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ON THE ROUTE TO RECOVERY

*A conversation with ...*

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President  
and CEO,  
Gulf Air**

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# The Long Night's Journey into Day

*With traffic, profits and demand on the rise, the world's airline industry appears to be on its way to brighter days.*

■ By B. Scott Hunt and Stephani Hawkins | *Ascend* Editors

If it is truly darkest before the dawn, then the airline industry certainly stands on the cusp of a spectacular sunrise.

After a prolonged period of darkness in the industry, many industry experts say that they see the first rays of the recovery dawn on the horizon, with increases in metrics such as passenger traffic, load factors and revenue per kilometer.

"Positive growth is expected in 2004, with a bounce back of 7 percent to 8 percent in international RPKs," said Giovanni Bisignani, director general and chief executive officer of the International Air Transport Association. "Our agenda for 2004 is designed to turn this positive trend into sustained growth and to help the industry repair damaged balance sheets."

The International Civil Aviation Organization also predicts that traffic, after two flat years, will grow this year. The ICAO projects traffic will reach 3.1 billion passenger kilometers performed in 2004, surpassing 2000 levels of 3.017 billion PKPs. The ICAO projects traffic will further increase to 3.3 billion passenger kilometers performed in 2005.

Even in North America, where impacts of the industry downturn have been felt most

acutely, there are rays of hope. According to the Air Transport Association of America, an industry trade group, the U.S. industry's losses decreased from US\$11.3 billion in 2002 to US\$5 billion last year.

"We're heading in the right direction," said James C. May, chief executive of the ATA earlier this year.

In January, the ATA reported that revenue from passengers carried was up 5.4 percent year-over-year, exceeding analysts' expectations. Most of the gains came from international travel, the ATA said.

"We see improvements across the board comparatively speaking against the previous two years," said Emre Serpen, a senior partner with Sabre Airline Solutions Consulting. "I would say the recovery happened faster than expected. In terms of profitability, European and Asian carriers are doing well. Market growth rates are back on track, load factors are recovering, and there's general improvement. We still need to be cautious,

of course. It's not like everything is perfect. But there's improvement."

The improving global economy and pent-up demand for travel have helped airlines around the world regain their footing. The low-cost segment, which was not impacted to the degree of some of the network carriers, continues to grow and stimulate traffic with low fares and by tapping underserved markets.

Although the recovery appears to be worldwide, it is progressing at different rates in the three regions most dramatically affected by the

events of the past three years.

**"Market growth rates are back on track, load factors are recovering, and there's general improvement. We still need to be cautious, of course. It's not like everything is perfect. But there's improvement."**

## Asia/Pacific

As the region least impacted by the industry's downturn, Asia/Pacific has also been the quickest to begin recovering.

Because the low-cost carrier segment is less developed in Asia/Pacific, the industry is more regulated, the region's economy is doing relatively well and the carriers receive more

## THE HIGH • LEVEL

### view

News Briefs from Around the Globe

#### Who

American Airlines, Northwest Airlines, Alaska Airlines and Midwest Airlines

#### What

Partnered with Travelocity to drive more passengers to check in via the

Web. Through the agreement,

Travelocity provides links to online check-in from its Web site as well as in an e-mail message sent to travelers shortly before the day of departure.

#### Why

By driving people who book their travel on Travelocity to check in via the Web, airlines help reduce their staffing needs at the airport as well as provide a popular customer service. [E](#)

## Global Passenger Forecast Summary

	2003	2004	2005	2006	2007	AAGR
<b>Total International</b>	-1.1%	6.9%	7.2%	5.6%	5.1%	4.7%
North Atlantic	-0.5%	4.7%	6.0%	4.2%	3.9%	3.6%
Trans-Pacific	-6.3%	9.4%	8.9%	5.9%	5.3%	4.5%
Europe-Asia/Pacific	-3.5%	8.9%	7.9%	6.6%	5.8%	5.0%
Europe-Middle East	-3.1%	7.0%	6.5%	5.8%	5.0%	4.2%
Europe-Africa	-0.6%	4.8%	7.0%	5.0%	4.7%	4.1%
North America-Latin America Caribbean	2.7%	5.7%	7.5%	5.5%	4.9%	5.3%
Within Asia/Pacific	-10.9%	14.0%	10.6%	7.8%	7.2%	5.4%
Within Europe	3.2%	4.6%	5.7%	4.7%	4.4%	4.5%
Within Latin America/Caribbean	0.8%	5.3%	6.7%	5.5%	5.2%	4.7%
<b>Total Domestic</b>	0.4%	3.9%	4.9%	4.4%	3.7%	3.4%
<b>Total</b>	-0.1%	4.9%	5.7%	4.8%	4.2%	3.9%

Beginning this year and continuing through 2007, passenger traffic is expected to increase, according to IATA forecasts. The average annual growth rate through 2007, including the declines in passenger traffic in 2003, shows positive growth worldwide of 3.9 percent, led by the intra-Asia/Pacific region.

revenue from international travel, they have been recovering more rapidly.

"In terms of profitability, the Asia/Pacific carriers are in a good position," said Serpen. "As far as passenger growth, China is very strong, Southeast Asia is very strong. I think Asia is very optimistic. The mindset is on growth."

Analysts in the region are also optimistic about the continuing recovery.

**"I don't know if the dark times have passed, but somebody turned up the dimmer switch a little bit. We're looking better than we used to, that's for sure."**

"If you look at traffic statistics that have been released by different companies, whether they are Qantas, Cathay or Singapore Airlines, you are seeing volume coming back," said Anthony Srom, Melbourne, Australia-based transport analyst for Goldman Sachs JBWere. "Load factors are beginning to improve. Generally, you are seeing those signs pointing that recovery is underway. If you look at the investment community, analysts that actually cover the Asia/Pacific airline stocks are saying they've upgraded their forecasts for profits, so there's a bit of an anticipation that the recovery should continue."

The Centre for Asia Pacific Aviation is also optimistic about the region's recovery. The Centre said 2003 was a "surprisingly good" year with traffic levels close to the previous year levels despite the impact of severe acute respiratory syndrome. If the current momentum is maintained, the Centre said, "double-digit traffic growth (is) assured."

For 2004, a "year of massive opportunity," economic conditions are favorable across the region with consumer confidence high and strong gross domestic product growth anticipated throughout the region, the Centre said. With effective capacity management growth, the region's recovery should stay on track.

Srom projected that it will take 12 to 24 months for the region to make a full recovery, provided that there are no additional setbacks. He said the carriers are "becoming leaner and meaner" taking steps to succeed in a new industry environment such as restructuring labor deals, revamping fare structures and thoroughly examining their product.

He also said the region is "seeing a nice little rebound in business traffic at this point," which bodes well for the yields of major carriers.

### Europe

"It is slow and painful, but the recovery is underway," said Ian Tunnacliffe, U.K.-based vice president, industry services at META Group Inc. "Not everyone is recovering at the same rate as everyone else."

Tunnacliffe said after the collapse, the region's airlines lowered their pricing to entice passengers back onto their aircraft.

"They made some very attractive fares," he said. "They got the cabin factors back fairly quickly. The real struggle has been to get the yields back."

Tunnacliffe pointed to British Airways reporting in January a 1.1 percent year-over-year increase in traffic in its first and business classes as evidence that yields are improving. January 2003 was the last month before the Iraq war threat started to affect airline results, Tunnacliffe said, so to be ahead of that pace represents a significant achievement. Late last year, BA's premium traffic was growing by 2.5 percent to 3.5 percent per month.

"Their load factors were up in the premium classes," Tunnacliffe said. "BA historically has tended not to discount its premium classes very much. When the load factors are going up in the premium cabin, it's interpreted as a very good sign."

"Obviously that sort of growth rate is unsustainable in the long term, but it illustrates that the market is coming back quite quickly," he said.

A general economic recovery, led by the United States, has fueled traffic on North Atlantic routes, where many of the major European carriers generate a significant amount of their profits, said Tunnacliffe, who projects the regional industry, with a "fair wind and no major incidents" will return to some level of normalcy in two years.

"To have that market recover is very important to them," he said.

And, Serpen said, because the major European carriers rely more on long-haul intercontinental traffic, which is less susceptible to low-cost competition, they have been able to rebound more quickly than their North American counterparts, which depend more heavily on revenues from their domestic market.

Some positives have even come out of the last few years, analysts said. Carriers are opening their minds to new ways of doing business, embracing ideas many have resisted for a long time such as outsourcing some of their processes to specialty providers who can do them more efficiently and cost effectively.

"I think probably every airline CIO in the western world now is moving very strongly to get rid of proprietary technologies and move to standard technologies," Tunnacliffe said. "It is good news because it will ultimately lead to lowering of cost and improvement of efficiency."



Airlines are also beginning to change their focus, Tunnacliffe said.

"It has appeared that market share has been more important to many airlines than profitability," he said. "Where I think we're seeing that change is in the new generation of airlines. Those airlines have been resolute on profit; they don't do stuff unless it's profitable. That's the mindset that ought to be spreading."

## North America

The region most impacted has finally begun to show some positive signs of a comeback.

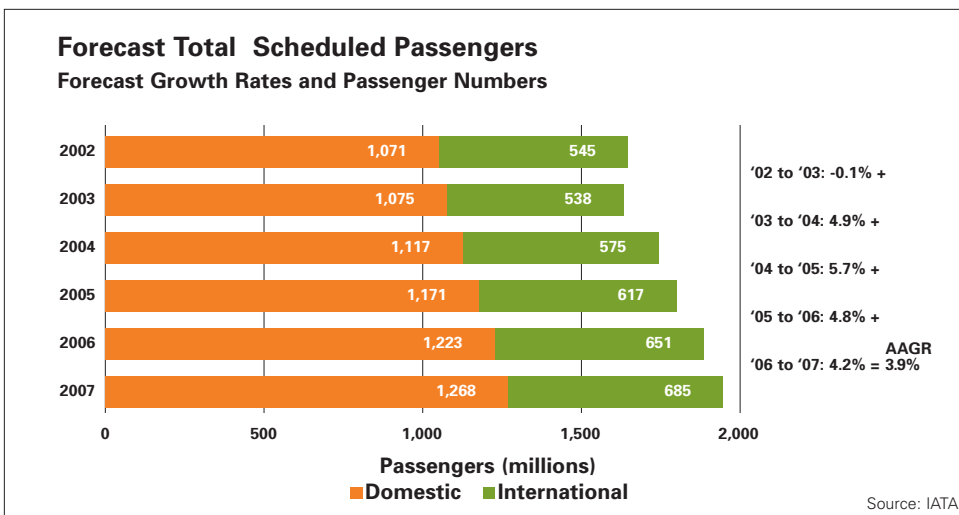
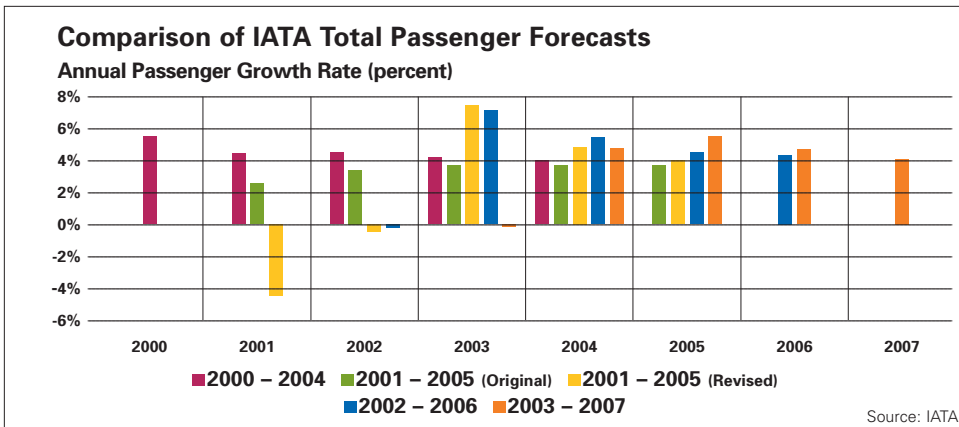
"I don't know if the dark times have passed, but somebody turned up the dimmer switch a little bit," said Steve Hendrickson, senior partner with Sabre Airline Solutions Consulting. "We're looking better than we used to, that's for sure."

The sun began to shine again in the North American airline industry during the latter part of 2003, he said.

"A lot of things caused people to take their travel dollars and put them on the shelf for a while," Hendrickson said. "It would appear in the third quarter, people said, 'hey, you know, SARS is gone, the war is over, the economy is back, interest rates are low, job losses are tapering — let's go out there and do what we used to do as a family, as a business, as an economy.'"

One of the brightest spots for North American carriers has been on international routes.

"In North America to some of the international regions, not only do the second half of '03 numbers beat out the '02 numbers, but



According to global passenger projections from IATA, recovery is expected this year with a large bounce back in 2004 and 2005, followed by a return to more traditional levels of growth through 2007. IATA also projects the average annual growth rate for scheduled international passenger traffic to be 4.3 percent from 2008 to 2017 and an AAGR of 3.4 percent in domestic passenger traffic during the same time period.

## THE HIGH LEVEL VIEW

News Briefs from Around the Globe

### Who

Phuket Air

### What

Selected the *SabreSonic*™ passenger solution for its reservations and departure control. The solution will help the airline improve distribution to travel agencies, create greater efficiency in booking capabilities and

lead directly to increased revenue.

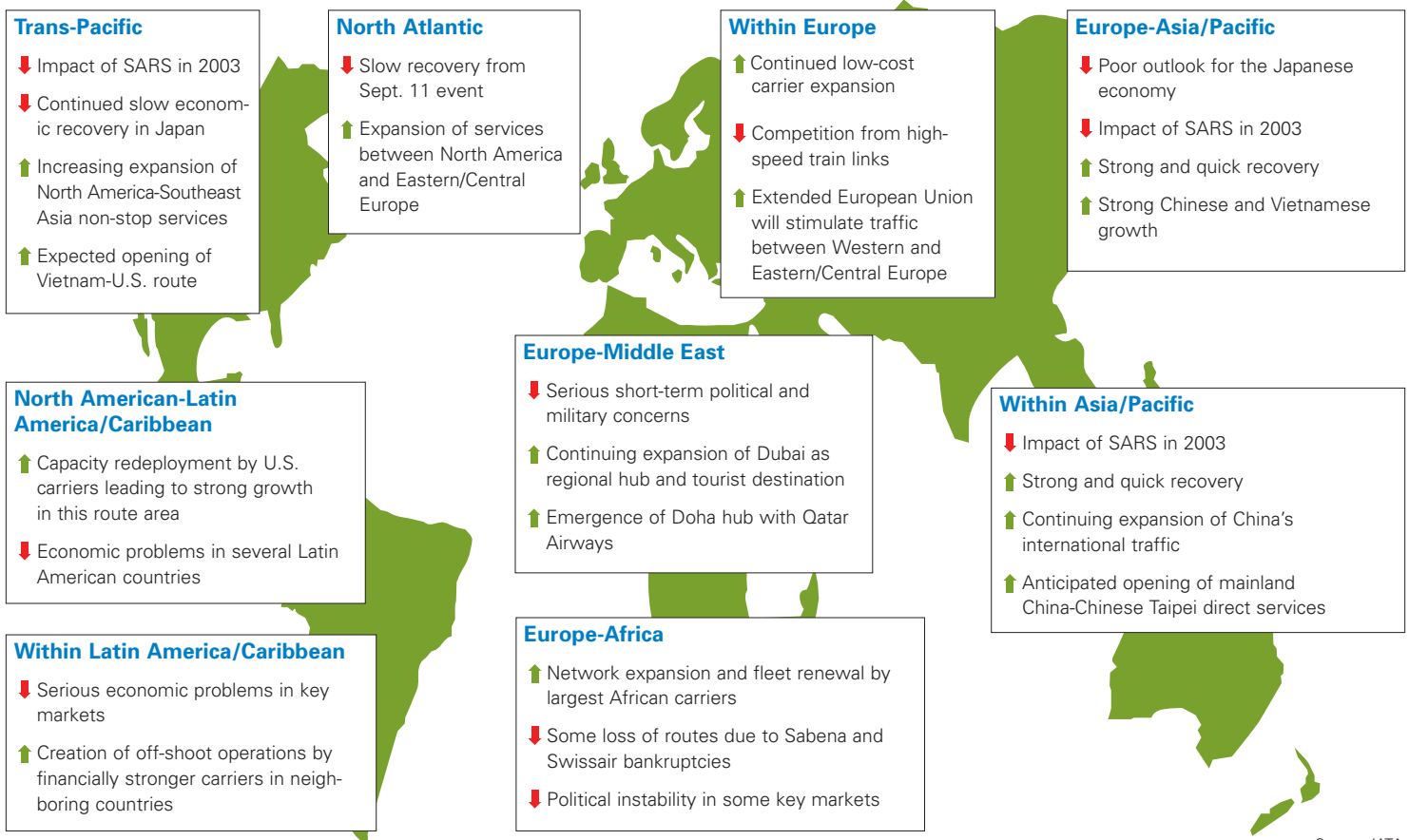
The airline will also implement the *Sabre*® *AirOps*™ Load Manager and the *Sabre*® *Qik*® business processing solutions.

### Why

"Phuket Air has experienced exceptional growth in the first two years of operations, and we aim to improve

our reservations efficiency and the level of services offered to our customers with this implementation," said Kanin Phuvastien, senior vice president of Phuket Air. "Sabre Airline Solutions is also allowing more extensive distribution options by our participation in a number of global distribution systems." [a](#)

## Regional Outlook 2003—2007: Broad Factors Affecting Passenger Growth Trends



Source: IATA

According to IATA, airlines in various regions are expected to recover at different rates due to unique circumstances that affect the local industry. While some areas such as Asia/Pacific are bouncing back more quickly, other regions including Europe and North America will experience slower recoveries due, in part, to their struggling economies.

## THE HIGH • LEVEL view

News Briefs from Around the Globe

### Who

Jardines Aviation Services Group


### What

Implemented Asia/Pacific's first new-generation, integrated resource management suite, including the *Sabre® StaffAdmin™* employee tracking and assignment system, the *Sabre® StaffManager™* automated staff allocation system and the *Sabre® StaffPlan™*

staff forecasting and planning system, to efficiently manage its resources at Hong Kong International Airport.

### Why

"JASG required an efficient and centralized staff and equipment planning system for both passenger and ramp handling that would enable a move away from the current non-centralized setup," said David Clymo, finance

director for JASG. "We visited several Sabre Airline Solutions resource management customers throughout Europe and could see similarities with our operations. After an intensive evaluation, Sabre Airline Solutions was proven to offer the best-of-breed customized solution for the requirements of JASG, which was instrumental in the contract win." 



they also, in some cases, eclipse the 2000 numbers, so it's pretty encouraging," Hendrickson said.

In the U.S. to Latin America sector, revenues are up about 11 percent. In the U.S. to Europe market, the revenue per available seat mile numbers have passed 2000 levels. Even in domestic travel, which is still lagging well behind 2000 levels, passenger levels are climbing.

"Year over year we've turned the corner," Hendrickson said. "Coming from an environment like the one we've just experienced, that's a positive thing."

Much of this growth, he said, is fueled by the burgeoning U.S. economy, which in the third quarter of 2003 grew by 8.2 percent — "It has been more than five years since we have seen economic growth of that magnitude."

As the economy improves, some of the pent-up demand for travel is being released.

"Companies are saying, 'OK, it looks like the markets have stabilized, we know what our future looks like, let's go out and face those customers and chase those deals,'" he said.

The region's airlines have also taken some other steps to regain health such as focusing on long-haul trunk routes, aggressively pricing their product, attacking inefficiencies and rationalizing their fleets.

Still, it will take six to eight quarters of consistent revenue and earnings growth to return to some semblance of health, Hendrickson said.

"The industry really needs to show some earning power and some revenue growth momentum before Wall Street is ever going to recapitalize it," he said.

## The Future is Still Cloudy

Even with the positive signs, "it seems like we're always right around the corner from something unforeseen that could potentially be another major setback, or at least the fear of such a force," Hendrickson said.

Industry experts say there are several factors that could send the industry back into the dark.

"In the last few years, you could call it the 'constant shock syndrome' where there always seems to be an 'X' factor you have to be cognizant of," Srom said. "You have potentially SARS, terrorist activity, continued emer-

announced plans for their own low-cost carrier within a carrier. Others such as Air New Zealand have revamped their pricing structure to offer reduced fares.

According to Srom, to compete with low-cost carriers going forward, traditional airlines should ensure that they are "reexamining their networks and the profitability of each

individual part of those networks (as well as) examine the products. Are they differentiated enough in their market niche?"

Beyond restructuring to address the challenge from low-cost carriers, one of the main themes that could continue to fuel a strong recovery still remains on the horizon.

"The world has too many airlines," Tunnacliffe said. "Any other industry faced with these sort of economic conditions, the natural reaction would be consolidation. Airlines would merge. Some airlines would go bankrupt. Some would be

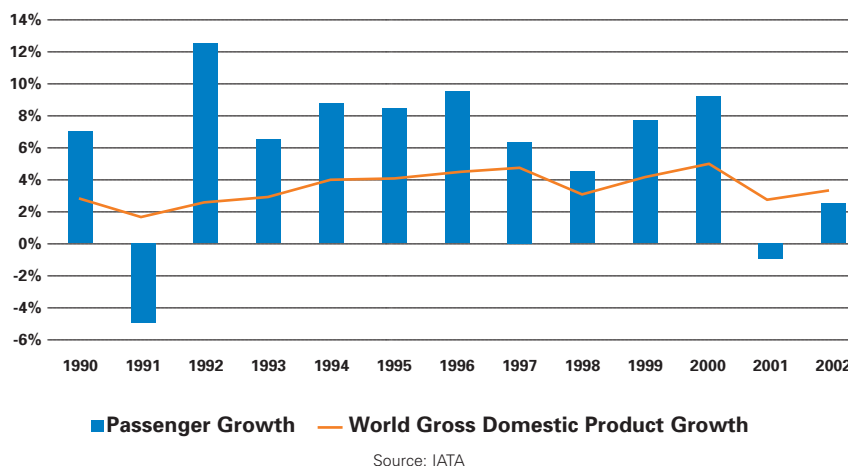
acquired. This is very difficult to happen under the current regulatory environment that the airlines operate in, especially internationally. But I think we have to see that change, and we have to see the ability of major airlines to consolidate."

Still overall, the future looks bright especially compared with the recent past.

"I'm optimistic," said Tunnacliffe. "I think we're going to see some quite substantial changes in the way the industry operates over the next decade. I think we will see some rationalization as far as the regulatory environment. We will see consolidations in the industry. When that happens, the industry should be stronger. Individual airlines will be more profitable. They will be able to invest more in technologies that they're going to need in the coming years." **E**

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**World Economic Growth Verses Scheduled International Passenger Growth (percent change)**



**According to IATA statistics, the health of the airline industry continues to mirror that of the world economy. From 1990 to 2003, the growth of scheduled international passenger traffic has reflected the growth of the world economy as measured by gross domestic product. Based on improving economic conditions, IATA predicts an "upbeat" forecast for passenger traffic during the next few years.**

gence of low-cost carriers, potential fuel price increases that could derail the recovery."

Of the potential barriers to recovery for major network carriers, the growth of low-cost airlines presents the biggest challenge. With low fares and point-to-point route structures combined with competitive levels of service and unique amenities, the entire concept of low-cost flying has changed in the minds of many travelers, sending them aboard those airlines that bring the most value.

"There's no doubt that the network carriers as we know them are going to have to remake themselves if the marketplace continues to move the way it has with the low-cost carriers bringing products that are of comparable quality into the market with much lower costs," Hendrickson said. "They can't just sit there doing what they've always done."

Even in Asia/Pacific where low-cost carriers are just beginning to make their mark, the traditional carriers are having to respond. Carriers such as Qantas Airways, Singapore Airlines and Thai International Airways have