noted that United's costs were down by 17% compared to the same period last year, while revenues fell 18%.

In comparison, its July unit revenues increased 10% year-over-year, and United earned $35 million from operations, the first time it has been cash positive for more than two years. United's performance signals that it is on the road to recovery and should emerge from Chapter 11 on schedule.

Delta Airlines is arguably in the worst position of the majors. Unable to gain significant operational efficiencies through cooperative methods, like American achieved, Delta may have no choice but to seek Chapter 11 to reorganise. Failure to do so would put it at a disadvantage to its trimmed down competitors.

Delta cabin crew recently rejected a revised salary offer from management, which was asking for several hundred millions of dollars in savings. Delta's inability to achieve cost parity with its competitors is worrying some analysts.

American has managed to restructure itself outside of bankruptcy, and is now performing well. American is chasing $4 billion in annual cost savings from an annual cost base of $20 billion. $1.8 billion of the $4 billion target is scheduled to come from labour concessions. The labour breakout has been set to achieve: Pilots-$660 million, mechanics $620 million, flight attendants $340 million, management $100 million, with other area contributing $80 million.

Seeking to cut other costs, American is reducing its fleet complexity and is also revamping its network, including removal of St Louis as a significant hub, one of the last legacies of TWA. American's fleet is set to reduce by 57 more aircraft by summer 2004, adding to the 57 already parked. The sum total of the retirements makes American 15% smaller.

Overall, American's unit cost is expected to fall to 10.11 cents per ASM for the while of 2003, compared to 10.70 cents for 2002. Further reductions are expected in 2004 when savings are more fully realised, and unit cost for the year should reach 9.35 cents per ASM.

American's RASM rose 11% in July, compared to the industry average of 8%. Michael Linenberg, Aviation analyst at Merill Lynch, expects this trend to continue as American shrinks its St Louis hub, reduces its reliance on low-yield connecting traffic and rationalises its fleet to save more cost. The cost savings may be offset to some degree by increased costs in other areas, for example security and fuel.

Continental is also displaying improved performance, having posted monthly profits since June 2003. Continental will probably be the first network carrier to post a profit since 9/11. Continental is also focussing on reducing unit costs, having targeted $400 million savings for the current financial year and a further $500 million in the following year.

Overall, the air transport is showing signs of recovery. This is partly assisted by the US economy and concessions. The industry outlook, with RASM growth of 10% in the past two months, signals that the market is returning normality. AC