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While world economic recovery may be lopsided, there appears to be a “pony” out there with most regions of the world seeing measurable signs of an upswing.

■ By Lynne Clark | *Ascend* Staff

Former U.S. President Ronald Reagan's favorite story, or joke, lends a buoyant perspective on dismal world economic news. The story was published in a book written by Peter Robinson, who spent six years as a speechwriter in the Reagan administration, and President Reagan enjoyed telling this story over and over again.

"Worried that their son was too optimistic, the parents of a little boy took him to a psychiatrist. Trying to dampen the boy's spirits, the psychiatrist showed him into a room piled high with nothing but horse manure. Yet instead of displaying distaste, the little boy clambered to the top of the pile, dropped to all fours, and began digging.

"What do you think you're doing?" the psychiatrist asked. "With all this manure," the little boy replied, beaming, "there must be a pony in here somewhere."

In a year marked by gloomy headlines about oil spills, massive worldwide deficits and stagnant employment rates, it is startling that a "pony" can be uncovered in news about the hard-hit, beleaguered airline industry.

However, the "pony's" arrival was predicted earlier this year by many cautious prognosticators, but it wasn't until June that it was actually spotted.

In June, Paul R. La Monica, editor-at-large of CNNMoney.com, wrote that a group of 13 leading airlines' stocks was trading at its highest level in more than a year.

"The NYSE Arca Airline Index, which includes U.S. giants such as American Airlines parent AMR, discounters Southwest Airlines and international airlines such as Ireland's Ryanair and Brazil's GOL, is up about 9 percent since the end of April," he wrote. "What gives?"

The International Air Transport Association also in June signaled cautious optimism when it revised a March outlook saying it expected airlines to post a US\$2.5 billion profit this year, recovering from two years of ailing business.

"What gives" according to IATA is increasing passenger travel, a climb in cargo trade and effective cost-cutting measures that will continue to accelerate the industry's rebound.

"The global economy is recovering from the depths of the financial crisis much more quickly than could have been anticipated," IATA Director General Giovanni Bisignani told reporters. "Airlines are benefiting from a strong traffic rebound that is pushing the industry into the black. We thought that it would take at least three years to recover the US\$81 billion drop in revenues in 2009. But the US\$62 billion top-line improvement this year puts us about 75 percent on the way to pre-crisis levels.

"The recovery from this crisis is asymmetrical. Worsening conditions in Europe are in sharp contrast to improvements in all other regions," Bisignani said.



Photo: Airbus



Photo: Airbus

Low-cost carriers, such as AirAsia and Tiger Airways, have been instrumental in the rise of passenger growth by growing network expansion, introducing additional international routes and increasing flight frequency, completely changing the dynamics of Asian aviation.

Asia/Pacific

Leading the recovery charge is the Asia/Pacific region. Kunal Sinha, aerospace and defense consultant for Frost & Sullivan, said in a press release that the World Bank forecasts the Asian economy to grow by an average of 6 percent this year, translating into an estimated 12 percent growth in the demand for air services. As a result, the region's carriers are expected to deliver the largest profit at US\$2.2 billion.

"Asia/Pacific's aviation prospects are improving much faster than other regions, and within Asia/Pacific, 217 million more passengers are expected to take to the skies by 2013," Sinha said. "As with the industry in the United States, the global economic downturn took its toll on air travel in Asia as well. However, the APAC region is rebounding quicker than many parts of the world, largely attributed to its relatively healthy economy and rising incomes that make it affordable for people to fly more frequently."

He said the region's two largest markets, China and India, are expected to expand by 9 percent annually for the next few years. To accommodate this growth, airlines will buy nearly 9,000 new aircraft for service in the Asia/Pacific market during the next 20 years. The relatively fast recovery and encouraging signs have made the people in the region more confident about flying.

Sinha said that struggling U.S. and European airlines are increasingly looking to Asia to bolster their fortunes. For U.S. carriers, Asia represents a way to diversify overseas as their domestic market share continues to be whittled away by low-cost carriers such as Southwest Airlines.

"They are forging new alliances with Asian airlines, increasing flights to major cities and are competing to launch services in fast-growing markets in the region, like Malaysia," he explained.

Growing network expansion, inauguration of new international routes and increased flight frequency by low-cost carriers such as AirAsia, Firefly, SilkAir, Tiger Airways and Jetstar Airways have played a major role in the surge of passenger growth.

"The low-cost movement, which has now become an integral part of the mainstream of the industry in Asia, has completely changed the Asian aviation dynamics," said Sinha. "Considering the benign regulatory stance, the LCC movement will prosper, driving economic integration and a more widespread network of air transport services throughout Asia. In the future, the interests of economic development and the region's growing tourism sector are expected to be better served by LCCs than full-service carriers."

North America

Economists with Kiplinger said in June they expect a 3 percent gain in gross domestic product this year for the U.S. economy with a net gain of 1 million jobs. That will be a welcome change after two years of job losses, but the payroll gains will still leave the unemployment rate at close to 10 percent.



Photo: Boeing

Along with many other airlines around the world, carriers in Central America are experiencing a positive shift in the economy. Panama-based Copa Airlines late last year boosted to 15 its order for Boeing 737-800 aircraft.

"Recoveries from a financial crisis are slow," said Nigel Gault, chief U.S. economist with IHS Global Insight.

U.S. corporate earnings are likely to remain impressive, business analysts predict. As earnings season begins to heat up, the spotlight will likely shift from the trouble overseas to the relative strength at home, especially in the wake of heavy cost cutting that has made companies much leaner.

Earnings "have been outstanding across virtually all sectors," Peter Kenny, managing director at Knight Capital Group, told Fox Business. "That's the rebound story. Companies are delivering on the earnings."

For the airline sector, IATA forecasts American carriers will return a profit of US\$1.9 billion, a major improvement over the US\$2.7 billion the region lost in 2009. Driving the recovery are improved efficiencies as a result of demand in growth, capacity cuts and domestic mergers.

Speaking at a June Bank of America Merrill Lynch Transportation Conference, airline executives said recovery in business travel has accelerated alongside gains in international and domestic passenger revenue, bucking lingering concerns about higher fuel prices.

Most major U.S. carriers forecast double-digit gains in average revenue for the second quarter, helped by more corporate travel after the unprecedented declines of as much as 40 percent seen a year ago. The revenue picture has strengthened through the quarter, with United Airlines' parent UAL Corp. leading the industry with a forecast for an increase of 26 percent to 27 percent in the three months to June 30 from a year earlier.

"We're also seeing corporations beginning to allow their employees to travel in the premium cabins," said Gerard Arpey, chairman and chief executive of American Airlines parent AMR Corp.

Some executives, however, remain cautious despite the positive trends.

"Business travel, although it's improving, is still nowhere close to fully recovered," said Southwest Airlines' treasurer Laura Wright. "Unemployment remains very high."

Latin America

"Latin American countries weathered the global economic crisis of 2009 relatively well, with GDP contracting 3 percent overall, a decline largely attributed to Mexico's exceptionally difficult year," said Shelly Shetty, senior director

for Latin American sovereign ratings at Fitch Inc. in New York. "Latin America has been more of a spectator in this global crisis."

The region should recover to 4 percent growth this year, business analysts estimate. Adding to the recovery are Latin American carriers, which are projected to show a profit of US\$900 million, up slightly from the US\$800 million previously forecast. Having posted a US\$500 million profit last year, Latin America will be the only region to post two consecutive years of profit. The region's commodities are closely linked with Asian growth and supported by a 3.9 percent GDP expansion this year.

The pervading optimism in Latin American aviation is also demonstrated by the flurry of financial transactions executed last December. In Brazil, the region's largest market, the National Bank for Economic and Social Development approved an additional US\$640 million for Argentina's purchase of 20 Embraer 190 aircraft for Austral Líneas Aereas.

Embraer also signed a three-year, US\$2.2 billion memorandum of understanding with CDB Leasing, a branch of China Development Bank, for new regional aircraft destined for Chinese airlines. Last September, Embraer reported that its aircraft order backlog added up to US\$18.6 billion and that it was on track to close the year with a company record of 232 units delivered. In Panama, Copa Airlines announced toward the end of 2009 that it had increased a previous order to 15 Boeing 737-800 aircraft.

Other signs of progress come from commercial airline flight expansion. For example, in Uruguay, the Civil Aeronautics Board has presented to the executive branch a "free skies" policy proposal for the Punta del Este airport. If passed, the measure would largely open traffic to all non-regular flights at the country's second-largest airfield.

But while profits are up, ongoing safety concerns make a sustained recovery shaky. Last October, ALTA members, representing some 40 Latin American and Caribbean airlines and government organizations, addressed the concern and issued a set of resolutions for 2010. The top concern was air safety. They agreed to establish a centralized entity to develop and oversee technical certification standards and improve international aviation relationships.

Middle East

Most of the Middle Eastern economies are expected to enjoy a recovery in 2010 as oil prices stabilize and OPEC increases production. The Middle East and North Africa together are predicted to grow by 4.5 percent this year and 4.8 percent next year.

IATA said Middle Eastern carriers are expected to post a profit of US\$100 million — their first since 2005. This is significantly better than the previously forecasted US\$400 million loss and the US\$600 million that the region's carriers lost in 2009. GDP growth of 4.3 percent is outstripping the global average, and Gulf carriers continue to



Photo: Boeing

A significant indicator that the airline industry is returning to good health is the increase in aircraft orders from the main manufacturers. For example, earlier this year, Emirates Airlines announced it would purchase 32 Airbus A380 aircraft at a list cost of US\$11.5 billion. This brings to 90 the firm orders Emirates has placed for the super jumbo jets.

gain market share through their hubs in Europe and Asia/Pacific even as capacity is being added at a more cautious rate.

Willis Aerospace executive director Stephen Doyle told reporters in June that all signs point to strong economic recovery. He said that, particularly in the Middle East, low-cost carriers could play a major role in boosting the industry's growth.

"It could be said that the low-cost carrier segment has benefited from the challenges of the legacy carriers," he said. "The Middle East and parts of Asia have not been hit as hard as other parts of the world, and it will be interesting to watch how the recovery develops."

One indicator that the industry might be turning the corner is Emirates Airlines' recent announcement that it will buy 32 Airbus A380 Super Jumbo Jets at a list cost of US\$11.5 billion.

"It's very good news, and Emirates is a strong customer," said Airbus spokeswoman Maryanne Greczyn. "It is a strong airline in a greatly emerging economy. So it's a good bellwether for the industry."

A survey by MEED of senior management executives at firms with business interests in the Middle East revealed 62 percent of companies expected to spend more on business travel in 2010 than last year, another sign the region is on the road to recovery.

The majority of companies surveyed expected to make up to 25 visits to countries in the Middle East and North Africa this year. Of the Gulf Cooperation Council (GCC) countries planned to be visited, the United Arab Emirates ranks the highest, followed by Saudi Arabia and Qatar. This reflects the fact that these countries have the

largest economies in the region and the highest number of projects under way.

Africa

African carriers are expected to post a US\$100 million profit, their first since 2002. This reverses the US\$100 million loss previously forecast in March and the US\$100 million that the region lost in 2009.

The turnaround can be attributed to an increase in Africa's average GDP growth, which is predicted to rise to 4.5 percent this year and 5.2 percent next year, according to a report by the Organization for Economic Co-operation and Development.

"The good news is that the continent has proved resilient to the crisis," said Henri-Bernard Solignac-Lecomte, head of the Europe, Africa and Middle East desk at the OECD Development Centre. "The bad news is that, despite rebounding growth next year, the downturn could make it more difficult for some African countries to meet the Millennium Development Goal of halving the number of people living in poverty by 2015."

The recovery will not come at the same rate across Africa: Southern Africa, which was affected the most by the crisis, is forecasting only 4 percent growth this year and next, while East Africa, which fared best on the continent, could achieve 6 percent on average during the same period.

There are many outside influences spurring this growth. China is investing heavily in Africa to procure natural resources needed to fuel its ever-hungry economic engine. U.S. companies also have longstanding relationships built on business surrounding oil and other resources. Tourism

is strong and growing, and trans-Atlantic flight frequencies are increasing.

Still, there are hindrances that could slow aviation growth. While the U.S. Trade and Development Agency has estimated that nearly 90 projects worth US\$2.6 billion will modernize African airport infrastructure in the next three years, the continent still has significant safety issues.

In a December 2009 interview with Aviation & Allied Business, Manoj Ujoodha, chief executive officer of Air Mauritius, said that African airlines also suffer from the competition of major network carriers as well as from the Middle East.

"These carriers operate hubs and have synergies with partners worldwide," he said. "Their competitive advantage is exacerbated by the economies of scale they benefit from, and many African carriers find it difficult to compete.

"The latter operate within limited isolated markets and don't have access to the critical mass that would give them the means to attract the resources and operating capabilities that would enable them to compete on a level playing field," Ujoodha said. "African carriers would only be able to compete if they can find synergies among themselves and benefit from the support of crucial stakeholders like their respective governments."

At its November 2009 conference, The Africa Airlines Association (AFRAA) urged the continent's largest players to work with smaller carriers to create codeshares, joint ventures, cross-border and equity partnerships.

"I think the message of cooperation is not a fancy, trendy word, but an absolute necessity for Africa," Kenya Airways chief

operating officer Bram Steller told AFRAA conferees.

Europe

Economic growth in the European Union will solidify toward the end of the year and accelerate in 2011, according to Economic and Monetary Affairs Commissioner Olli Rehn.

"We assume that economic growth will be around 1 percent in 2010, which will solidify toward the end of the year so that next year, economic growth would be on a scale of 1.75 percent in the European Union," he said.

According to IATA, European carriers will be the only ones in the red with a US\$2.8 billion loss. This is a downgrading from the US\$2.2 billion loss previously forecast in March, although it is an improvement on the US\$4.3 billion that the region lost in 2009. GDP growth of 0.9 percent is not enough to support a recovery, and the currency crisis clouds the future with uncertainty.

April's eruption of the Eyjafjallajökull volcano in Iceland and the subsequent closure of European airspace because of the ash cloud drove profits down in Europe. IATA's Steve Lott said the Greek economic crisis and the fall of the Euro against the dollar have also slowed profits in Europe.


"Europe has seemed to have lagged the rest of the world in terms of economic recovery," he said. "Some of that is due largely to the Greek debt crisis and some of the financial problems in other countries. Germany announced major budget cuts and problems with its budget. And this is all really accumulating in a weak European economy."

Wild Card

The wildcard in a sunnier outlook for air carriers is jet fuel prices. After a three-week slump, which saw the price of WTI crude down to almost US\$60 per barrel in late May, oil

prices recovered in June to US\$75 per barrel. Conflicting signals from the Middle East contribute to the uncertainty of which direction oil prices will head. IATA expects 2010 oil prices to average US\$79 per barrel. However, David Greely, chief commodities strategist at Goldman Sachs Group Inc., told reporters in June that oil prices will return to a higher-price environment, trading between US\$85 and US\$95 a barrel by the end of this year. Oil may reach US\$100 by 2014 on future supply constraints, he said.

"Unfortunately, there is a risk that the fuel goes up faster than the economy, and so this creates a problem," said IATA's Bisignani. "It will be difficult to apply fuel surcharge in this weak environment.

"Seeing black on the bottom line is a great achievement. The resilience of the industry has been strengthened by a decade of cost-cutting, restructuring and re-engineering processes," Bisignani said. "But even with all of our hard work, the result is just a 0.5 percent margin that does not even cover our cost of capital. The industry is fragile. The challenge to build a healthy industry requires even greater alignment of governments, labor and industry partners. They must all understand that this industry needs to continue to reduce costs, gain efficiencies and be able to restructure itself if it is to be sustainably profitable. We must all be prepared for a greater change." 

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+count it up

7.8 billion

The amount in U.S. dollars, U.S. airlines collected in ancillary revenue in 2009, according to the U.S. Department of Transportation. Of that amount, US\$2.7 billion was from baggage fees alone.

40

The percentage of international tourists who travel by air, according to enviro.aero. Aviation now transports more than 2.2 billion passengers annually.

40+ billion

The amount in U.S. dollars air transport pays annually to use air transport and air navigation services infrastructure through specific landing, passenger and air traffic control fees, according to enviro.aero.