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IN THE BLACK

A Conversation With ...
JOE LEONARD,
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER,
AIRTRAN AIRWAYS

One of the most successful airlines during the past few years, Orlando, Florida-based AirTran Airways has become a growing force in the North American aviation industry. Since its founding in 1993, the airline has become one of the largest low-fare airlines in the United States — and one of the most profitable. For 2004, a year plagued by high fuel costs and yield pressures, the airline earned a net income of US\$12.3 million. During the year, it also reported a traffic increase of 18.7 percent.

As one of the industry's most progressive low-cost carriers, AirTran Airways has creatively pursued ways to protect its revenue as well as find additional income streams. Although it is a low-cost carrier, AirTran Airways actively pursues business travelers. The carrier, unlike many of its low-cost peers,

enhancement to its frequent flyer program, A+ Rewards, offering its top passengers the opportunity to redeem rewards to any destination in the world — even if AirTran Airways had to purchase a ticket on another airline.

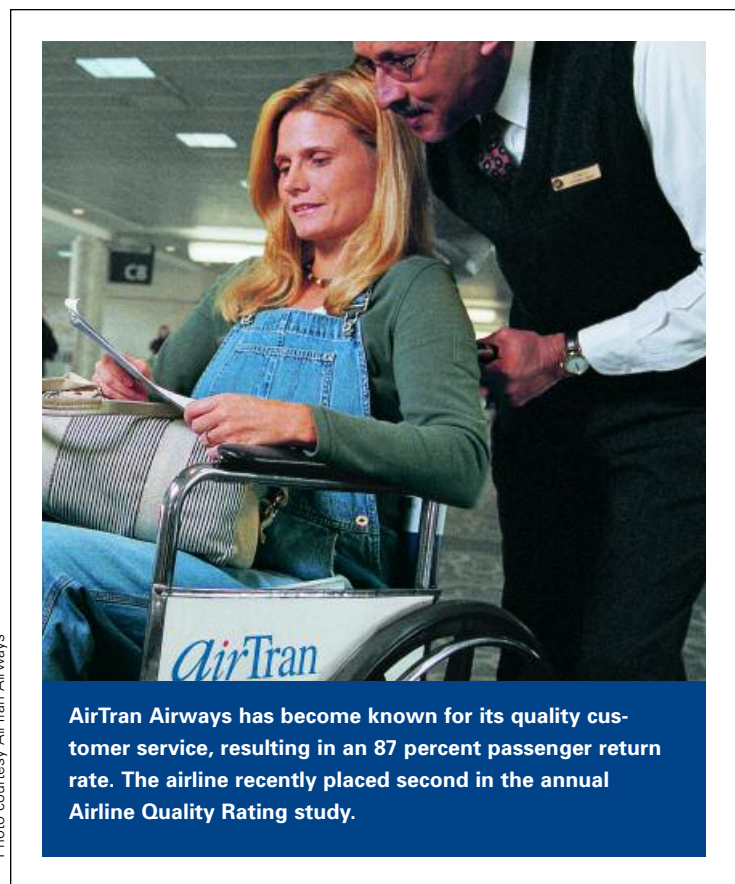
In its pursuit of additional revenue opportunities, the airline has even broken away from the single fleet type. In July 2003, AirTran Airways, which is the single largest operator of the Boeing 717-200, announced an order for 100 Boeing 737-700s to compete more vigorously in longer-haul and transcontinental U.S. markets.

The airline, which operates a hub at the Hartsfield-Jackson Atlanta International Airport where it is the second largest carrier trailing only Delta Air Lines, has also begun expanding in other markets such as Dallas/Fort Worth, Texas.

Combined, the various programs the airline has implemented have helped it achieve positive results. During the past five years,

AirTran Airways has increased the number of passengers enplaned by 80 percent, to 11.65 million. During the same period, the airline realized an increase in total revenue of 75.5 percent, to US\$918 million. The airline has also increased its route network from 30 to 46 destinations since 1999.

Since 1999, the award-winning airline, which has been honored by *Entrepreneur Magazine* and *Aviation Week and Space Technology*, has been led by industry veteran Joe Leonard. Leonard, with 30 years of experience in commercial air transport, previously was chief operating officer at Eastern Air Lines and held management positions at American Airlines, Northwest Airlines and Boeing. The Augusta, Georgia, native recently shared his thoughts on how his airline has become one of the most successful in the industry.



AirTran Airways has become known for its quality customer service, resulting in an 87 percent passenger return rate. The airline recently placed second in the annual Airline Quality Rating study.

offers assigned seating and a business-class cabin. It has also installed XM Satellite Radio on its aircraft, providing free access to 100 digital channels. The airline recently launched a campaign featuring famous British pop singer Elton John to promote its XM Satellite Radio. Last June, AirTran Airways announced a major

commercial air transport, previously was chief operating officer at Eastern Air Lines and held management positions at American Airlines, Northwest Airlines and Boeing. The Augusta, Georgia, native recently shared his thoughts on how his airline has become one of the most successful in the industry.



Question: We know 2004 was a pretty tough year for the airline industry, especially North America. But you were still profitable. How were you able to enjoy a profit even during a very tough year?

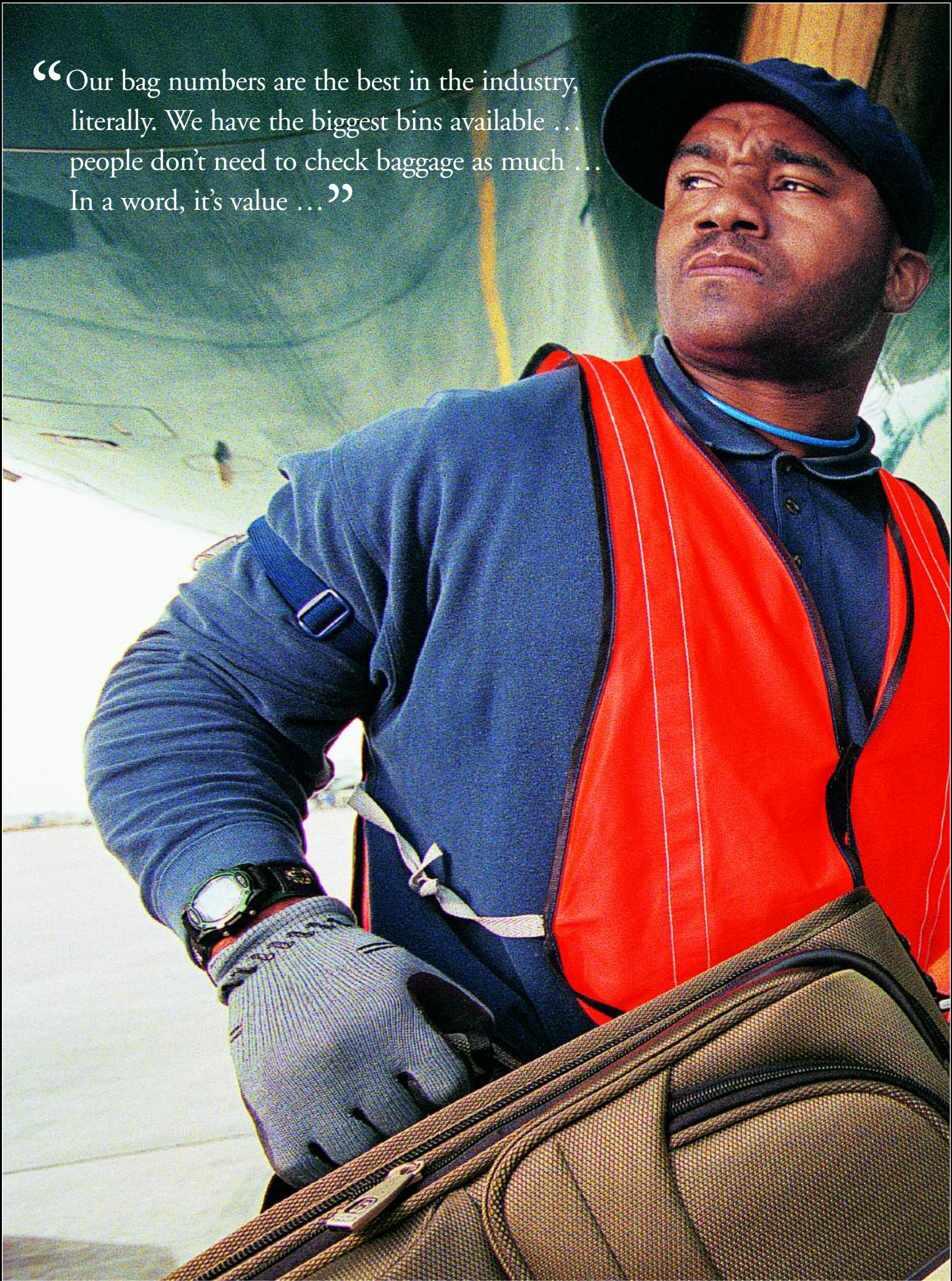
Answer: Well, I think a couple things, but the primary key is keeping our costs low. We have managed to bring our non-fuel costs down 12 consecutive quarters to one of the lowest in the industry. Actually, our non-fuel costs are lower than Southwest's at this point — somebody we benchmark against regularly. So it starts there, and then we've got a great product. You can't have just low costs. You've got to have a good product. We have that. Our completion factor is good. Our bag numbers are the best in the industry, literally. Our people are terrific — very nice, very friendly service. Our brand new airplanes help a tremendous amount — first, by improving our efficiency, and second, the impression that it makes on our customers.

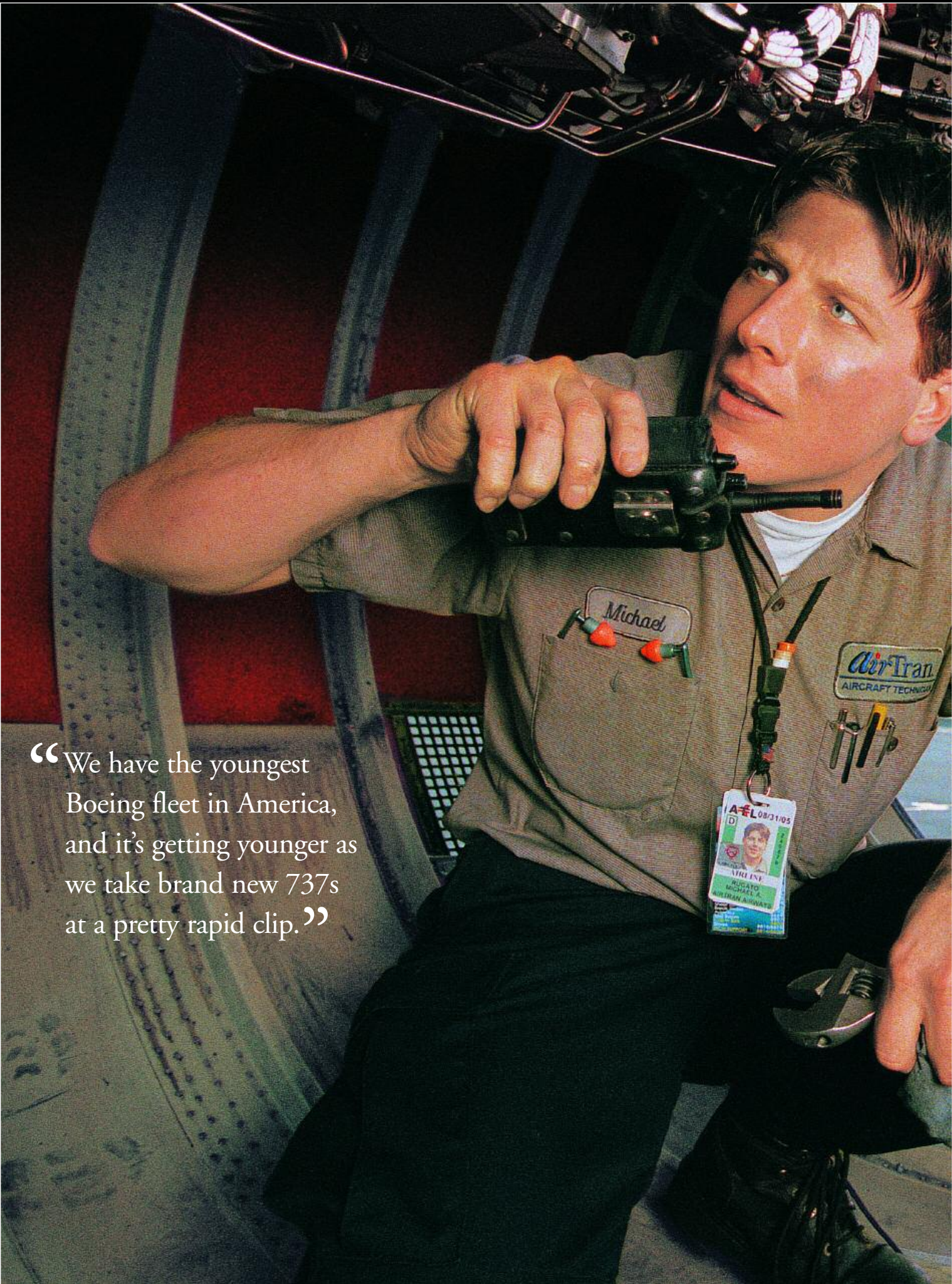
We spent extra money to put in wide-body bins so that we have the biggest bins available. We have them in our airplanes so people don't need to check baggage as much as they do on some others. It's just a whole package. In a word, it's value — a great product at very low prices.

Q: You touched on something by mentioning value. You've been very innovative, and you deviate somewhat from the pure low-cost carrier model that Southwest pioneered, offering things such as a business class and assigned seating. How do you think that helps generate revenue?

A: We think it helps a great deal. It certainly helps with the impression of the company. You know, we're kind of counterintuitive. We do everything that people say you can't do. We do have business class. We have assigned seating. We run a classic hub-and-spoke out of Atlanta. So we do a lot of things that people say you can't do and have low costs. But we do it. And, I think if you look at our research, it shows that 87 percent of the people who fly

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“We have the youngest Boeing fleet in America, and it’s getting younger as we take brand new 737s at a pretty rapid clip.”



us are either likely or highly likely to fly us again. So if we can get people to try us, we don't have any trouble getting them to come back, generally speaking.

Q: We wanted to talk a little bit about your frequent flyer program, the enhancements you've made allowing customers to fly anywhere in the world. How has this helped you retain your high-yielding customers and offset the cost of the program?

A: It was decided a long time ago that one of the limitations of our frequent flyer program was that we had a fairly limited network at that time. Today, we have a pretty extensive network in that we have 46 cities that we serve. But there are still places we don't serve that people would like to go to. So to make our frequent flyer program attractive, it was decided some time ago that if we didn't go there, we'd buy you a ticket on somebody else. And this past year, we decided to, because it was working and was reaching the objective that we had set out, expand it by taking you anywhere in the world, not just the U.S. system. We think it will pay off for us. Again, we don't have any intention of flying internationally any time soon. This is a way for people who would like to go international to do so using their AirTran Airways frequent flyer program.

Q: You mentioned earlier that you've broken the rules so to speak and that you're doing things that people say you can't do and be successful. How are you able to do that? How are you able to run a hub system profitably? How are you able to do things that some say low-cost carriers can't do and do them successfully?

A: It starts with the principle of keeping things as simple as possible. We work diligently every single day to make sure we keep our systems as simple as we possibly can. There's a lot of hubbub these days about rolling complexes or continuous-flow complexes at the hubs. We've been doing that since the first day of the company, so this is nothing new for us; it's something we've always done. We bring the airplanes in, drop the folks off, pick up a new load and the airplane goes out.

In addition to that, about 30 percent of our flying is point to point now. It used to be 98 percent of our flying was in and out of Atlanta. Today, it's only about 70 percent. By flying point to point in conjunction with the hub, you can get your utilization up over 11 hours a day. And right now, they're flying at about 11.1. We think we can get utilization up to about 11.5 hours per day per aircraft. And so that's one way that you can provide rev-



AirTran Airways, with the help of legendary musician Elton John, raised the bar on customer amenities when it launched XM Satellite Radio programming. As part of the initiative, the airline painted a rendering of Elton John on more than 20 Boeing 717s and donated US\$50,000 to the Elton John AIDS Foundation.

Photo courtesy AirTran Airways

enue enhancements of a hub-and-spoke, which are definitely there, but also get the utilization of a point-to-point carrier.

Q: Another exciting thing you have done is installed XM Satellite Radio. Although it's a complimentary amenity, how do you see that contributing to the bottom line?

A: We think XM radio is the future. You can't buy a new car hardly without getting satellite radio in it. We think, obviously, XM is the best. We think it will be great for us. They're going to have sports and over 100 channels of music

and news and that sort of thing. We looked at video. We just don't think video works for us because our stage length is an average of about an hour and a half, so you're not going to watch a movie in that time. And, we think XM radio is a good alternative to that. We're going to give it away. We think it's an amenity that people will like. We don't see the point in charging them for it. Obviously, we're very excited about the launch with Elton John. I just saw one of the latest airplanes taxi past my window about 10 minutes ago with Elton's

picture on the side and XM radio on board the airplane. So, we're pretty excited about that. We'll have the whole fleet up and running by this summer.

Q: Do you think that's one of those things that breeds customer satisfaction and keeps them coming back to your airline when there's a choice?

A: Oh, without a doubt. I definitely believe it further enhances the experience. There's a certain segment of people who believe if you're flying low fare you're not going to have any amenities. So to the extent that we offer more than people expect, we exceed their expectations. We think that's a real plus for us. And complimentary XM radio will be just one more element of exceeding the customer's expectation, we believe.

Q: Are you considering other options such as buy-on-board programs to generate revenue?

A: Not really at this point. We don't look at XM radio as far as a revenue producer. We view that as a customer enhancement. But we look at everything from time to time. But again, we get back to our basic principle of keeping things as simple as we possibly can. So unless there is a compelling reason to do something, we generally reject it. So again, we keep things as simple as we possibly can.

Q: You referred earlier to your fleet. Specifically, you are the largest single operator of the Boeing 717. What kind of benefits does that have? Does having modern aircraft differentiate you, and do you think that helps attract passengers?

A: I don't think there's any question about it. The number of comments that we get about the new airplane is just phenomenal. We have the youngest Boeing fleet in America, and it's getting younger as we take brand new 737s at a pretty rapid clip. We'll take 19 airplanes this year. So our average fleet age is actually very, very low and going lower rather than getting higher. The 717 was a remarkable transformation from the DC-9.

They're all brand new. They've got state-of-the-art cockpits, auto-land capability, built with extra wide bins so you can store your bags, clean fresh air. It's the only airplane flying today that has continuous flow fresh air. And it's got a number of enhancements. Then on the business side, it burns 23 percent less fuel than the DC-9s that they replaced — so very fuel efficient, very modern, state-of-the-art airplane encased in a structure that's proven to be truly remarkable over a number of years with the Douglas manufacturing techniques.

Q: You also talked about adding the Boeing 737. What other revenue opportunities does this create for you?

A: Well, the 737 does a good deal for us. Again, from an efficiency standpoint, the 737 actually burns less fuel than a 717, believe it or not. On absolute terms, it burns less fuel. It has the same complement of flight attendants and pilots, a five-person crew, with 20 additional seats. From an efficiency standpoint, it will help drive down our non-fuel unit costs, around 3 percent to 5 percent in 2005. From a capability standpoint, the 737 has far more range than the 717, and so it opens up the entire continental North America. We can go from any two points, one point in North America to another point in North America, nonstop without exception. What we really get out of the airplane is an enormous amount of range increase and 20 additional seats.

Q: You talk about your mantra of keeping it simple. And one of the rules of the low-cost fare segment is a single fleet type. Do you think the opportunities of having the 737 are going to more than offset the added costs of the second fleet type?

A: We've always had two fleet types since I've been here since 1999. There's actually one point where we had three fleet types — 737, 717 and DC-9s. So we don't see that as a big deal. I think it's overstated a bit. And even Southwest, from a practical standpoint, has more than one fleet type. They're not as pure as it may look because there are 737s, and then there are 737s. The real thing is do you have a fleet big enough to make sure your pilot utilization is efficient, and we clearly believe that we're in very good shape in that regard.

One of the things that we have here at AirTran Airways that most of the airlines do not have is that as part of our pilot agreement, our

pilots make the same amount whether they fly 717s or 737s. There is no reason for pilots to move from airplane to airplane to chase higher income, which is what they do at a lot of the legacy carriers. So in that regard, we solve that problem by having a composite pay rate, so when we hire somebody off the street, they may go to a 717 or they may go to a 737, depending on what our needs are at that particular time.

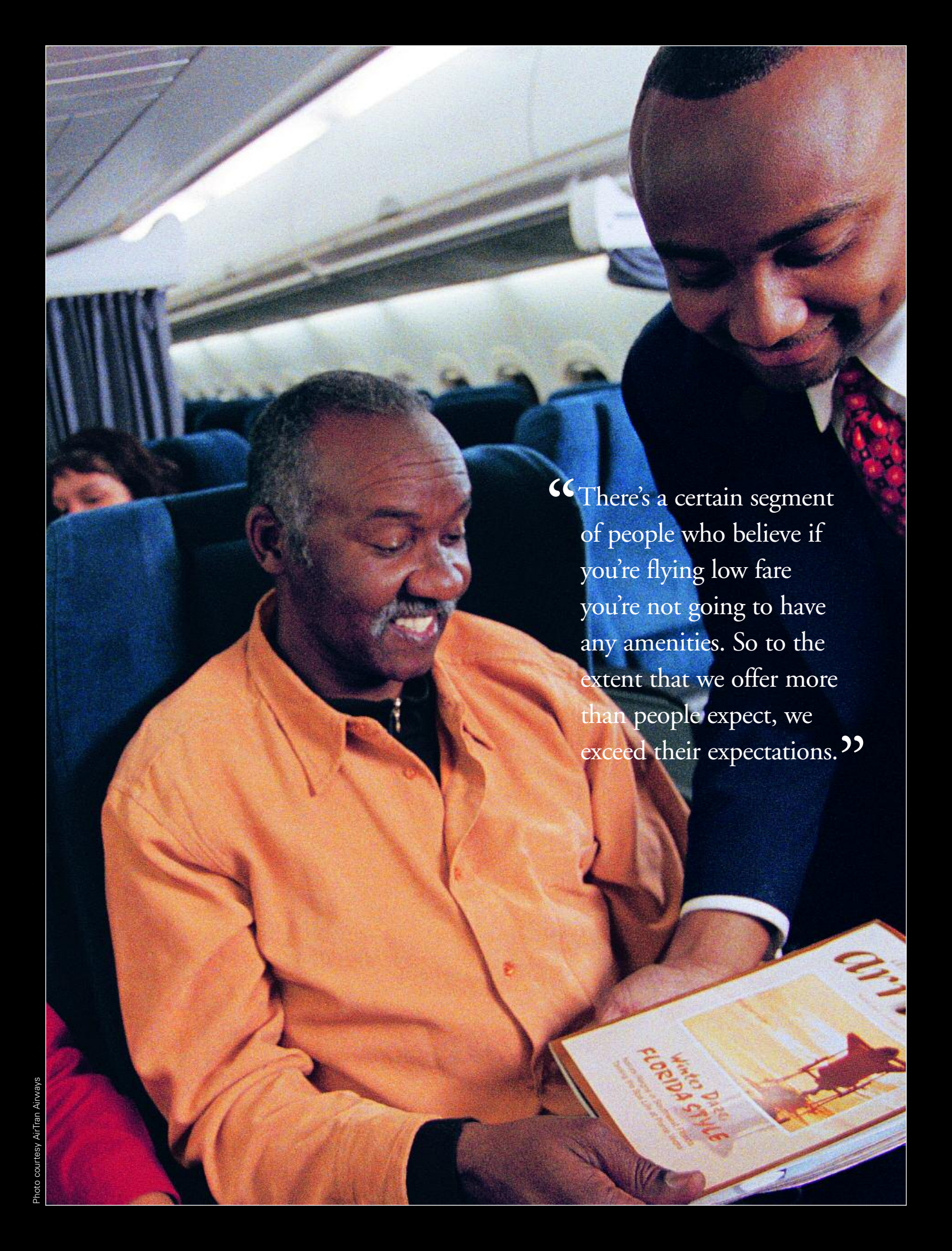
Q: You've expanded service in areas such as Dallas/Fort Worth, breaking out a little bit of your Atlanta hub. Do you anticipate further expansion in markets outside Atlanta? And how does this play into your future strategy?



AirTran Airways' new fleet of Boeing 737s, which replaced its DC-9s, burns 23 percent less fuel than its predecessor and is expected to drive down non-fuel unit costs about 3 percent to 5 percent this year.

Photo courtesy AirTran Airways

A: We'll continue to grow outside of Atlanta. Like I said earlier, in 1999, 98 percent of our flights were to and from Atlanta. And while we've grown Atlanta substantially bigger today than it was back in 1999, today only 70 percent of our flights are to and from Atlanta, so we'll continue to grow there. It's a huge market. Atlanta is one of the very few airports in the country where there's going to be a substantial improvement in capacity. A new runway comes online next year, which will be about a 20 percent improvement in airport capacity. There are also plans to add additional



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gates down the road. So Atlanta is one of the few airports where you could actually grow. And we intend to grow Atlanta. But by the same token, we'll go outside of Atlanta as well, as part of our diversification efforts.

Q: What role will technology play in helping maintain or generate revenue for your airline?

A: Considerable. We book about 65 percent of our tickets on the Internet. And to put that in comparison, we just turned our Internet site on in August 1998. So we've gone from zero in January of '99 to about 65 percent today. The most recent numbers in January, we had about 53 percent of our passengers either checked in over the Internet or using kiosk technology at the airport. So this is permitting us to grow at a very rapid rate as we've been doing without adding a commensurate number of personnel to handle customers. We see that as we improve the functionality of our technology, we'll see those numbers rising significantly. Obviously, if you're selling 65 percent of your tickets on the Internet, you have a clientele that is already predisposed to using technology. We think we're in very good stead there.

Q: Are there areas where you think technology can be a benefit?

A: I think we've addressed most of them. Both our 737s and some of the 717s are auto-land capable, which if you're familiar with Atlanta, you know you get fog in the spring and fall, so we'll be able to get in and land when other carriers may not be able to do so. That's clearly a technology advantage with the capability of the airplanes that we purchased. We are equipping all of our fleet now with ACARS equipment, which is not new technology per se, but we think that in the very near future with some of the air traffic control initiatives, if you have ACARS, you'll get some means of communicating with the airplane not using voice — that you'll get some preference with air traffic control routing.

And so we're equipping our aircraft with ACARS today to be ready for when those capabilities come online with air traffic control. I think from a safety standpoint, we have introduced a program called FOQA where we download data from our airplanes on a fairly extensive sampling basis, and it gives us the ability to look for trends and to identify deviations from the norm very, very early. I think this is a huge step forward in enhancement of safety, which we've incorporated across the board at AirTran Airways.

Q: We talked about how AirTran Airways,

in particular, has helped break some of the rules of the low-cost carrier business model. How do you see that business model continuing to evolve? What kind of impacts do you think it will have on the airline industry as a whole?

A: We'll continue to do what we've been doing, growing at about 20 percent per year, which we think is very manageable. And that is measured in available seat miles. We'll do that by growing our hub in Atlanta first, adding frequencies to cities that we already serve out of Atlanta. So that's No. 1. No. 2, we'll connect the dots, i.e. fly from cities we already serve to other cities that we already serve. And lastly, we'll add some additional cities.

Last year, we didn't open any new cities at all. We normally open three to five. We've already announced three this year: Sarasota [Florida], which we're operating; Indianapolis [Indiana]; and, most recently, Charlotte [North Carolina]. We'll probably announce a fourth one in the not too distant future, and we'll probably announce one or two toward the latter part of the year. So this year, we'll open more cities than normal. I think we'll continue to provide new equipment very efficiently in the manner that I've just described. And I think as more and more people hear about us and know about us and try us, our research shows that we have no problem getting people to come back.

The other thing I would say about the new airplanes is the built-in fuel hedge they give you. We operate the most fuel-efficient airplanes in the categories that we operate. When we put our 737 new generation up against a 737-200, it's going to burn about 23 percent to 24 percent less fuel. When we put our 717 up against a 737 or an MD-80 or a comparable airplane, it's going to burn about 23 percent less fuel than the older airplanes. So with fuel prices hovering around US\$50 a barrel, we have a significant advantage over our competitors in that all of our airplanes are brand new and, by definition, burn less fuel than a significant portion of our competitors' fleet.

Q: Do you see low-cost carriers continuing to grab market share? Do you think that will force the consolidation that some people have claimed is necessary in the airline industry?

A: I don't know if it's low-cost carriers per se. There's really too much capacity in the system. To me, it makes sense for companies like us that are profitable to continue to grow. What doesn't make sense are for companies

that are losing enormous amounts of money, hundreds of millions of dollars a year, to continue to grow. This is one of the very few industries you'd see that happen.

I do believe there will be consolidation at the legacy end of the industry and probably at the lower-cost portion of the industry. That consolidation is taking much longer than it should because some of the weak carriers keep getting propped up either by the government or other interested parties. But eventually, something has got to give. You can't keep flying and losing US\$5 billion a year or more year after year after year. So at some point, there will be a shake out, either through consolidation or failure or some other mechanism. I can't predict how that's going to happen. But it has to happen.

Q: You talked about consolidation maybe in the low-cost carrier sector. As low-cost airlines such as yourself continue to expand, do you think increased competition is going to cause you to bump up against each other and affect your ability to remain profitable?

A: No, I don't. First of all, we bump up against each other already and have been for a long time. So that's nothing new. If you look at the overlap in route structures, all the low-cost carriers pretty much bump up against a significant portion of the rest of the industry. So that's already been occurring for some period of time. As long as we keep our costs low, I think we can grow and do so profitably. So I'm not too much concerned with that, but at some point, you need a little more real estate or different real estate or whatever that tends to drive these consolidations. We'll see how that plays out.

Q: We talked about how AirTran Airways was profitable even in the tough year of 2004. But the industry still suffered from low yields and cost pressures. And you probably would have liked to have been more profitable if you could have been. What do you think will be required to return the airline industry to full health where you're seeing the kind of profits that you would like to achieve?

A: It's going to take a shake out. It's going to take some capacity to be taken out of the industry. And management of the various airlines have proven that they don't have the discipline to do that. My guess is it's going to require some failures in order to get the supply and demand balance back in some proper alignment. But that's going to take a significant amount of time in all likelihood. **E**