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LEAPS AND BOUNDS

A Conversation With Pham Ngoc Minh, President and Chief Executive Officer, Vietnam Airlines, Pg 18.



Special Section



Record Aircraft Orders

38

10	American Airlines' fuel program saves more than US\$200 million a year
31	Integrated systems significantly enhance revenue
72	Caribbean Nations rely on air transportation



Aircraft Shopping Spree

Aircraft manufacturers have experienced record-breaking orders during the last couple of years, but a decrease in capacity, the need to hold onto operating cash because of fuel costs and production delays with new next-generation aircraft could impact the trend.

■ By Lynne Clark | *Ascend Staff*



Photo courtesy of Boeing

With current orders for passenger aircraft through 2011 and delivery dates rapidly approaching, delays of the next-generation Boeing 787 Dreamliner pose less of a concern for the manufacturer's investors, who are focusing more intently on the impact today's oil prices will have on current and future orders.

In 2005, airlines worldwide went on a shopping spree based on industry assumptions that by 2010 a seating capacity of more than 3.1 million seats would grow 20.3 percent. Fleet planners placed record orders for more than 2,000 aircraft with manufacturers Boeing and Airbus, notably for the fuel-efficient 787 Dreamliner and the Airbus A380 models.

At that time, the International Air Transport Association was predicting industry profits of US\$4 billion. But at its 2008 annual meeting in Istanbul, Turkey, in June, IATA Chief Executive Officer Giovanni Bisignani forecast industry losses

of US\$6.1 billion this year if the average price of oil remained at US\$135 a barrel for the rest of the year. Oil prices hit an all-time high of US\$147.27 a barrel on July 11, roughly doubling during the past year.

IATA said the combination of high fuel prices, a U.S. recession and accelerated deliveries of aircraft ordered at the peak of the economic cycle but delivered during a slowdown meant the outlook for 2008 was "clouded by the perfect storm." The last perfect storm churned as the result of the Sept. 11 terrorist attacks and restructuring fallout.

"Adding to the downward pressures on revenue growth from the U.S. recession will be the acceleration in aircraft deliveries in 2008 and 2009," IATA said.

New Aircraft, Fewer Passengers

At a time when aircraft deliveries will rise from 1,041 in 2007 to 1,281 in 2008, Bisignani said traffic growth in the industry at best would be 3.9 percent this year, down from a growth of 5.9 percent last year.

The two largest mainline aircraft manufacturers — Boeing and Airbus — broke all sales records in 2007. Their combined total of 2,754 net orders worth US\$321 billion beat the previous high of 2,057 set in 2006.

Regional aircraft manufacturers also saw a surge in orders for next-generation, eco-friendly models. One in every three commercial flights worldwide is on regional jets, and Bombardier aircraft have become the backbone of many operations. The company recently has seen a sharp increase in demand for its 20- through 149-seat C-series and Q-400 turboprop aircraft. In May, the company released figures that anticipate demand by 2027 to reach 12,900 new aircraft, valued at approximately US\$528 billion.



Rival Embraer, the world's fourth-largest aircraft maker, said its first-quarter profit more than tripled after deliveries jumped 80 percent. The company delivered 45 airplanes during the quarter and reported backlogs totaling a record US\$20.3 billion by the end of March.

"The prospects for the company are good," said Caio Pereira Dias, an analyst with Banco Santander SA in São Paulo, Brazil, before earnings were released. "It increased its orders backlog, and I don't see a risk of a wave of cancellations due to the airlines' crisis."

Production Delays

Brian Pierce, IATA chief economist, told reporters at a December conference that airlines had done a better job of managing capacity during the current cycle than in the past. But a flurry of recently announced capacity cuts and aircraft delivery deferrals has investors worried if airlines will have the money to buy more planes for a long while.

"It's a point of concern, but nothing unexpected," Boeing CEO James McNerney told analysts on May 21 when asked about the consolidation of airline capacity as the result of the oil run-up.

The problem for Airbus and Boeing isn't too few customers — it's getting planes off their production lines fast enough to meet demand. Even as new orders slow, passenger jets are mostly sold out through 2011 or even later. Both companies have wrestled to get new models to the airlines lining up to buy them.

In May, Boeing pushed back the inaugural flight for its much-anticipated 787 Dreamliner, delaying the test flight until the end of the second quarter because of supply chain problems and slow progress on the assembly line. A September machinist strike further delayed production, and a new production schedule has not been released.

Airbus' flagship A380 superjumbo has been delayed as well, and the company had to redesign its planned competitor to the Boeing 787, the Airbus A350.

The delays aren't the only challenge facing these larger aircraft makers. Cathay Pacific Airways, Qantas Airways and Ryanair have parked planes, reduced capacity and/or deferred aircraft orders due to a decline in air travel in some of the world's highest-traveled markets.

"There's no question it's a difficult situation," Randy Tinseth, vice president of marketing for Boeing's commercial airplane division told the Chicago Tribune in June.

The manufacturer's investors are more concerned with today's oil prices and the impact they'll have on current and future orders than with the delays of the Boeing 787 Dreamliner.



Photo courtesy of Airbus

Although Airbus has achieved record-breaking orders for the Airbus A380 Superjumbo and other aircraft during the last couple of years, elevated fuel prices and tightening credit for many airlines may contribute to a slow down of future orders.

Delays: Good News For Some Airlines

The delays are good news for some airlines struggling to enhance liquidity and defer debt obligations.

John Leahy, chief operating officer for Airbus, warned last January that rising oil and tightening credit could mean that the interest of airlines in — and their ability to pay for — new planes could drop off.

“In this kind of market, it’s not just about booking orders anymore,” he said. “You also have to be able to manage your order book. There’s a good chance that some airlines won’t be able to take delivery of all these aircraft.”

The dire predictions came true just months after Leahy’s comments. In March, India reported a steep fall in air traffic growth, from a 2007 yearly average of more than 30 percent to 11.5 percent last January and February. Budget airline SpiceJet responded and, earlier this year, returned two Boeing 737s it was leasing. Deccan Air and Kingfisher Airlines sold delivery spots and also delayed delivery of previous orders.

Southwest Airlines cut 20 unproductive routes last year and doesn’t plan to add capacity for the rest of the year. It will take delivery of 14 aircraft next year, compared to the 23 previously ordered. For 2010, Southwest will have 22 airplanes on firm delivery with options to buy, down from 34. It intends to buy 29 aircraft this year, but it will get rid of 22 other airplanes, for a net growth of seven planes, unless other airlines’ shrinkage provides growth opportunities, in which case it may hold onto some of the 22 it plans to offload.

In May, jetBlue said it would put off buying 21 new Airbus jetliners for four to five years. It said it would take delivery of nine Airbus A320s this year and sell the same number by the end of the year. AirTran Airways also announced it would

defer delivery on 18 Boeing 737s by about four years. Also in May, the Centre for Asia Pacific Aviation said it expected Virgin Blue to follow Qantas Airways and retire or cancel the delivery of new aircraft.

“In the face of escalating fuel costs, we believe it is essential to take a more financially conservative approach to managing our business,” jetBlue CEO Dave Barger said in a statement to reporters. “The aircraft deferrals we announced today will help us further moderate our growth rate in 2009 and beyond, which will enhance liquidity and defer debt obligations.”

Independent aviation consultant Michael Boyd agrees a deferral strategy makes sense.

“Most of those planes were meant for expansion,” he told the Associated Press in May. “You don’t expand at US\$4-a-gallon jet fuel. When you have a downturn, not taking on the debt and the problems with new airplanes, that’s a good move.”

Although many airlines are scaling back their expansion plans, some airlines are looking at new aircraft to replace their aging fleet.

American Airlines CEO Gerard Arpey told reporters they are looking at both the Boeing 787 and the competing Airbus A350.

“We continue to look very carefully at the 787 and the A350, and frankly, the Boeing production delays have given us more time to make a decision.”

American has also cut U.S. capacity and is retiring 85 older jets because of staggering fuel costs and slowing demand.

Delays Bad For Some Carriers

Boeing said its 787 Dreamliner is perfectly positioned for a world of pricy petroleum. The plane will use 20 percent less fuel than today’s

models because of its lighter-weight composite fuselage and other advances.

Airbus states the A380 will also use 20 percent less fuel and will fly quieter, cheaper and more environmentally friendly than the Boeing 747.

The U.S. Department of Transportation estimates that the Boeing 767, a plane that began service in 1982 and is used by many U.S. carriers on trans-Atlantic flights, burns an average of US\$3,946 worth of fuel and oil per hour during a 3,000 mile flight, or US\$17.85 per passenger hour, based on an average 221 seats. By contrast, a new Airbus A330 used by Air France and other European carriers burns and average US\$15.72 per passenger hour, about 12 percent less, under comparable conditions.

The newer the fleet, the lower the total cost of operations. Older planes cause airlines to spend more on parts and maintenance. Big jets must undergo major checkups every six to eight years that costs an average US\$1.5 million and keeps the plane grounded for up to a month, according to Adam Pilarski, senior vice president of the Avitas aviation consulting firm in Chantilly, Virginia. To avoid that, some foreign airlines such as Emirates replace their planes after five or six years.

So it comes as no surprise that some airlines are counting the days when they can replace old gas guzzlers with new eco-friendly models. For them, delays could mean the difference between declaring bankruptcy and staying in business.

Northwest Airlines, which is merging with Delta Air Lines, has 18 Dreamliners on firm order with options for more. When Boeing announced earlier rounds of 787 delays, CEO Douglas Steenland expressed his disappointment. “Given the price of fuel, the impact and consequences of the delays has gotten greater.”

Peter Morris, chief economist of Ascend, a London aviation consulting firm, believes high fuel prices have benefited aircraft manufacturers.

“You could argue that high fuel prices are one of the best things to happen to the aircraft manufacturing industry,” he said. “When you look at the large sums of money spent on fuel, at least on long-haul [flights], the arguments in favor of re-fleeting become pretty obvious. The alternative — raising ticket prices in a weakening environment for air travel — is probably a losing proposition.”

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Photo courtesy of Boeing

Supply chain issues and a machinist strike have caused Boeing to delay the inaugural flight of its 787 Dreamliner and, as a result, won't deliver the first plane later this year as originally planned.