AIRLINE weekly®
INDEPENDENT WORLDWIDE COVERAGE

November 2, 2009
Issue No. 260

Earnings

July 2009-Sept. 2009 (3 months)
Lufthansa: $271m net profit ($140m net profit)*
Finnair: $30m net loss ($2m net loss)*
Vueling: $100m operating profit
All Nippon: $42m net profit
Air China: $130m net profit ($49m net profit)*
China South.: $ 49m net profit ($45m net profit)*
China Eastern: $3m net profit ($18m net loss)*
China Airlines: $81m net loss
Eva Air: $68m net loss
Jet/JetLite: $114m net loss ($106m net loss)*
Kingfisher: $89m net loss
SpiceJet: $22m net loss
LAN: $52m net profit
Royal Jordanian: $25m net profit
Pakistan International: $64m net loss
April 2009-Sept. 2009 (6 months)
Kenya Airways: $11m net profit
Jan. 2009-June 2009 (6 months)
Aeroflot: $14m net profit
*ex special items

ISSN 1942-2059.

David Fights Goliaths, Again

Airline Weekly speaks with David Neeleman, founder of JetBlue and, now, Azul

Skeptics question whether Brazil needs another airline—and whether this one in particular is taking the right approach. But David Neeleman is used to skepticism. He began his airline carrier by launching Morris Air, which Southwest later acquired (and then employed him for a time). He helped launch WestJet and the Open Skies reservation system before making his biggest impact on the industry when he founded JetBlue in 2000. Forced out by its board of directors in the aftermath of an operational meltdown, he went south to Brazil, where he holds dual citizenship. Last December, he launched low-cost, all-E190/195 Azul. Neeleman spoke with *Airline Weekly* last week via phone from Brazil.

Airline Weekly: What are some of the biggest differences between running an airline in Brazil and North America?

David Neeleman: We're really teaching people how to fly here. The market in Brazil should be a lot bigger than it is. People need to be flying by air a lot more. Traditionally the airline business here catered more to the upper class and the upper-middle class. So here it's about getting people to fly for the first time.

See also:
• Evaluating Azul's prospects, p. 6
• Brazil's top airlines, p. 9

AW: You've suggested that revenue management and pricing in Brazil has lacked the sophistication and effectiveness that it has in North America. Can you explain this?

DN: I think there are a couple of reasons airlines here haven't grown traffic as much as they should. They don't segment pricing as much as in the U.S. The highest fares are too high, and the lowest fares are too low. That doesn't allow for enough stimulation. We have brought fares down. And we've been able to get the full value of the business traveler while stimulating leisure traffic.

AW: September data from ANAC shows Azul's load factor at 80%, considerably higher than everyone else. Are you still in the stage of your development where you're just discounting heavily to get people to try your product, even if it's loss making for now?

DN: Well in September Gol and TAM had a big fare war with each other, and our fares were probably higher than theirs. But

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Pushing Back: Inside This Issue

Carriers from Europe, the Far East, the Indian subcontinent, Latin America, the Middle East, Africa and Russia provided earnings updates last week, offering some new insight into what's going on these respective regions. In some places like India, airlines are still suffering terrible losses. In others like Latin America, however, at least one airline (LAN) showed it's still more than capable of making money.

It was hard to avoid thinking about airline consolidation last week. Continental officially joined the Star Alliance and stood shoulder to shoulder with United in announcing their grand joint venture ambitions. United's Glenn Tilton even suggested that all-out mergers are becoming more feasible now that balance sheets are healthier.

One airline that knows a thing or two about consolidation is Lufthansa, which reported decent if unspectacular third quarter financial results. It now controls or owns a substantial stake in Swiss, Austrian, bmi, Germanwings Brussels Airlines and JetBlue. And it's in on the United-Continental joint venture.

Lufthansa's rival Air France/KLM, meanwhile, became Europe's first airline to take possession of an A380, which it will start sending to New York later this month.

Air France/KLM and Lufthansa both appear to be readying new shorthaul business models. BA is changing its practices as well, and even All Nippon hinted at some a la carte pricing moves. For its part US airways—already an a la carte zealot—was busy restructuring its network and cutting more jobs last week. ❍

Verbulence

"I can tell you this much: Crisis or not, we are not satisfied with the absolute figures, although this was the best result possible given the current circumstances.

—Lufthansa CEO Wolfgang Mayrhuber"

Europe's tale of three airline types—the big, the cheap and the midsized—continues to unfold with predictable storylines. The big are challenged but strategically well positioned, the cheap are doing better than ever and the midsized are fighting for their lives. Belonging to the first category is the giant **Lufthansa**, which last week announced a $271m Q3 net profit, or $140m ex special items. Operating margin ex special items was 4%. That more or less matched its operating margin from last summer, though it falls well short of the 9% operating margin it earned two summers ago. In addition, management worries that the off-peak fourth quarter, which ends next month, could tip the company to a full-year loss. The headwinds last quarter were clear enough: premium traffic collapsed, sending overall yields down 14%, while newly added subsidiaries **bmi**, **Austrian** and **Brussels Airlines** all added losses on a net basis. So too did cargo. Nor was the revenue picture helped by what executives complained were "many ridiculous players" competing with excessively low prices just to raise cash. Increasing overlap with low-fare rival **Air Berlin** is adding to the pressure, and in the end, Q3's total operating revenue fell 9% y/y even including the new subsidiaries in this year's figure. Remove them from the equation and revenues are down 19% year to date. To nobody's surprise, however, fuel deflation saved the day, with outlays down 36% (despite $53m in hedge losses and $119m in negative currency effects). **Swiss** did well again too, earning a 4% operating margin for the quarter. And help also came from management's Climb 2011 cost-cutting program, an investment grade credit rating, benefits from an aggressive alliance strategy, a 6% reduction in flights and positive operating profits from the low-fare **Germanwings** unit, whose operating margin was nearly 9% for the first nine months of the year. Even Austrian seems to be coming around in response to aggressive cost cutting, itself earning a 4% Q3 operating margin ex special items. Lufthansa must now work to secure network, IT, sales and operational synergies across its far flung empire of airlines—or sell them off, as it may yet do with bmi. Building synergies with **Continental** is also a priority, as is revitalizing its lethargic shorthaul business, downsizing its regional operations by dumping 50-seat jets, securing a new contract with pilots and lobbying against a nighttime flight ban at key German airports.

For a look at one of Europe's badly struggling independent midsized airlines, take **Finnair**. It suffered a $30m Q3 net loss, or $2m ex special items. Operating margin ex special items was negative 8%. This would be a pretty lousy result for any quarter but is a particularly alarming one for the peak summertime period. Revenues tumbled 22% y/y, with more than half of total revenue coming from Europe-Asia passengers. But operating expenses fell only 15%, with labor costs down just 8% (less than its 11% capacity cut) and fuel costs down just 28% (less than what other airlines are reporting). To make maters worse, pilots are threatening to strike later this month. The problems, in other words, are starting to appear existential in nature, though the carrier does have a decent balance sheet following a recent round of fundraising. Further cost cutting, a possible shift to a la carte pricing on shorthaul routes and the consolidation of domestic, international and oneworld partner traffic at Helsinki airport may help in the quarters ahead. But without a robust recovery in Asian traffic—and perhaps even with one—Finnair's survival as an independent government-owned airline will remain tenuous.

Now to Europe's low-cost segment, where evidence from two airlines so far indicates enormous success. Two weeks ago, **Norwegian Air Shuttle** reported a dizzying 21% operating margin, and last week Spain's **Vueling** topped that by reaching 26%. Now the fourth largest Spanish domestic carrier (after **Ryanair**, its partner **Iberia** and **easyJet**), Barcelona-based Vueling and its merger partner **Clickair** received 10% of their revenue from ancillaries and two-thirds of their revenue from travel agents and Iberia codeshare traffic. If there's one downer, however, it's a 10% increase in non-fuel unit costs. But executives see little volatility in demand and expect 2010 to be even more profitable than 2009, boosted by ongoing merger synergies. In the meantime, they will watch what Iberia has in store with respect to a merger with **BA** and plans to launch a new low-cost unit in Madrid. Vueling, by the way, does not disclose net results for the third quarter.

There are no major LCCs in Japan, which leaves two heavily loss-making legacy carriers, one on death's doorstep. But the other, **All Nippon** at least managed a summertime net profit of $42m and an operating margin of 4%. During last year's calendar Q3, it earned double that margin. And two summers ago it earned more than triple that. Indeed, even with its arch-rival **JAL** on the ropes, ANA suffered a 15% fall in total revenues, a 34% freefall in international revenues and just a 23% decline in fuel outlays due to aggressive hedging. In response, management is undertaking a "radical reform and restructuring" that includes steep cost cutting, a new business model for non-Tokyo routes, building a more international route network, enhancing cooperation with alliance partners, preparing for new Tokyo capacity, eventually incorporating B787s and, interestingly, consideration of new fees for various services. On a happy note, swine flu fears have receded, demand is improving, surcharges are back and, yes, JAL's troubles continue. ANA does, however, expect to lose money for the full fiscal year that ends in March.

Moving to the Greater China region, the major mainland and Taiwanese carriers reported Q3 results last week. Beijing's **Air China**, for starters, did best among its country's Big Three, earning a $130m net profit, or $49m ex special gains. Operating margin was 4%. Revenue actually increased 1%, but only thanks to a 10% increase in ASK capacity and an 18% increase in RPK traffic. In other words, Air China's planes were busier and fuller but passengers were paying a lot less. Most of the volume growth, moreover, was driven by domestic routes, with international capacity actually down 6%. Still, many international markets experienced strong load factor recoveries, most notably Europe and Japan/Korea.

Guangzhou's **China Southern**, meanwhile, managed a $49m net profit in Q3, or $45m ex special items. Operating margin for the peak summer period was 3%. Though less internationally oriented than Air China at the moment, China Southern sees a pressing need to eventually get more of its revenue abroad for one key reason: it sees China's huge investment in high-speed rail as a yield killer for domestic airline routes. In fact, it's already seeing this in markets like Shanghai-Wuhan, where high-speed trains are up and running. By 2012, one will even link Beijing and Shanghai. For many travelers, these trains are perceived as safer, cheaper and more convenient than air travel. To manage such state-backed competition, China Southern, for one, wants more government subsidies.

China Eastern's challenges go well beyond the looming threat of high-speed rail. The Shanghai-based carrier, whose liabilities exceed its assets, officially earned a tiny $3m net profit from July to September but really lost $18m net excluding special items. Operating profit, peak season and all, was negative 2%. The carrier is now integrating rival **Shanghai Airlines** but still faces hometown competition from **Juneyao**, a business-oriented carrier, and **Spring**, the country's only LCC success story. Last summer, by the way, China Eastern suffered a negative 16% operating margin, which makes this year's red ink seem negligible by comparison.

One important reason why China's airlines are doing better this year than last is newly won access to cross-Strait Taiwanese markets. Well the same goes for airlines based in Taiwan, namely **China Airlines** and **Eva Air**. New mainland markets helped reduce Q3 net losses to $81m and $68m, respectively. Operating margin for China Airlines was negative 1% and for Eva a much more troubling negative 11%. Despite the new cross-Strait revenue, overall revenues plummeted by more than 20% at both carriers, with cargo markets especially weak. And despite the y/y improvement in margins, losing money in the peak summer quarter highlights serious concerns about both airlines' ability to sustain operations. More integration with mainland carriers may be inevitable.

Like mainland China, India has become an overly fragmented domestic market with six major competitors bleeding each other. Unfortunately, even deep capacity cutting couldn't prevent more losses at **Jet Airways**, a one-time consistently profitable carrier now unable to escape quarter after quarter of red ink. From July to September, it posted a $114m net loss, or $106m ex special items. Operating margin was negative 12%, or negative 8% excluding another big loss at **JetLite**, one of Jet's two low-fare brands. The loss also included a roughly $11m impact from a five-day pilot strike in September. Jet again cut capacity last quarter, this time by 10% y/y domestically, and now operates about a third fewer domestic ASKs than it did in 2007. Overall industry capacity in the domestic market, meanwhile, grew 5% last quarter. No wonder Jet's mainline losses on domestic routes alone amounted to $76m, up from $20m a year ago. But the news was better on the international front, where capacity fell by an even greater amount, pushing load factors up 15 points and reducing losses to just $8m (compared to $62m a year ago). Put it all together and mainline revenues were down 27% while mainline operating costs fell 28%, the latter driven by a 54% drop in fuel outlays. To help with domestic losses, Jet now has its low-fare **JetKonnect** product operating nearly two-thirds of capacity. And internationally, it's operating more Gulf routes and leasing out bigger widebodies to other airlines.

As bad as Jet's results were, **Kingfisher**'s were worse. It endured an $89m net loss and a negative 33% operating margin in calendar Q3, which is an off-peak quarter yes, but not that off-peak. Capacity fell 17% but passenger counts actually increased 9%, highlighting the industry's higher load factors but extremely weak yields—down 32% y/y in Kingfisher's case. Company revenues declined 14%, and management was forced to pull the plug on routes like London and Colombo from its home city Bangalore. It's now sending A330-200s to Hong Kong and Singapore, and it has returned a number of other planes to lessors. In part thanks to these measures, management expects "much stronger" yields in the current peak quarter.

SpiceJet, an LCC with hints of profitability in recent quarters, didn't do well at all from July through September. Its net loss was $22m while its operating margin was negative 22%, again underscoring just how big a mess India's airlines find themselves in. But at least SpiceJet is growing, with revenues up by 27% y/y and imminent prospects to fly abroad. It has reported a sharp rise in fares during the past few weeks and may raise additional funds for its balance sheet. *Bloomberg News*, by the way, said the international markets it's evaluating include Sri Lanka, Maldives, Nepal and Bangladesh. As for other Indian carriers, **Air India**, **Indigo** and **GoAir** don't report financial results, but it's safe to assume they're not good, especially in Air India's case.

If India's victim-filled airline market has you down, cheer up with results from Latin America. **LAN** became the first airline there to report Q3 figures, and once again they were predictably good. Net profit was $52m and operating margin was 10%, just below last year's 11% Q3 figure. As in India, July to September is an off-peak period for South America's airlines. And LAN's revenues did indeed suffer, falling 19% y/y in part because of wintertime swine flu fears in nearby Brazil and Argentina. Premium and cargo demand were also hit hard. But fuel outlays fell 39% despite 9% capacity growth and $14m in realized hedge losses. LAN expects to grow another 10% in 2010, with a renewed emphasis on longhaul markets as they recover. Domestic markets in Chile, Argentina, Peru and Ecuador, however, are where traffic is growing fastest at the moment—and where yields are somewhat protected from fuel spikes thanks to the steady application of surcharges. During its earnings presentation to investors, management downplayed the impact of the **Avianca-TACA** merger and emphasized its pursuit of more frequent flier plan revenue.

Russia's **Aeroflot** managed a $14m net profit in the six months from January through June, with revenues and operating costs both dropping by 32% y/y. The resulting operating margin was a healthy 7%. The carrier did no provide details on the money it received from of overflight fees, which are often solely responsible for its profitability. Counter-intuitively, oil's recent rebound may be good for Aeroflot because its home economy ebbs and flows with energy markets.

Expensive oil also helps many economies in Africa—and even airlines in non-oil exporting countries like Kenya. Indeed **Kenya Airways** is rushing into commodity-rich markets like N'Dola, Libreville, Malabo, Brazzaville, Bangui and Kisangani. Still, the consistently profitable airline, which is partly owned by **Air France/KLM**, earned a paltry $11m net profit in the six months from April through September, with operating margin barely above break even. Revenue only declined 2%, helped by a weaker local currency which boosted tourist receipts, but operating costs increased 2%. A major labor strike also did damage during the peak summer tourist season and only ended after management agreed to 20% wage hikes. Its cash balance, moreover, fell by 40%. Executives didn't sound terribly optimistic about the future, noting excess industry capacity and a volatile political environment at home. As if to underscore the country's problems with violent crime, the airline's CEO Titus Naikuni was injured last week when assailants robbed a restaurant where he was dining.

Add **Royal Jordanian** to the list of airlines doing much better this year than last. It reported a $25m net profit from July to September, bringing its nine-month profitability to $36m. Though it didn't provide operating results, Q3 net margin was an impressive 10%. Last year RJ was in the red for the nine-month period ending in September. The oneworld member—now trying to win antitrust immunity to coordinate international planning with **American**, **British Airways**, **Iberia** and **Finnair**—saw operating revenues fall 16% from January to December, in part because last year's fuel surcharges are now gone. Yields, in fact, fell 14% y/y. But RJ also saw fuel outlays plummet 50%, with ASK capacity down by 4%. The carrier's new executive team, which replaced Samer Majali after he left for **Gulf Air**, says the airline will end this year with "satisfying results."

Pakistan International unveiled a $64m Q3 net loss, marking a major improvement versus last year's obscenely high losses. Operating margin this year was negative 5%. Reasons for the turnaround, if you can call it that, included cheaper fuel, reduced forex losses and a mere 4% decline in revenues, not bad relative to what other airlines are reporting. The good news for PIA is that it's not too exposed to premium traffic or inbound international tourism and has a steady business transporting religious pilgrims to Saudi Arabia with B747s. But Pakistan is politically tumultuous and economically dependent on foreign aid. To manage under these conditions, PIA's management is now developing a new strategic plan.

SkyMoney

Airline Finance

- You better Czech yourself before you wreck yourself. Someone should've told that to **CSA Czech Airlines** when it over-expanded during the boom. Its government owners, moreover, might have been wiser to sell it during the boom, when **Air France/KLM** for one was seriously interested. As things stand now, the mess of an airline got a mere one bid from a rival, Travel Service, which the government deemed insufficient last week. The airline's new management, in turn, will now undertake its own restructuring, which at least has gotten off to a good start, with pilots having already accepted a 30% pay cut. The new management team, by the way, is linked to the management of Prague's airport.
- **Avianca** and **TACA** added Ecuador's **AeroGal** to their budding empire of Latin American airlines. That's hardly a surprise given the equity links between AeroGal and Avianca's controlling shareholder, the Synergy Group. AeroGal is small, focusing mostly on domestic flights including those to the Galapagos Islands made famous by Charles Darwin. It does, however, serve Bogota and Miami as well.
- Lebanon's **Middle East Airlines**, also known in French as **Air Liban**, expects a $100m net profit for 2009, which would be a company record. So writes the *Daily Star*, which also notes that this past summer was a strong one for the country's tourist sector. Middle East Airlines is owned by Lebanon's central bank and can attribute its success to years of restructuring. It does, however, worry about competition from what it says are government-supported carriers like **Emirates**.
- The U.S. economy grew a healthy 3.5% y/y in the third quarter, a big change from its 0.7% decrease in the second quarter. Consumer spending was up strongly on vehicle sales, housing was up for the first time 15 quarters, inventory investments grew as businesses re-stocked and exports, the biggest contributor to growth last quarter, jumped thanks to the weaker U.S. dollar. Government stimulus spending clearly played a role as well. Using 2005 dollars as a benchmark, the U.S. economy is still worth $13.0b, compared to $13.3b at the end of last year's third quarter.

Fleet Sheet

Aircraft Markets

- While **Continental** and its new Star partners partied in Newark, **Air France** held a soiree of its own in Paris to celebrate receipt of its first of 12 A380s. Late this month, the plane will perform its first revenue flight from Paris CDG to New York JFK, a market loaded with premium travelers. Two more A380s will arrive before the spring, with Paris-Johannesburg the next route to get the plane. In the welcoming ceremony, Air France stressed the plane's environmental credentials, cost efficiency and capacity—it holds as many people as a B777-200 and an A340-300 combined. In fact, Air France's A380s will hold 538 seats, more than those offered by **Singapore Airlines**, **Emirates** or **Qantas**.
- **Lufthansa** is next in line to receive the A380 in March. But it also disclosed plans to defer some future deliveries. It remains in negotiations with Airbus and expects to provide details soon.
- In with the new and out with the old: As A380s rejuvenate the fleets of some airlines, others are retiring their aging sky-weary models. **United**, for example, operated its last older-generation B737 last week (its newer generation narrowbodies are Airbus models) while United and **Lufthansa** both moved to shed some of their 50-seat RJs. **Air India**, too, will stop flying B747s in January, while **Finnair** does the same with MD-11s in March.
- There was a plane order last week as well, namely by **Turkish Airlines**. It exercised options on three more A330s, even as it prepares to pull the trigger on a blockbuster buy that's likely to includes B787s or A350s.
- Back on the topic of deferral, **AirAsia** is pushing back receipt of eight more A320 that were supposed to arrive in 2011. They'll now come in the 2014-15 period, by which time the LCC terminal at Kuala Lumpur will hopefully be expanded.

JetGreen

Environment, Conservation & Fuel

- Evaluating the feasibility of alternative jet fuels, the Massachusetts Institute of Technology and Rand Corporation have released a study, which provides a rare third-party forecast—one that doesn't come from either an environmental group or the aviation industry. Looking at the spectrum of liquid fuels, the study narrowed to three those that could be available as jet fuel in commercial quantities in the coming decade. None was a surprise and each has its own set of challenges. One of the three fuel types is petroleum-based Jet-A extracted from unconventional sources such as oil sands or very heavy oils. However, according to the study, these fuels currently come with a 10% to 25% *larger* carbon footprint than conventional Jet-A. This could be mitigated with carbon capture and sequestration, but will it drive up the cost too much? Synthetic fuels such as gas-to-liquid (GTL), coal-to-liquid (CTL) and biomass to liquid (BTL) fuels, however, had a larger range of possibility. CTL, already in use at Johannesburg's O.R. Tambo International Airport, roughly doubles the lifecycle greenhouse gas emissions. Meanwhile GTL, which **Qatar Airways** plans to soon implement, brings with it, according to the study, a 15% increase in lifecycle emissions compared to conventional Jet-A. That could be reduced to "slightly below" conventional Jet-A levels if carbon capture is employed. But apparently synfuels can be truly greenhouse friendly. The study says a combination of CTL and BTL fuels (CBTL), with carbon capture, potentially could emit 50% less emissions than conventional Jet-A. However, the infrastructure and supply chain isn't as far along for CBTL fuel. Lastly, one alternative that wouldn't require carbon capture technology is renewable biojet fuel. The airline industry will be pleased to hear that this study considers renewable biojet fuel—the lynchpin in the industry's plan to halve its carbon emissions—both a near-term alternative and a potential reducer of greenhouse gas emissions. However, the report contains strong language regarding the sourcing of biojet feedstocks, such as camelina, halophytes and jatropha. Essentially, the study indicates that all the advantages and more could be lost if land use is altered to obtain biojet feedstocks. The study, by the way, was requested and sponsored by the FAA.
- The U.N. Framework Convention on Climate Change (UNFCCC) has published a greenhouse gas inventory. The report compares 1990 emissions with 2007 in 41 countries. During that period, the report says, greenhouse gas emissions from aviation increased nearly 66%. Hmmm... wonder if that figure will be mentioned in Copenhagen in December?

AirBuzz

Marketing, Price & Promotion

- Never in the decade-long history of airline alliances has a carrier so large jumped from one team to another. Last week, **Continental** and its $15b dollars of annual revenues officially became the 25th member of the Star Alliance, having exited SkyTeam just days before. The switch was marked by a formal celebration in Newark, N.J., attended by alliance member CEOs, members of the media and a newly painted B757-200 in Star alliance livery. Continental's executives explained their reason for switching, saying the carrier's key strengths across the Atlantic from the New York area and southward to Latin America largely overlapped what **Delta** and its partners already offered. **United**, in fact—which is weaker in those areas—took the initiative to sponsor Continental for the Star alliance immediately after the Houston-based carrier got cold feet about an all-out merger early last year. Continental heavily advertised its new Star membership, especially in the New York metro area.
- Continental also signed codeshare deals with Japan's **All Nippon,** with which it eventually hopes to gain antitrust immunity, and Korea's **Asiana**. Both are Star members as well.
- By now, the shift in pricing philosophy toward service unbundling is well established in the domestic U.S. market. Is the European market next? So it seems, as **Lufthansa** and **Air France/KLM** prepare new business models for their shorthaul networks. Details will be announced soon.
- That's not to say U.S. airlines are done unbundling their products and services. Continental's CEO in waiting Jeffrey Smisek told *Bloomberg News* last week that there are "no sacred cows" when it comes to what it will offer as part of the ticket price, and that presumably means inflight food. Continental is now alone among the Big Five to provide complementary meals in coach class.
- Airlines typically allow premium passengers and travelers with children or special needs to board the airplane before anyone else. But who goes next? It's a question with important implications for on-time performance (some boarding methods take less time than others) and customer service (those boarding last may find that all overhead bins are full). Well, **Virgin America** is testing a novel idea on some of its San Francisco-originating flights: travelers with personal items only—in other words, those with no bags to put in the overhead compartments—can board first.
- Nobody loves their sports teams like the people of Boston. But which airline do they love? **Southwest** is now sponsoring the Celtics, a basketball team, while **jetBlue** sponsors the Red Sox, a baseball team and **American** sponsors the Patriots, a football team. All three, by the way, have won championships in recent years.
- Speaking of sports, this year's baseball World Series will bring little joy to the airline industry. The two contestants, The New York Yankees and the Philadelphia Phillies, play close enough to each other that fans and even players can travel by road or rail. **US Airways** and **Continental** do fly some regional jets between the New York area and Philadelphia, but mostly to accommodate connecting passengers.
- If the Phillies and Yankees return to the World Series next year, fans taking Amtrak's high-speed Acela rail service between the two stadiums will have Wi-Fi access. Government-owned Amtrak, whose trains already have power ports and allow mobile phones, says Wi-Fi will initially be offered for free. Other reasons to travel in the Boston-New York-Philadelphia-Washington corridor by rail rather than air include conveniently located downtown stations and no airport security hassles.
- **AirAsia X**, reports *The Australian*, sees an opportunity to steal premium passengers from incumbents. As such, it plans to install lie-flat seats on some of its longhaul planes. Its A330s and A340s already feature a handful of premium seats with extra pitch and width.

The Backend

Sales, Distribution, Tourism & Corporate Travel

- Third quarter financial results at Expedia, America's busiest online travel site, show that at least some travel retailers are doing well despite the downturn. The Seattle-based company earned an adjusted net profit of $145m, up 22% y/y on a 26% jump in transactions. Airline ticket bookings alone spiked 27% as fee eliminations were extended to markets outside the U.S. On the other hand, revenue from airline bookings still declined by 8% y/y as ticket prices fell substantially from year ago levels. Some of Expedia's success this year—its results are better than executives expected they'd be when the year began—is attributable to the leisure travel segment's relative strength. At the same time, however, the company's corporate travel unit Egencia, while small, saw positive transaction growth and won new accounts. As for the large hotel side of Expedia's business, greater access to distressed room inventory enabled higher markups. One key question for online travel agencies is where exactly their robust airline booking growth is coming from. Most airlines responded to this question—asked by UBS analyst Kevin Crissey during their earnings presentations—by saying their own websites aren't losing share. Offline agents, therefore, seem to be the victims.
- During its results presentation to Wall Street, Expedia spoke a bit about the great promise of the Chinese leisure market, and how its subsidiary eLong is locked in a tough battle with online leader Ctrip. But there are others in that battle, including the on- and offline Shenzhen-based Universal Travel, which sold 1.7m airline tickets last year. Now trading on the New York stock exchange, Universal says it earns a roughly 6% commission on air bookings from Chinese and international carriers and also makes money from selling travel packages and other travel products.
- **Air France** and **KLM**, which both use the Amadeus reservation system, will jointly adopt the IT company's solution for managing seat inventory as well. One important task the system will manage is re-accommodation of passengers in the event of a schedule change or disruption.
- Mexico's **Volaris**, like **WestJet** and **JetBlue**, chose SabreSonic as its new reservation system. It's the latest LCC to adopt a new-generation res system designed to handle things like codeshares and third-party distribution. For the record, **AirTran** uses Navitaire's res system—which WestJet, JetBlue and Volaris previously used—while **Southwest** uses an older system inherited from the long-defunct **Braniff**. That explains, by the way, why it's taking so long for it to attain the technological capability to codeshare with WestJet and Volaris.
- **Jetstar**, which uses Navitaire's system, signed new GDS distribution deals with Sabre and Travelport's Worldspan unit. They apply to **Jetstar Asia** in Singapore and **Jetstar Pacific** in Vietnam along with the core Australian operation. Jetstar, of course, is wholly owned and operated by **Qantas**.
- Another week, another airline customer for GuestLogix and its inflight merchandising devices. The latest: **VivaMacau**, a small low-cost longhaul carrier.

Azul: Can It Succeed? Some Reasons Why It Might or Might Not

Things change quickly in Brazil. This time last year, Azul didn't even exist. This time last decade, neither did Gol. Today, the old Varig and its forever-stumbling rivals Transbrasil and VASP are long gone, replaced with more dynamic airlines like TAM and Gol, both with solid if imperfect records of profitability. They've become powerful and successful enough, in fact, that one startup called BRA failed in its bid to sustain scheduled low-fare competition.

So what about the young upstart Azul? Will it be able to compete with the Big Two?

Clearly, David Neeleman has a record of figuring out how to beat incumbents. He did so twice in the U.S. and once in Canada. More tangibly, the new airline seems off to a good start, generating lots of new traffic and building a network that already includes 14 cities. Natal in the Northeast will become the 15th next month. JetBlue's emphasis on quality customer service and product is clearly on display at Azul, be it the leather seats, seatback satellite televisions, refusal to overbook, assigned seating, no middle seats, additional legroom, bus connections to its key airports, a loyalty program, travel agency distribution or even interest-free deferred payment options. It even let the public name the company—well, sort of. The public chose "Samba," but Neeleman went with their second favorite option Azul.

Perhaps most critically, Azul is well financed and won't run out of cash any time soon. It surely got a good price on its E190s and E195s (the latter are a better fit for capacity-constrained Santos Dumont airport in Rio). It managed to win flight rights at key airports thanks in part to Neeleman's political skills, which also served him well when he needed New York JFK slots to launch JetBlue. And Brazil's economic future seems bright, promising more frequent air travel. Besides, as Neeleman likes to point out, there are no ice storms in Brazil.

On the other hand, battling against TAM and Gol, which recently cut fares, won't be easy. Both are well regarded for their customer service too—Gol doesn't overbook either, for example—and together dominate the main airports in Sao Paulo and Rio. They also presumably bought their planes at good prices, based on their strong relationships with manufacturers. Their large and growing frequent flier programs and codeshare partners abroad are other advantages they have relative to Azul.

Nor is Azul alone in competing against the Big Two. WebJet has the marketing and distribution advantage of being owned by a large travel agency. TRIP has a strong record of success conducting regional flights and a strong financial partner in America's SkyWest. And OceanAir, while itself small, is linked to the large Avianca/TACA team. LAN, which cooperates with TAM, clearly wants more exposure to the Brazilin market as well.

Azul has high load factors, but is it giving away tickets at well below cost, as competitors suggest? Will Brazil's economy continue to develop so impressively? Will the country's problematic aviation infrastructure again become a concern?

All told, however, the biggest test will be whether Azul can make a low-cost, low-fare business model work with E190s and E195s, which seat just 106 and 118 passengers, respectively. JetBlue itself most certainly regrets buying E190s, as does US Airways. All other major LCCs around the world operate either B737 or A320-family planes. But maybe Azul will pioneer a new model. The airline business does, after all, change quickly in Brazil. ❍

State of the Unions

Workforce Developments

- Earlier this decade, many U.S. airlines like **United** and even **Alaska Airlines** shuttered some in-house heavy maintenance bases and gave the work to outside companies. Doing so was simply more economical. Well now **American** is following suit. It will close its ex-**TWA** heavy maintenance base in Kansas City next fall, leaving just two in-house bases—one in its home city Dallas-Fort Worth and another in Tulsa. The carrier had hoped to keep all three with the help of ancillary insourcing revenues from other airlines. That worked for a while, but the downturn means there's less of that type of business to go around now. In addition, American itself is flying less, meaning less maintenance work overall. The airline is also closing smaller maintenance operations in Detroit, Minneapolis and San Jose, resulting in 700 job cuts in all. The Transport Workers Union, while normally less confrontational that the Allied Pilots Union, did cite "frequent mismanagement" as partly responsible for the closures.

- **US Airways**, in conjunction with its network realignment (see page eight), will close crew bases in New York LaGuardia, Las Vegas and Boston, all cities where it's scaling back capacity. Bases are essentially cities where airlines don't have to overnight their crews, with all the expense that entails, but they have fixed costs that only make sense with a certain amount of production. The US Airways move will result in 1,000 job cuts during the first half of 2010, with airport workers, pilots and flight attendants among the affected. Ten years ago, by the way, US Airways produced 59b ASMs with 45,000 workers. Last year it produced 74b ASMs with 38,000 workers.

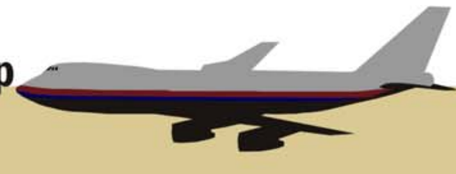
- **British Airways** intends to forge ahead with plans to unilaterally change work rules for new hire flight attendants later this month. It said so, however, as attendants voted on whether to give their union the go-ahead to call a strike, possibly in the peak Christmas holiday season. Management, for its part, hoped to sway currently employed attendants by noting that they'll be eligible for wage hikes. Oh and by the way, said CEO Willie Walsh, BA attendants get paid a lot more than their counterparts at **Virgin Atlantic** and **easyJet**.

- Two Republican members of congress urged the National Mediation Board, which governs airline labor disputes, not to unilaterally amend its election procedures. Right now the majority of an airline's workers must vote yes to a unionization effort for it to succeed. But unions want to change this so that only a majority of actual *voters* are required. The example they gave was an airline with 4,000 non-union workers, where 2,001 must vote to unionize under current rules. If amended and only 1,000 vote, only 501 would be needed for all 4,000 to be unionized. The dispute has direct relevance to **Delta**, which is vehemently lobbying against a change.

- **Delta**, of course, was all over the news in recent weeks after a **Northwest** flight overflew its destination and lost contact with controllers for a frighteningly long period of time. While the issue has some labor implications, some said the episode highlighted the obsolescence of the ATC system.

The Landing Strip

Airport Developments



- Star, oneworld and SkyTeam, which debuted in 1997, 1998 and 1999, respectively, have played a vital role in enabling the world's full-service airlines to grow their revenues, lower their costs, better serve their customers and differentiate themselves from upstart LCC rivals. One important way they've achieved these goals is by co-locating at key airports like London Heathrow, where oneworld members are consolidating into terminals three and five, SkyTeam into terminal four and Star into terminal one (and later terminal two when it reopens in a few years). The airport is a key alliance battleground, with oneworld holding the upper hand thanks to **British Airways** and seven other carriers but Star holding an important advantage via **bmi**, which **Lufthansa** now controls. SkyTeam is no slouch at Heathrow either, with 42 daily flights this winter, mostly to member hubs like New York JFK, Atlanta, Paris, Moscow and so forth. Since the 2008 opening of BA's new terminal five, more than 50 airlines have moved or are in the process of moving at Heathrow.

- As bad as things are economically in London and its battered banking sector, at least it's not Detroit and its battered auto sector. The unemployment rate there is 17%, highest in the U.S. among metro areas with more than 1m people. Nevertheless, the city's airport is celebrating a number of newly added flights, including coveted Asian service to Seoul and Hong Kong by **Delta**. The new owner of **Northwest** is also expanding capacity to Shanghai from Detroit, which is well situated geographically to compete with Chicago as an Asian gateway (southern U.S. cities like Atlanta are more poorly positioned). At the same time, **Southwest** is adding new Detroit flights to Denver while **USA3000** will connect the Motor city to Cancun, Ft. Myers and a number of Caribbean island destinations.

- With America's intercontinental airlines having downsized their domestic networks and upsized their international networks all decade, it's only natural that U.S. airports with only limited international hub potential would rely on LCCs for growth. The bad news is that LCCs are shrinking now too. But the good news for selected airports is that LCCs now find themselves engaged in head-to-head battles with each other. In Milwaukee, for example, traffic was up 17% y/y in September, and that was before **Southwest** made its entry against **AirTran** just this past weekend. At Baltimore BWI, a three-way slugfest between Southwest, AirTran and **jetBlue**, traffic was up 6% y/y in August. Ditto for Boston Logan in September, reflecting the tussle between Southwest and JetBlue (which will only grow more intense—see page eight). Note to air service development personnel at primarily domestic U.S. airports: act like a boxing promoter and arrange a fight between two heavyweight LCCs.

- Fort Lauderdale wants to become America's fourth airport with authorized charter flights to Cuba—the others are Miami, New York JFK and Los Angeles. *The Miami Herald* reports that other Florida cities including Tampa and Key West are also eyeing Cuba flights, hoping to serve the state's large Cuban expatriate community. The Obama administration lifted some restrictions on Cuba travel earlier in the year, but an embargo on scheduled flights remains. In the meantime, airlines like **American**, **Spirit**, **JetBlue** and others are awaiting what could be a lucrative opportunity.

- Geneva's international airport unveiled a terminal expansion that leaves it with 40% more floor space for things like retail shops, passenger check-in areas and a centralized security screening area. Geneva, where a can of coke can sell for about US$6, isn't known as a low-cost city. But sure enough, its busiest airline is a low-cost carrier: **easyJet**.

- Winnipeg airport in Canada saw traffic decline 6% y/y in Q3, though the airport's revenues increased by the same amount. The city is served primarily by Canada's airlines, though **Delta**'s **Northwest** unit connects the city with Minneapolis and **United** operates some Express flights to Chicago and Denver.

Who's Flying Where

- Remember the old slogan, "**USAir** begins with you?" Well the restructuring of today's struggling US Airways begins with a U-turn on several European routes, along with a more narrow focus on four key markets: Philadelphia, Charlotte, Washington Reagan and Phoenix. Flights to London Gatwick, Birmingham, Milan Malpensa, Shannon and Stockholm will go, as will all flights to and from Colorado Springs and Wichita. Las Vegas—once an **America West** hub—will be further downsized to just a few dozen flights per day, an application to fly to Beijing will be withdrawn and the handful of E190s it can't seem to get rid of will find homes on the once mighty Boston-Philadelphia and Boston-La Guardia routes. Overall, though, Boston and LaGuardia will both lose their status as US Airways focus cities. All of this comes amid ongoing losses, questions about the airline's role in the Star Alliance now that **Continental** is a member and never-ending uncertainty about how it can survive caught between rivals either larger or lower cost. In fact, US Airways is starting to look like its old pre-merger self, shedding much of America West's old network and becoming largely east-coast centric again. But for all of the gloom, there are some pro-growth areas. Flights to both Brussels and Zurich, for example—which are Star Alliance hubs—will operate year-round rather than seasonally. As previously announced, Rio and Honolulu flights from Charlotte start next month, which follow recent Charlotte adds to Paris and Montreal. Phoenix-Montego Bay will be another new international route next month as well, while a slot swap with **Delta** means eight new markets at Washington Reagan. Finally, a new lie-flat business class product for A330s will debut next month. Fortunately for US Airways, its history proves time and again that it's too big to fail, if not in the eyes of politicians then at least because of free-flowing capital from investors and help from key suppliers.

- **Air China** raised hopes of better market conditions by announcing some rather bullish international moves. For one, it's re-starting Beijing-Sao Paulo flights via Madrid, a route aided by the presence in Brazil of Star Alliance partner **TAM**. And closer to home, it's launching flights from Beijing to Tokyo Haneda, complementing existing service to Narita. Air China announced a number of new domestic routes too, including Beijing to Daqing, an oil city in the far northeast, Chengdu to Zhuhai near Hong Kong and Shenzhen to Dazhou in Sichuan province. The carrier also reminded travelers that it now flies nonstop from six mainland cities to Taipei. They are Beijing, Shanghai, Hangzhou, Chengdu, Chongqing and Tianjin.

- **Southwest** should be careful what it says. **JetBlue** may have been listening when, a few weeks ago, the Dallas-based LCC said things were off to a good start in Boston. Now, as if to spoil that good start, its New York rival has announced a 30% increase in Boston departures next summer, an expansion that includes additional frequencies to Chicago O'Hare, Raleigh-Durham, Baltimore (as previously announced), Charlotte, Denver, Fort Lauderdale, San Diego, San Francisco, Washington Dulles, Santiago (in the Dominican Republic) and Montego Bay. The move also comes as US Airways cuts back in Boston and in response to **Virgin America**'s transcon presence there. Southwest, meanwhile, began operating from Milwaukee, where it has a fight on its hands with AirTran. **Midwest** remains in the market as well, though AirTran says "it's not fooling anyone" with respect to its greatly diminished customer offerings.

- For all the global expansion undertaken by Arabian Gulf carriers, Japan has remained largely off limits… until now. **Etihad** announced that starting in the first quarter of 2010, it will fly to both Tokyo Narita (thanks to the airport's expanded capacity) and Nagoya. Not even **Emirates** serves Tokyo, though it does serve Osaka and once served Nagoya. It will surely make a Tokyo announcement of its own soon.

- **Edelweiss Air**, a subsidiary of **Swiss**, which in turn is a subsidiary of **Lufthansa**—which is not a subsidiary of anybody but has many other subsidiaries—plans weekly A330 flights to Calgary, with onward service to Vancouver. Even when gobbled up by larger buyers, European airlines often retain their identities because of the resonance they have in their home markets, not to mention labor and regulatory reasons.

- Speaking of consolidation, one of the many carriers partly purchased by **Air Berlin** is Switzerland's **Belair**, whose fleet will triple to nine aircraft by next spring. The German LCC is also adding a number of new Swiss routes for its summer 2010 timetable, including Zurich to Malaga, Basle to Ibiza and Catania, and Zurich to Naples, Bari and Palermo. A new flight from Munich to Constanta on the Black Sea, meanwhile, will mark Air Berlin's first foray into Romania. Berlin Tegel to Corsica and Stuttgart to Bodrum in Turley are other noteworthy additions. Perhaps more interestingly, Air Berlin continues to expand its longhaul offerings with new twice-weekly nonstops to San Francisco starting in May. The California city joins New York, Miami, Los Angeles, Fort Myers and Vancouver in its portfolio of North American routes inherited from another purchase: that of **LTU**.

- **easyJet** launches eight new routes today, including three from Rome Fiumicino, where **Alitalia** remains a bulls-eye. London Luton-Tel Aviv and Madrid-Amsterdam are other notables. But the wintertime ramp-up doesn't stop there. Tomorrow marks the start of easyJet flights from London Luton to Sharm El Sheikh and from Liverpool to Lanzarote in the Canary Islands. Then, during the next couple of days, the airline launches an additional three routes from London (one each from Stansted, Luton and Gatwick) and two from Manchester.

- **Delta** stops flying to Lyon nonstop from New York JFK this week. It's the second time this decade that the route failed to work, this time even with the help of joint venture links to **Air France** and use of a smaller plane (B757s instead of B767s).

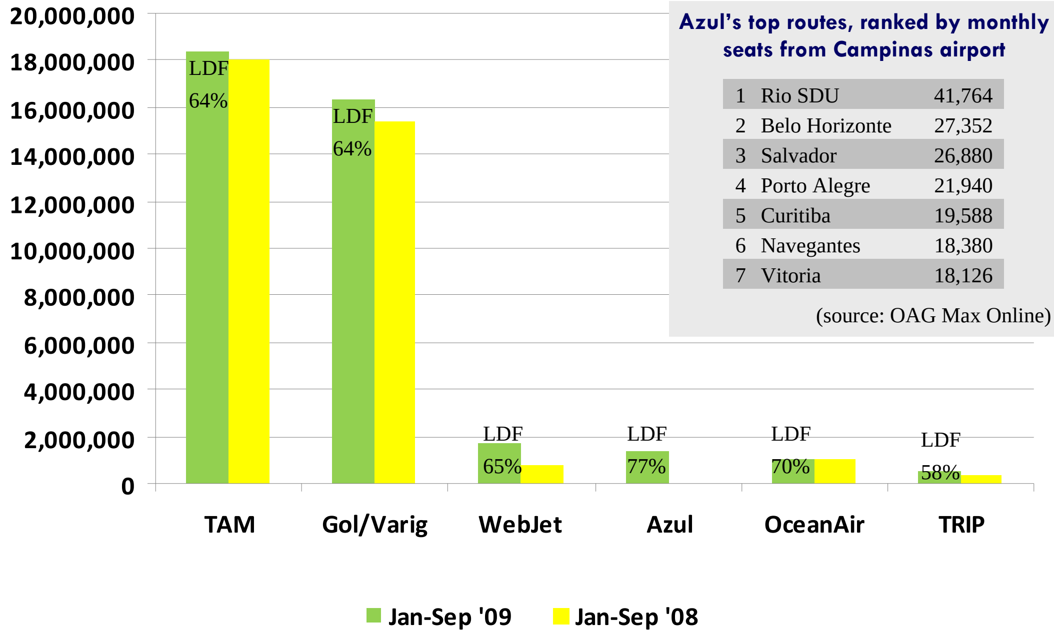
- **JetBlue** launched two new Caribbean destinations last week: St. Lucia and Kingston. Both JFK routes were announced in the spring. **WestJet**, meanwhile—with a similar Caribbean fixation—began flying to St. Maarten and Veradero, Cuba.

- Senegal's government is trying again. **Air Afrique**, jointly controlled by a number of west African governments, failed shortly after 9/11. Then came **Air Senegal**, a joint venture with **Royal Air Maroc**, which suspended operations this spring. So now comes **Senegal Airlines**, a startup backed by the government but controlled by private sector investors. It aims to launch early next year with a focus on African and European routes. It expects to unveil further details at the Dubai Airshow, which begins Nov. 15. Separately, **South African Airways** and **Egyptair**, both Star Alliance members, are entertaining the notion of a joint venture, according to *Business Report*.

Brazil's Busiest Domestic Airlines

Ranked by domestic RPKs, January-September 2009 and 2008 (source: ANAC)

Year to date through September, total Brazilian domestic RPK traffic is up 11% y/y on 13% more ASK capacity. But remove **Azul**, which only started during the last few weeks of 2008, and traffic and capacity are up just 6% and 10% this year, respectively. **Webjet**, meanwhile, which is owned by the country's top leisure tour operator, also more than doubled traffic y/y. As for **TAM**, it grew domestic traffic 2% while **Gol/Varig** grew 6%. TAM, by the way, continues to expand internationally (international RPK traffic up 15% ytd) while Gol/Varig refocuses on domestic (intentional RPKs down 53%). Gol, remember, dismantled Varig's European network last year.



Azul's top routes, ranked by monthly seats from Campinas airport

1	Rio SDU	41,764
2	Belo Horizonte	27,352
3	Salvador	26,880
4	Porto Alegre	21,940
5	Curitiba	19,588
6	Navegantes	18,380
7	Vitoria	18,126

(source: OAG Max Online)

Around the World

A Look at the World's Airlines, Including Endweek Equity Prices

Airline	Price	Last Week	Last Year	Comment
Delta	7.14	8.24	10.98	Believes it has "way too many" 50-seat regional jets post-merger
American	5.39	6.31	10.21	Reminds JAL that oneworld has no prohibitions against working with non-oneworld airlines
United	6.51	6.86	14.56	Says Middle East markets (Dubai and Kuwait) have been a "tremendous success"
Continental	11.50	12.60	18.92	Executives say "I'd like to thank my co-workers" at least 50 times whenever they speak
US Airways	3.06	3.69	10.14	Says it does "quite well" in the Caribbean; adds that it's one of the better parts of its network
Southwest	8.40	8.84	11.78	17% of the tickets it sold in Q3 were full-fare/refundable; last year the figure was 24%
Alaska	25.72	27.01	24.70	Like many other airlines, it could quickly increase capacity through higher plane utilization
JetBlue	4.96	5.38	5.55	Admits that it's overstaffed due to no-furlough policy; inflating ex fuel unit costs
AirTran	4.22	4.77	4.09	Last year's fourth quarter RASM was unusually high thanks to steep capacity cutbacks
Allegiant	37.71	36.67	36.74	Expects to add a few new cities in '10 even as it tempers growth in response to pricier fuel
SkyWest	13.97	15.03	15.41	Will announce Q3 financial results Thursday
Republic	8.01	9.11	14.95	Will announce Q3 financial results Thursday
ExpressJet	3.00	3.89	1.73	Will announce Q3 financial results Wednesday
Pinnacle	6.03	6.61	2.73	Will announce Q3 financial results Tuesday
Air Canada	1.03	1.37	5.14	Will announce Q3 financial results Friday
WestJet	10.94	11.30	10.45	Will announce Q3 financial results Wednesday
LAN	10.46	9.15	7.36	Mexicana officially joins oneworld next week; alliance gets even stronger in Latin America
TAM	25.25	27.50	22.99	More rumors about a possible TAM-TAP merger; both are already linked via Star alliance
Gol	10.27	10.97	4.34	Will announce Q3 financial results Nov. 9; rival TAM will go Nov. 12
Copa	42.23	42.03	25.37	Panama City airport handled 4.5m pax in 2008; busiest routes were Bogota, Miami, San Jose
Emirates	(not publicly traded)			Celebrating its 24th anniversary; first route ever was Dubai-Karachi in 1985
Air Arabia	1.12	1.15	1.21	Saudi Arabian LCC rival Sama will re-start flights to Sharjah from Riyadh this month
Turkish Airlines	4.22	4.48	0.95	Iran's government asks Turkey's if it's interested in establishing a jointly owned airline
Kenya Airways	24	24	27	Fuel now 24% of total expenses, down from 40% last year
South African Air.	(not publicly traded)			Hopes to appoint a new CEO by the end of this year
Jet Airways	380	428	155	Interest costs spiked 50% y/y last quarter; reflects heavier borrowing amid losses
Aeroflot	1.45	1.43	2.12	Rival Transaero promoting Tel Aviv-Toronto trips via Moscow; geography works well
Crude oil futures (for delivery next month; source New York Mercantile exchange)	$77	$80	$68	Lufthansa warns against government rules that would force companies to hold collateral for all fuel hedges; would have forced a large number of cash-strapped airlines into bankruptcy

Note several stocks traded on multiple exchanges; not intended for trading purposes

Around the World

A Look at the World's Airlines, Including Endweek Equity Prices

Airline	Price	Last Week	Last Year	Comment
British Airways	182	210	136	Says it's made a lot of progress on Iberia merger in the past month (*Bloomberg*)
Air France/KLM	10.46	11.31	11.24	Low-fare Transavia unit profitable for 31 years in a row
Lufthansa	10.46	11.62	10.99	CEO Mayrhuber says customers would "scream" if regulators blocked alliances
Iberia	1.88	2.13	1.84	Flight attendants, demanding a wage increase, follow through on threatened strike
SAS	4.40	4.67	40.20	Will announce Q3 financial results Thursday
Alitalia	(not publicly traded)			Will be integrated into the Air France/KLM-Delta transatlantic joint venture next year
Finnair	3.87	4.00	3.95	Flying to both Bangkok and Phuket in Thailand this winter
Aer Lingus	0.57	0.63	1.08	Irish unemployment rate now 13%; second highest in western Europe after Spain
Virgin Atlantic	(not publicly traded)			Still codesharing with Continental despite the latter's alliance moves
easyJet	360	378	308	IATA throws a verbal punch at the U.K. for its latest APD hike; took effect this weekend
Ryanair	3.34	3.30	2.50	Launching four new routes from Bordeaux: Bologna, Brussels CRL, Edinburgh and Porto
Air Berlin	3.47	3.71	3.58	Announces new codeshare with Bangkok Airways
Norwegian	163.00	157.00	30.00	Now has six planes at its new Copenhagen base; sees pressure on yields there
Vueling	12.32	12.16	4.26	Reach extends as far east as Russia, where it serves both Moscow and St. Petersburg
Aegean	4.20	4.19	3.36	Rival Olympic offering a free Mercedes rental car for a day to domestic biz class pax
Japan Airlines	117	114	222	Will start Tokyo Narita-Okinawa route in January; most domestic routes fly from Haneda
All Nippon	253	250	373	Japan and U.S. meet again on open skies but no deal yet; U.S. wants more Haneda rights
Singapore Airlines	6.50	6.63	5.96	AAPA reports member international traffic roughly flat y/y in September; ASKs down 6%
Cathay Pacific	12.74	12.74	9.33	Started flights to Jeddah last weekend
Korean Air	45850	48000	36000	Low-fare Jin Air unit pushing back launch date to next month
Air China	4.32	4.41	2.07	Air Macau unit decreased ASK capacity 15% y/y in Q3
China Eastern	2.15	2.27	0.94	Shanghai Airlines now flying from Shanghai Hongqiao to Seoul Gimpo
China Southern	2.30	2.44	1.16	Will receive its first of five A380s in early 2011; first of 13 B787s won't come before 2012
Malaysia Airlines	3.10	3.13	2.84	Online booking temporarily disabled this weekend as it upgraded reservation system
AirAsia	1.35	1.36	1.13	AirAsia X boosting capacity on routes to Melbourne and Gold Coast from Kuala Lumpur
Thai Airways	19.80	21.10	7.60	Intends to resume Bangkok-Johannesburg service next year
Qantas	2.80	2.93	2.42	Non Australians hold 47% of its equity, just below the 49% foreign ownership cap
Virgin Blue	0.51	0.57	0.35	V Australia's new Melbourne-Johannesburg flights now on sale; starts in March
Air New Zealand	1.02	1.12	0.77	Signs codeshare pact with fellow Star Alliance member South African Airways

Note several stocks traded on multiple exchanges; not intended for trading purposes

David Fights Goliaths, This Time in Brazil: Azul takes on successful incumbents TAM and Gol

CONTINUED FROM p. 1

overall our load factor probably has more to do with the fact that our planes are smaller, more than anything else. We just did an all-you-can-fly pass [similar to JetBlue's recent promotion; Azul is allowing unlimited travel on its network from Oct. 15 through Nov. 16 for about $285] and that will probably add another 5% to our load factor. We'll probably be in the mid to high 80s for October.

AW: What kind of indication can you give about your financial results so far? Have you broken even yet?

DN: We've been doing well except for September, and that was an outlier because of the fare war. We were very close to break even in July. We took a step back in September, but we've got a lot of cash and a lot of staying power, and we expect to be profitable next year. Our costs are coming down because of economies of scale.

AW: And with about a dozen aircraft now, how many will you need to have the economies of scale that you would like?

DN: I'd say about 25, maybe 30. Our CASM will be close to TAM and Gol by the end of 2010 but with 40% to 60% lower trip costs [because of smaller aircraft] and much higher RASM.

AW: What's the profile of Azul's passengers? Are most buying full-fare tickets as opposed to your 30-day advance purchase fares, for example?

DN: Brazil buys really late, so the profile tends to be last minute purchasers. We have a lot of business travelers, a lot of leisure and a lot of first-time fliers. I met a couple the other day going to Fortaleza that had never flown before. They go there all the time, but airfares were too high. I also met a couple of domestic maids that were flying home to Salvador for the weekend. They could never do that before. We're generating a lot of new passengers.

AW: What is Azul's distribution strategy? How much business do you do through travel agencies?

DN: It's much more travel agencies and commissions here, in the 50% range. And that's fine because they do a good job booking the product.

AW: Many airlines globally are making more and more money through ancillary sales. Is that true for Azul?

DN: The ancillary stuff here in Brazil hasn't taken off. For one thing, there's a government policy against charging for bags. Now, we do charge 10% more to book over the phone or at an airport. We are going to launch Azul Viajes, our vacation unit, which will help. But the heavy ancillary initiatives aren't as big of a focus here.

AW: Would you ever serve Sao Paulo's two main airports, centrally located Congonhas and longhaul-oriented Guarulhos, if given the slots?

DN: If we had the slots, yes. But right now the situation probably benefits us because it forces a lot of people to go to Campinas [the alternative Sao Paulo airport served by Azul].

Photo courtesy Azul

Azul of thumb: *Don't underestimate founder David Neeleman*

But there's a lot of opportunity around Congonhas, and certainly the crash there [in 2007 of a TAM A320] has caused them to move slowly. As far as Guarulhos, they have a lot of work to do but are moving forward. The good thing about the Olympics and World Cup two years apart is that they have to focus on infrastructure.

AW: Nearly all successful LCCs around the world operate mostly A320s or B737s. Why are E190/195s the right planes for Azul?

DN: When we bought the E190s at JetBlue, we did it because there were four times as many markets where we could fly the lower trip cost planes as the higher trip cost planes [A320s]. Brazil needed service like that. About 80% of our routes had no nonstop service before, and today we have the most frequencies or only frequencies in all of our markets.

AW: Almost like Flybe's strategy in the U.K?

DN: Yes, it's somewhat like that.

AW: Speaking of E190s at JetBlue, those aircraft haven't been as successful for them as hoped. Was there a miscalculation there, or was it largely that fuel became much more expensive after you ordered them in 2003?

DN: I think the problem—and one of the things I didn't realize when I bought the planes—is incorporating the smaller planes into a larger airplane fleet. I think it doesn't really work as much at JetBlue as if you have all E190s and 195s. At JetBlue, for example, you had the same number of people turning both fleet types. We don't have the A320 mentality here.

AW: Can you imagine Brazil ever building a network of bullet trains? Would high-speed rail be a major competitive threat to Azul and other airlines?

DN: I think they *should* have bullet trains. In fact they're talking about buiding a bullet train between Rio de Janeiro and Sao Paolo. I love trains. If they can do it, more power to them. They're also talking about a train between Sao Paulo and Campinas, which would of course benefit us.

AW: Tell us about airport facilities in Brazil. Are the facilities adequate? Do you support airport privatization?

DN: We are vehemently opposed to airport privatization. They've proved in Argentina and the U.K. that that's a disaster. The counterbalance to that is, can the Brazilian government run an efficient airport operation? We're saying yes you can, you have good people and a good foundation. But they can take Infraero [the Brazilian airport agency] and make it a somewhat independent organization and hire their own people and do what they have to do. The airports are okay today. They need to utilize them, and airspace, more efficiently. It's a step-by-step process. I have a lot of confidence they'll be able to pull it off. What's there is enough for today, but they'll need more in the future.

AW: When you started JetBlue ten years ago, its competition was largely troubled legacy carriers with high costs and a record of poor profitability. Gol and TAM, by contrast, have good reputations and records of success. Does that make this more challenging?

DN: Well they have a lot of good things about them, but they charge high fares and the seating is really tight. But mostly we're flying where they're not. We're generating a lot more traffic than we're stealing.

AW: Your domestic market share after less than a year of service is already about 5%. Any forecast of what it might be five years from now?

DN: Well we don't measure by market share. We judge by being profitable. So I think that's really the key. Now there's no reason we shouldn't get to 20% or 25% share. But it all depends on how big the pie gets. The pie could get really big, and I'd rather have a smaller share of a bigger market.

AW: Can you envision all of Latin America becoming one unified market from a regulatory point of view? Where, for example, LAN would be able to operate within Brazil? Would this be good for Azul?

DN: There's just so little inter-Latin American traffic right now. They're very thin markets. Anything they can do to make them bigger, I'm all for it. ❍