The airline industry is in recovery from the worst recession in its history. It must be so. The data from individual airlines and from the industry associations shows very strong improvements in traffic and yields (see last month’s Aviation Strategy). Global traffic levels have returned to the peak levels seen in 2008. Premium cabins – the bedrock of long-haul profitability – have, according to IATA, seen year-on-year percentage growth in passenger numbers (at least on long-haul services) sufficient to suggest that the demand is really recovering from the halt in the world economy that appeared after the collapse of Lehman Bros at the tail end of 2008. In 2009 the global industry saw passenger yields slump by an unprecedented 13% - so it should hardly be surprising that individual airlines are reporting substantial improvements in traffic yields and total revenues as we go through the rebound. IATA keeps on upgrading its forecasts for the global industry profitability. We are definitely on an uptrend and the consensus seems to suggest a recovery leading to a peak of the current cycle by 2013/14 at least.

Have the financial markets taken this totally on board? Airlines are not a “must-have” sector for most investors. Accounting for less than 2% of global market equity capitalisation (albeit accounting for a far higher overall proportion of global GDP), one can perhaps understand that any airline investment may be treated as a marginal choice by most professional investors. The airline indus-

SELECTED AIRLINE SHARE PRICE RECOVERY
(INDEXED TO THE TROUGH IN MARCH 2009)
try encompasses two basic seemingly incompat- 
patible economic fundamentals – it is highly 
capital intensive and the product itself has a 
very short shelf life. Revenue is a function of 
demand and price; in the upturn demand is 
sufficient to absorb almost any price 
increase; in the downturn the price is never 
sufficient to catch the falling demand. Given 
this operational gearing it may hardly be sur-
prising to see that the airline share prices 
have high betas and display significant 
volatility in comparison with the underlying 
stock markets.

The operational peak of the last industry 
cycle appears to have occurred in the first 
half of 2008. Stock markets, with their usual 
preclusion, provided peak share prices 
during the first half of 2007 (and not just for air-
lines). The old rule of thumb had been that 
in the downturn of the airline industry share 
prices would halve (only to double again in 
the upturn): but in this financial crisis and 
global recession, stock markets also halved 
in value and the airlines were hit even hard-
er (almost as hard as the banks themselves). 
In the sample of carriers shown in the table 
on page 3 these declines averaged 75% from 
peak - although the share prices of those 
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more than 90%; BA, Air France and Delta by 
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The markets touched their nadir in March 
2009 at the depths of the level of economic 
confidence and have at least bounced back 
reasonably strongly. The London market as a 
whole – beset even by the woes in the UK 
economy and despite the weakness in ster-
ling – has recovered (although as if on a roller-
coaster through the summer) to a point 
where the FTSE 100 index stands a mere 
16% below the peak of 2007. This sample of 
airlines have seen their shares recover 
strongly – on averaging trebling from the 
trough. Some of those that were particularly 
badly hit in the downturn have recovered 
 faster as one might expect – with United’s 
share price in particular increasing eightfold 
(alright – it did do the long awaited deal with 
Continental) and that of GOL by six-fold.

Some of the recovery euphoria did not 
quite last the full year 2009 results season 
and the likes of American, Delta, Air Berlin 
and Vueling have seen their share prices fall 
by around 35% from peaks achieved in 
spring of this year. Most of the others are 
now only a few points below the early year 
peaks – while four notable exceptions 
(Cathay, United, Lufthansa and Ryanair, see 
graph on page 1) are at their highs of this 
recovery period. Most are still at half the 
value they achieved in the peak of the last 
cycle; the two major exceptions being 
Cathay and Air Asia - respectively 2% and 3% 
above the highs achieved in 2007.

Those two may be the anomalies; but 
reflect the current euphoric trading condi-
tions in China and the Far East in comparison 
with the continuing slow and halting 
developments in economies in Europe and 
the US – pointing if anything to the two-tone 
nature of the economic recovery with the 
developing nations leading the way - 
(although interestingly SIA is still 20% below 
the 2007 peak). In addition there are still 
doubts of the shape of this recovery in the 
developed economies; and with the need of 
many governments to unwind their fiscal 
deficits there are fears that too rapid a 
 reduction in government spending will stifle 
the potential growth and bring on a double-
dip recession in 2011.

The table opposite attempts to tabulate 
 this and shows the share price performance 
of a select group of quoted airlines (all data 
in local currency units). The first column 
picks up the high value achieved in the last 
cycle – the timing for which varies for each 
individual carrier but generally took place 
during 2007. The second column shows 
the low point achieved (mostly in March 2009) 
at the bottom of the market dive; the third 
shows the percentage change from the high 
in 2007 to the low in 2009 (P-T). The fourth 
and subsequent columns pertain to data 
since that low point; the recent peak refers 
to highest share price level achieved since 
the low in 2009 and the fifth column is the 
absolute percentage increase from the low 
point (T-P). The sixth column reflects the 
closing share price on Oct 8 and the seventh 
(P-C) shows the percentage fall from that 
recent peak. A value of zero in that column
Ryanair, after a decade of phenomenal expansion, will officially go ex-growth from 2013. Passenger growth for FY2010 (to March 31st) was 14%, this year it will be 11%, 9% in FY2012, 6% in FY 2013, then two years of zero growth maybe resuming at around 4% thereafter. As CEO Michael O’Leary puts it, the “land grab” is over.

While the fundamental adherence to strict cost disciple will remain, the revenue focus will be on pushing up yields. Ryanair’s yield performance, usually declining in recent years, is largely the result of its rapid growth: it has to generate the traffic to fill its additional capacity, at least in the early stages of new route development.

This year yield growth will be in the order of 5-7% and the aim by 2013 is to push the average fare (excluding ancillaries) up from €35 to €45. This should be eminently doable: apart from cutting out ultra-low incentive fares on new routes Ryanair will be focusing on higher yielding markets. Its recent move into primary airports, notably Barcelona El Prat, is according to the airline not the result of any change in

<table>
<thead>
<tr>
<th>SELECTED AIRLINE SHARE PRICE PERFORMANCE (LCU)</th>
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<tr>
<td><strong>LAST CYCLE</strong></td>
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<tr>
<td>Peak (2007)</td>
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<tr>
<td>Air Berlin</td>
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<tr>
<td>Air France/KLM</td>
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<tr>
<td>AirAsia</td>
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<td>American</td>
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<td>British Airways</td>
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<td>United</td>
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<td>S&amp;P 500</td>
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Ryanair in zero-growth mode

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Ryanair will switch capacity from its poorer performing bases to its higher yielding bases unless it is compensated by a reduction in charges (and/or an increase in subsidies from, say, the local tourism authority). No one doubts Ryanair’s determination to act swiftly and brutally when it is baulked at an airport – the recent closure of the Marseilles base, for instance. But for this strategy to work consistently, airports have to be genuinely starved of alternative growth opportunities; Ryanair is convinced that it is the only airline that can guarantee traffic volumes, others are not so sure – Flybe quickly moved into Belfast City when Ryanair exited because plans for a runway extension stalled.

Ryanair will still need to place a substantial new aircraft order just for replacement. Ryanair’s current fleet age is around three years but in order to minimise maintenance costs it adheres to a maximum aircraft age of seven years. Without a growth story, will it be able to achieve the type of bulk discounts that it locked into during the early 2000s, placing mega-orders at a time when the manufacturers were desperate? Ryanair points out that the reason for the termination last December of its 737NG negotiations with Boeing was not about price but about warranties. It also makes clear that the re-engined A320 is a genuine alternative.

On personnel costs Ryanair contends that cost pressure will be contained by its pay structure which provides very strong incentives for productivity. Its remuneration package is designed to be competitive, and its effectiveness is measured by crew turn-over and absence days – which Ryanair claims are very low.

However, Ryanair does at least have a major diplomacy challenge. In October it will pay a one-off dividend of €500m to shareholders, and such is its cash generative power, especially with no new capex, another such dividend becomes likely around 2013. Ryanair staff have minimal stock ownership in the airline so they will required to exercise pay restraint at the same time as huge sums are being returned to shareholders, which they will not appreciate.
Monarch Airlines: Last of the large independents

Outside of the TUI Travel and Thomas Cook Group airlines, the largest of the remaining independent charter airlines is the UK’s Monarch Airlines - but after reporting its worst-ever set of financial results (which has prompted a major reorganisation across the group), the question has to be asked - is the future of Monarch as an independent company assured?

Based at Luton airport, Monarch dates back to the 1960s and in 2009 its 30-strong fleet carried 6.3 million passengers to more than 100 destinations across Europe, the US, Caribbean, Africa and India at a load factor of 84.2%.

Monarch is a private company owned by the Globus Travel Group, which in turn is controlled by the billionaire Swiss-based Mantegazza family. Until recently the last filed accounts for Monarch Holdings (which owns the airline and related businesses such as the Cosmos tour operator and Avro seat-only operation), were for the year ending October 31st 2008. However, figures filed this summer at Companies House in the UK for the 12-month period ending October 2009, show revenue at Monarch Holdings fell to £790.8m compared with £813.3m in the 2007/08 financial year, while the group made a hefty operating loss of £24.2m, compared with a £8.5m operating profit in 2007/08. At the net level, Monarch Holdings made a loss of £26.8m in the 12 months ending October 31st 2009, compared with a £5m net profit in the previous year.

This is the group’s first loss in its history and more worrying was the revelation that as at the end of October last year, cash and cash equivalents had fallen to £11.8m compared with £26.1m as of 12 months earlier, despite a shareholder loan of £15m in the year. Of most concern was that net assets (i.e. all assets minus all liabilities) excluding pension liabilities totalled £58.4m at October 2010, compared with a net asset value of £94.1m a year previously – but when a huge pension liability of £98.1m is taken into account, net assets were negative to the sum of £39.7m.

The impact of airline pension deficits in the UK has been highlighted by the BA situation, but a couple of points should be borne in mind. Pension accounting rules are very conservative – a relatively minor change to the modest rate of return assumption and or the inflation index used in the calculation can turn a deficit into a surplus. Perhaps more importantly, a pension deficit normally will not affect the company’s cash flow – UK corporate law only allows company pension contributions to be made out of retained profits, so if the company is unprofitable no payments can be made to the fund.

Revenue at “airline operations” (which include both the charter and scheduled businesses) fell 6.1% year-on-year to

![MONARCH'S AIRLINE OPERATIONS REVENUE](chart)

<table>
<thead>
<tr>
<th>Year</th>
<th>£m</th>
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<tbody>
<tr>
<td>03/04</td>
<td>300</td>
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<tr>
<td>04/05</td>
<td>400</td>
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<tr>
<td>05/06</td>
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<td>07/08</td>
<td>700</td>
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<td>08/09</td>
<td>800</td>
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Note: FY is Nov 1st-Oct 31st.
Result is for Monarch Holdings’ “Airline Operations”
£517.7m in the last financial year, and a £3.3m profit before tax in 2007/08 turned into a £19.1m pre-tax loss in 2008/09.

As can be seen in the table (above), the “airline operations” provided the majority of group revenue (65%) in the 12 months to October 31st 2009 but contributed a £19m pre-tax loss to the group result. In contrast, the engineering business unit had revenue of just £22m in 2008/09 but reported a £2.5m pre-tax profit, representing a pre-tax margin of 11.5%.

In its brief report filed with the UK’s Companies House, Monarch Holdings says that it encountered “exceptionally challenging market conditions” during the year, driven “primarily by a combination of high fuel costs and the inability to pass on these costs to passengers due to a suppressed marketplace”. However, the report adds that after the financial year-end the group “drew down on a further shareholder facility of £25m” from an entity called Transcontinental Aviation, controlled by the Mantegazza family, as well as revising the terms of a previous loan of £15m from Transcontinental so that it did not become due in the 2009/10 financial year, as was previously the case.

While it’s undoubtedly true that the Mantegazza family can well afford to keep funding Monarch Holdings in troubled times, they will not want that burden indefinitely, particularly as there have been rumours swirling around the City that Monarch had been set for a sale or float. Whatever the long-term plans of the Mantegazza family for Monarch, the company has undergone a period of instability through 2010.

In February it was unexpectedly announced that Peter Brown, the chief executive of Monarch Airlines, was leaving the company with immediate effect after eight years in the position. More significantly, over the summer the group began extensive restructuring, aimed at bringing all its activities into six divisions – the scheduled airline, charter airline, “airline operations”, tour operations, engineering and retail. This is designed to allow the group to more easily manage products and services across these divisions - which is an implicit acknowledgement that the various parts of Monarch have operated in silos until now – or what Jeans calls “fairly separate lives”. Of course whether customers ever realised – or cared – that Monarch Airlines, Cosmos and Avro are part of the same group is open to doubt, but the reorganisation should mean better operational control and alignment between the divisions.

The group promises there will not be any redundancies under the reorganisation. Currently Monarch employs more than 3,000, with “airline operations” having 1,935 staff, aircraft engineering 409, tour operations 154 and “administrative” 547. Whether the airline operation needs that many staff is open to debate, as the group trimmed its fleet by three aircraft in the last financial year, and as can be seen in the chart (left), capacity and traffic has been down year-on-year at the airline over the...
last 12 months, with very large reductions to capacity through February, March and April this year.

Monarch has a multitude of types for a fleet that is just 30-strong, with A300s, A320s, A321s, A330s and 757s. They have an average age of 12.9 years, which means that a renewal programme has to be carried out pretty soon. Currently there are six 787s on order, and options for four more aircraft, but delivery has been pushed back from this year to 2013 at the very earliest. When they eventually arrive the 787s will replace the four ageing A300s (with an average age of more than 20 years) and be used for long-haul charters and potentially transatlantic scheduled services.

Within the overall Monarch fleet is a low cost, low fare scheduled business called Monarch Scheduled that dates back to 1986. This operates out of Luton, Gatwick, Manchester (where is it the leading international scheduled airline) and Birmingham to approximately 20 airports in Spain, Gibraltar, Portugal, Cyprus and Turkey, all of which are primarily leisure destinations. It launched eight scheduled routes last year and this May added new scheduled routes to three Turkish destinations. The scheduled service includes a FFP called the Vantage Club as well as optional paid-for frills such as meals, pre-booked seat and extra legroom.

The scheduled business is coming under increasing pressure from the LCCs; for example Ryanair’s scouring of Europe for routes to base its aircraft in the last few years has led it to the traditional holiday destinations (such as Malaga and Palma) that used to be the fiefdom of the charter operators - and that is forcing Monarch to look at ancillary revenue as average fares come down.

However, the majority of Monarch’s airline business remains in the charter segment, and it’s this that is suffering most at the moment. How Monarch will be affected by the decision of the Big Two tour operators (TUI Travel and the Thomas Cook Group) and their associated airlines to cut late summer holiday prices in an effort to shift spare capacity has yet to be seen, but that move may contradict the hope of Tim Jeans back in April when he said that “the race to the bottom has run its course because customers eventually recognise that there are differences in providers ... they recognise there is a difference between a Monarch flight and a Ryanair flight, between a Goldtrail flight and a Kuoni flight - and that has a value”. That’s a long-held wish in the seat-only market, but history has always proved that the lure of the lowest fare always trumps any other factor, and the decision of the Big Two to cut prices will make that ambition even harder.

The future?

“Further optimisation” of the Monarch group is promised, but quite what is left to reorganise is not clear at this moment. The managing directors of each of the new divisions will report into a “group executive committee” headed by a new post of group chief operating officer, who is Richard Mintern, also the managing director of the engineering business. Over the summer there were further reshuffles of management, including the appointment of Simon Tucker as group finance director, Kevin George as the managing director of the “airline operations” division, with Tim Jeans also put in charge of internal marketing (in addition to his day job, which is running Monarch Airlines). And in late September Monarch announced that Conrad Clifford – previously vice president for the UK and Ireland at Emirates and a former CEO of Virgin Nigeria – would become group CEO from December 1st.

Despite this new structure and management the group has declined to forecast it will return to profit this financial year, and all Rawlinson has said is that the group is seeking “steady improvement in financial performance over the next two to three years”. Whether that will be sufficient for the Mantegazza family remains to be seen. Combining the last six financial years together, Monarch’s airlines have made just £13m of pre-tax profit on £2.7bn of turnover, at a margin of less than 0.5%.
Southwest’s acquisition of AirTran: What will really happen at Atlanta?

Southwest’s planned acquisition of AirTran seems like a smart strategic move for both carriers. But can the world’s leading LCC really generate the famous “Southwest effect” at Atlanta, where AirTran has already given Delta a run for its money? Will the take-over enable Southwest to resume organic growth?

Southwest, the fourth largest US carrier in terms of system RPMs, announced on September 27 that it had entered into a definitive agreement to acquire AirTran Holdings, the parent company of AirTran Airways, in a $1.4bn cash and stock deal (or $3.4bn including AirTran’s net debt and capitalised aircraft leases). AirTran is the eighth largest US carrier, about a quarter of Southwest’s size; it began life as ValuJet in 1993 and in the past decade has positioned itself as a high-quality LCC with the lowest unit costs in the industry.

The deal has been unanimously approved by the boards of both companies. It is expected to close in the first half of 2011, subject to the approval of AirTran shareholders and regulatory clearances. The deal is not contingent on any union approval.

Under the terms of the agreement, AirTran shareholders will receive a combination of Southwest stock and cash valued between $7.25 and $7.75 per share, depending on the average trading price of Southwest stock in a 20-day period ending three days prior to the closing of the deal. At least $3.75 of it will be in cash. Based on share prices on September 24, the transaction values AirTran’s stock at $7.69 (or $1.4bn in the aggregate), representing a premium of 69%. AirTran shareholders would receive around 57m Southwest common shares, or 7% of its total on a pro-forma basis, as well as $670m in cash.

Law firms scrutinising the transaction on behalf of AirTran shareholders have suggested that the offer may undervalue the company, noting that at least one analyst had a price target for AirTran as high as $11 per share. However, analysts consider alternative bids unlikely. There are normal provisions to deal with superior proposals, including a timeframe for Southwest to respond and a break-up fee of $39m.

This would be a straight acquisition, anticipating the full commercial and operating integration of AirTran into Southwest over a two-year period. AirTran will lose its brand and identity, and its fleet will be transitioned to Southwest logo, colours and configuration. Corporate functions will be consolidated into Southwest’s Dallas headquarters. The plan is to eventually operate under a single operating certificate.

The deal is significant in that it would be the first combination between major US LCCs, bringing together airlines that generated $11.2bn and $2.5bn revenues in the 12 months ended June 30. It is also a rare move Southwest, which likes to grow organically – only its second large acquisition (following Morris Air in 1993).

The acquisition would reinforce Southwest’s position as the largest US carrier in terms of domestic passengers and its solid “number four” ranking in terms of system RPMs. With the closing of the UAL-Continental merger in the same week as the Southwest-AirTran deal was announced, it is amazing to think that US airline industry consolidation has got to the point where there are just four clear leaders: the “big three” legacies and Southwest.

AirTran will give Southwest some exciting new opportunities in eastern US, especially access to Atlanta - the world’s busiest airport where it has hitherto not been able to establish even a foothold – and a modest near-international network. But those opportunities also pose unique challenges for a carrier whose hallmark is simplicity. How will Southwest handle the Atlanta market? When integration is completed, how much will its business model have changed?
Southwest can certainly afford the AirTran acquisition. It plans to fund the $670m cash payment out of cash reserves. As of late September, Southwest had $3.3bn of cash, a fully available $600m unsecured credit line and over $7bn in unencumbered assets (primarily owned 737s). After the AirTran acquisition liquidity would remain very strong, with unrestricted cash exceeding $3bn or 20% of combined 2010 revenues.

Furthermore, there may not be any negative impact on Southwest’s industry-leading credit profile. While assuming about $983m of balance sheet debt and $1.7bn of capitalised aircraft leases from AirTran, Southwest is sticking to its plans to pay down debt in 2011 and 2012. Fitch has actually affirmed Southwest’s “BBB” ratings and “stable” outlook, though S&P placed the ratings on “creditwatch negative”.

The deal seems to be universally liked by analysts, because it will enable Southwest to resume growth without acquiring aircraft in the near-term. Many in the financial community feel that risk is minimised by acquiring another successful LCC with similar values and strategies. JP Morgan analysts pondered in a late-September research note that “integration challenges” were preferable to “more capital-intensive outcomes (new planes and organic growth)”. The verdict of BofA Merrill Lynch analysts was very clear from the heading of their research note: “Right price, right time, right target”.

Why now?

The curious thing about the Southwest-AirTran combination is that it has been on the cards for a long time, but the two parties never got together to talk about it until recently. Many analysts have suggested it over the years. AirTran’s leadership has frequently gone on record saying that they were open to being acquired. And Southwest’s CEO Gary Kelly conceded in the investor call on September 27 that “it has been a good idea for a long time”. Then why did it take so long? Why now?

The first thing to note is that Southwest’s move has nothing to do with the acceleration of the legacy-airline consolidation process. It is in no way a response to Delta-Northwest, United-Continental or any of the smaller-carrier mergers or international deals.

The short explanation for the delay given by Kelly: “We weren’t ready. It wasn’t the right time for us.”

Southwest is fiscally an extremely responsible company. Even though it has earned profits for 37 consecutive years, 2008 and 2009 turned out to be financially rather challenging, in the first place because of the waning of the airline’s advantageous fuel hedges and subsequently the recession. As a result, Southwest has had a few extremely busy years trying to find solutions. The numerous projects tackled by the airline have been discussed at depth in Aviation Strategy briefings (see January/February 2008 and April 2009 issues); here is a quick summary.

First, to compensate for the substantial hike in costs after losing the fuel hedge advantage, in mid-2007 Southwest embarked on an all-consuming drive to boost revenues by $2bn-plus annually. It was a major challenge for an airline that had hitherto focused mainly on keeping costs low. The effort has been highly successful, leading to lucrative new ancillary revenue streams, refinements to the business model and new products aimed at attracting more business traffic.

Second, there has been a major drive to
get the technology and systems in place to support the new revenue activities – another formidable challenge because Southwest was built on simplicity and had some serious “catching up” to do on the technological front.

Third, after reporting its first quarterly net losses in memory in late 2008, Southwest suspended ASM growth and began to defer aircraft deliveries – another first for the carrier. Contrary to large LCCs in other world regions, which continued growing through the recession, Southwest’s total capacity fell by 5.1% in 2009 and by another 3.3% in first-half 2010.

Fourth, to enhance the profitability of its network and maintain staff morale, Southwest embarked on a “network optimisation” drive. This meant eliminating flights in less profitable markets, while venturing into high-profile new cities, including Minneapolis, New York LaGuardia and Boston Logan in 2009.

With all of that to manage, and given Southwest’s conservative nature, it was hardly surprising that the airline did not want to take on a major merger or acquisition. That said, in the summer of 2009 Southwest did seek to buy another LCC, Frontier, through the Denver-based carrier’s bankruptcy auction process. The deal made much sense but was scuppered by Southwest pilots’ refusal to endorse it.

But the environment is now very different. In the past 12 months or so, Southwest has led the industry in demand, yield and profit margin recovery. In this year’s June quarter its operating margin was an excellent 13%. With continued extremely modest capital spending, Southwest should continue to grow its cash flow and reduce debt in 2011. CFO Laura Wright noted: “This puts us in an excellent position to structure a transaction in a manner that preserves our strong balance sheet but which also allows an opportunity to provide superior returns on the investment to our shareholders”.

Kelly noted that since Southwest is currently not growing its route system organically, now is an opportune time to manage a major acquisition. Furthermore, Southwest is now more confident in its capabilities on the revenue side. Since the merger may not produce any net cost savings, “it all hinges on whether we can make the networks work”.

What AirTran offers

Southwest wants AirTran for the profitable growth opportunity that it offers. Southwest’s growth opportunities have diminished as its network has grown nationwide. It has also been unable to access some major markets or build up frequencies due to unavailability of slots. It is indicative that Southwest is now seriously considering converting some of its 737-700 orders to the larger 737-800 (an option that it has always had) to help it grow at slot-restricted airports.

The growth opportunity through AirTran arises because the networks are complementary. AirTran would give Southwest 30 new destinations. Although the two overlap on 20 nonstop routes, which is more than United-Continental’s 14 and Delta-Northwest’s 12 (JP Morgan figures), there is significant overlap at only two airports: Baltimore/Washington and, to a lesser extent, Orlando. The consensus among analysts and industry observers is that, given the lack of competitive constraints at those two airports and Southwest’s pro-consumer reputation, there are not likely to be any DoJ-mandated divestitures.

But the most important reason Southwest is acquiring AirTran is that it offers access to Atlanta, the largest US city Southwest does not serve. AirTran is the second largest carrier at Atlanta, with a 22% market share (compared to Delta’s 62%) and a sizable hub operation covering 57 cities. CEO Kelly likens Atlanta to the “big pools of growth opportunities” that Southwest had in the 1990s (particularly California), as well as the Chicago and Denver opportunities in the last decade. “In terms of us filling our network gap, the major market that we don’t touch domestically that our business customers particularly want is Atlanta. So this is clearly a strategic move for us to fill that gap.”

Southwest will also gain improved access to the three most important
Northeast business markets: New York, Boston and Washington. It will gain more slots at LaGuardia and Boston Logan and, for the first time, be able to operate to Washington Reagan.

Southwest will also gain access to many smaller domestic cities that it does not serve today (because it is primarily a point-to-point carrier). Southwest executives commented: “That will also fit in very well with our desire to continue growing our route map domestically”.

And, significantly, Southwest will gain access to key near-international leisure markets in the Caribbean and Mexico, accelerating its own plans to go international. AirTran operates at least weekly, and in some cases daily, scheduled flights from Atlanta, Orlando and Baltimore/Washington to Aruba, Cancun, Montego Bay, San Juan, Nassau and (from February 2011) Punta Cana.

Southwest has long contemplated near-international service. Codesharing on WestJet flights to Canada and on Volaris flights to Mexico was supposed to be the first step in the process, with own-account international operations following after a few years. But the WestJet deal fell through last year (after the Canadian carrier forged a similar relationship with Delta), and the Volaris deal has been delayed by Southwest’s struggles to upgrade its reservations technology to handle international codeshares (now expected to be implemented in 2011).

Kelly confirmed in the late-September investor call that Southwest has taken the decision to replace its reservations technology and has narrowed the search down to two systems. That will bring the necessary capability, at least on the commercial side, to offer international service. In the meantime, Southwest would keep AirTran’s international service and learn from it, before eventually moving those operations under its own roof when it has the capability. While additional international expansion is probably several years away, one thing is clear: long-haul expansion to Europe is not on the cards; the furthest place that Southwest is likely to go is South America.

The AirTran acquisition would contribute to the gradual “eastward march” that Southwest began more than a decade ago, after its 1990s growth spurt in California. It would result in an approximate eight percentage-point decline in the West’s share of seats offered and a corresponding increase in the East’s share of seats. Specifically, the West coast and Southwest regions would account for about half of the combination’s total seats (51.4%, compared to 59.7% previously), while the Eastern half of the country would account for about a third of the seats (32.7%, up from 25.1%). Midwest’s share would remain roughly unchanged at 15-16%. International and Puerto Rico would account for 0.2% of the seats.

The two airlines’ fleets are compatible in that they include only Boeing aircraft and large numbers of 737-700s. However, AirTran does bring in a different fleet type,

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the 717-200, and in significant numbers too (86). Although Gary Kelly sportily described the 717 as “very cost-effective” and “an airplane that we think we can manage well”, it will be interesting to see if Southwest could actually get rid of the type, and if not, how it would operate the 717 and what the impact on costs would be.

Importantly, like Southwest, AirTran is a high-quality, low-cost operation with a very solid low-fare brand. Both have employee-centric cultures and dedicated workers with “kindred warrior spirits who care about serving customers”. AirTran is a profitable operation, though its margins have been lower and much more variable than Southwest’s.

But there are some differences. AirTran uses a hybrid hub-and-spoke network, whereas Southwest is point-to-point. AirTran is actually much more upmarket: it offers two classes and advance seat selection, contrasting with Southwest’s very basic approach (even after the past two years’ new product offerings). AirTran sells through GDSs, Southwest does not.

Synergies and dis-synergies

Southwest expects the AirTran acquisition to produce “at least $400m” of net annual synergies by 2013. This would be about 3% of the $13.7bn combined annual revenues in the 12 months to June 30 – in line with other recent airline combinations. One-time costs related to the acquisition and integration, to be incurred from close to 2013, are projected to be $300-500m.

The synergies will be driven mainly by the expanded and diversified network. The stronger joint network will facilitate hundreds of new itineraries to the combination’s 100m-plus existing customers. There would be incremental revenue from new Atlanta markets. The increased customer base would support the addition of brand new destinations. The combined company would have a more powerful FFP, providing a significant revenue opportunity (strengthening the new FFP that Southwest is scheduled to launch next year). And Southwest believes that, as the networks are combined, it will be able to capitalise on joint marketing, its schedule optimisation and revenue management capabilities, its “BusinessSelect” and “EarlyBird” products and, of course, its popular “Bags Fly Free” programme.

Interestingly, Southwest is counting on producing the famous “Southwest effect” at Atlanta, even though it is replacing an existing low-fare carrier there. A study by Campbell-Hill Aviation Group, which was retained by Southwest to evaluate the consumer benefits of the transaction, found that more expansive low-fare service at Atlanta alone has the potential to stimulate over two million new passengers and $200m-plus in consumer savings annually.

On the cost side, there are potential savings in advertising and distribution, facilities, corporate overheads, duplicative information technology, scale efficiencies and reduced financing rates thanks to the larger scale. The cost synergies are expected to “substantially offset” the dis-synergies of the deal, principally higher labour costs.

S&P noted in a late-September communiqué that Southwest’s labour costs are among the highest in the industry for the 737s it flies, while AirTran’s are among the lowest. “When two merging airlines have different levels of compensation, the pattern has been for the lower-paid employees’ compensation to rise to match that of the airline with higher pay.” The rating agency considered the labour dis-synergies to be “the greatest risk in this merger”.

BofA Merrill Lynch estimated that AirTran’s wage rates are 30% below Southwest’s, which would imply more than $150m of labour dis-synergies. Southwest has not released its own estimate, though it is apparently included in the $400m net synergy figure. In other words, the anticipated revenue synergies dwarf the cost issues.

CFO Laura Wright stated that the AirTran transaction should allow Southwest to meet its overall ROI and profitability targets sooner. The value created for shareholders fully supports the significant premium to be paid to AirTran shareholders. When the $400m net synergies are fully realised, Southwest expects to exceed its 15% pretax return on invested
capital target and produce a healthy return
on equity of over 20%. Including the net
synergies but excluding one-time costs, the
deal is expected to be accretive to
Southwest’s pro-forma EPS in year one and
“strongly accretive” in subsequent years.

Integration risks

Southwest is embarking on a challenging
undertaking, but it is not new to mergers
and its recent track record of moving very
slowly and methodically with difficult pro-
jects to ensure a successful outcome gives
much cause for optimism. With the AirTran
deal, there are integration risks essentially
in two areas.

First, technology integration, which has
caused problems in many airline mergers, is
a particular concern given Southwest’s diffi-
culties in that area in recent years and
because Southwest plans to move to an
entirely new reservations platform in the
middle of the AirTran integration.

Second, as Fitch put it, labour force inte-
gration is always a wild card in airline com-
binations. While the AirTran deal is not con-
tingent on any union approval, successful
integration will not be possible if labour
does not cooperate or if there are serious
disputes. Integration of pilot seniority lists,
which affects future pay, promotions and
flying assignments and has to be deter-
mined by the two pilot groups, is typically
the toughest issue - it has still not been
achieved at US Airways following its 2005
merger with AWA.

In this deal one potential problem is that
Southwest’s pilots are more senior than
AirTran’s, because Southwest has a longer
operating history. If the unions merge the
lists on the strict order of seniority, AirTran’s
pilots would find themselves at the bottom
of the list, which would probably cause a lot
of friction. Southwest’s management hopes
that the pilots will find a “fair and equi-
able” way of merging their seniority lists.

Southwest’s pilots have adopted very
hard line positions in the past. Their insis-
tence of putting Frontier pilots at the bot-
tom of the list helped scuttle that deal last
year. In their initial statement on the AirTran
acquisition, the pilots said that “no stone
will be left unturned to protect SWAPA
pilots’ interests”.

On the positive side, the potential growth
opportunity associated with this deal may
reduce the stakes of seniority integration.
AirTran’s pilots can also look forward to
much higher pay, greater job security and a
better relationship with their management.

Fleet considerations

Even though Southwest will be happy to
continue operating the 717-200s, which are
well suited to AirTran’s smaller markets, it
really does not need another aircraft type.
All but six of the 86 717s are leased, which
makes it harder to manage changes to the
fleet. But Southwest is likely to have already
approached Boeing Capital about potential
solutions such as early termination of leases.

If Southwest has to continue operating
the 717s, it has already said that it would
not want to cross-train crews and have
them switching back and forth between the
717s and 737s. The 717s would probably be
fenced off within the network until the leas-
es expire or agreement is reached with
Boeing on their transition. Southwest may
also seek lease rate reductions, given its
stronger balance sheet and credit profile.

Some analysts have suggested that
Southwest might delay any plans to switch
to the larger 189-seat 737-800s, given the
added complexity of the 717s. But Kelly
refuted such ideas, saying that the two
types are not mutually exclusive but com-
plementary and that the 737-800 might fit
in well in Southwest’s broader strategy for
the next decade. Kelly stated: “In my opinion, we have a better fleet plan going forward contemplating the 737-800 as a component. It can be more cost-effective on current routes. Clearly we’ll have more growth opportunities if we can bring the -800 to the property. There are just some routes that we won’t fly if we don’t have the -800.” Southwest was previously expected to decide on the 737-800 by year-end. It recently won approval from its flight attendants to add the type, though it is still discussing the plans with its pilots.

What will happen at Atlanta?

Southwest has made it very clear that Atlanta is where the big numbers are. Kelly stated: “It is about bringing more competition, bringing more low fares. We see a number of city-pair opportunities to go in with lower fares and stimulate traffic in classic Southwest fashion.” Kelly also reminded that Southwest likes “markets that are over-priced, and the icing on the cake is if they are also underserved.” It would be a reversal of the retrenchment that AirTran has been on in the last few years at Atlanta.

But some industry observers have questioned if Southwest can really stimulate traffic at a hub that has already been a battleground between a legacy and an LCC for more than a decade.

A study released on October 4 by Boyd Group International suggested that Southwest is likely to have a material effect in only two of the top 25 O&D Atlanta markets: Salt Lake City and Newark. Southwest is replacing an existing low-fare airline, not introducing low fares to Atlanta. The report called “ridiculous” projections of hundreds more flights per week or hundreds of millions in fare savings, pointing out that “the major demand markets at Atlanta are already stimulated” and that “every local O&D market at Atlanta is wildly overserved”.

The Boyd report made the point that AirTran’s Atlanta flights depend on flow traffic for around two thirds of the passengers. Southwest too depends on flow traffic at many locations these days; at Chicago Midway, 43% of its passengers are not local O&D. Nevertheless, the report argued, more reliance on “banking” schedules will be critical at Atlanta. “The extent to which Southwest will need to stimulate Atlanta as a hub goes far beyond anything it has done in this regard before.”

It is not at all clear what the impact on Delta might be. Some analysts have downgraded Delta merely on the basis that it will face a tougher LCC competitor at its main hub, but others believe that Delta is not uniquely threatened. JP Morgan analysts are in the latter camp, noting that Southwest is probably a more rational competitor than AirTran (because it has higher costs and is more profit-oriented) and that the 37 cities unique to Southwest (which it could link to Atlanta) represent less than 1% of Delta’s system revenue.

The Boyd report noted that Delta has succeeded in Atlanta in all three counts that matter: carrying more flow traffic than AirTran, maintaining a strong yield premium, and maintaining high load factors. “There are no indications that this situation will change when Southwest’s Red Bellied Warriors pull up to the gate.”

But Atlanta may one day make an interesting case study of airline brand loyalty. On the one hand, Delta may gain business traffic if AirTran’s passengers do not like Southwest’s open-seating policy and more basic product. On the other hand, Southwest’s “Bags Fly Free” policy may prove so popular that Delta will have to reverse its strategy for competitive reasons and lose a major revenue stream. With such considerations in mind, Southwest’s executives have stressed that they want to use the integration as an opportunity to learn from AirTran and are not ruling out future changes to the brand.

The transaction is widely regarded as a near-term positive for the US airline industry. By eliminating the lowest-cost, lowest-yield producer, it is likely to enhance capacity and pricing discipline. Of course, the longer-term implications are less favourable since the acquisition is likely to encourage Southwest to start growing its fleet again.
Operational management: the aim is “unremarkable service”

When a flight is on time, with OK cabin service, and your luggage arrives when you do, most passengers do not notice. This is how it is supposed to be. If, however, the flight is delayed, especially if this starts to be a pattern with an airline, then this is not OK.

As has been extensively researched since the 1980s one delayed or otherwise dissatisfied passenger tells at least nine other people – a passenger whose flight was reasonably on time and with adequate service will probably just answer a direct question with “yes, it was OK”. For most airline passengers unremarkable service is as good as it gets.

Unremarkable service, however, is the product of skilled operational managers who constantly integrate and adapt the outcomes of many different functions from within and outside an airline. They in turn are often regarded as unremarkable in terms of the role they perform and their visibility compared to the powerhouse functions of corporate strategy, international relations, finance, marketing and systems development. They usually only come to notice when the operation suffers serious disruption or when further cost savings need to be made, since they often control large numbers of direct or contracted staff susceptible to culling when additional savings are looked for.

Now, however, airlines are looking with a renewed focus on operational performance as a competitive differentiator. Not least because the web-enabled world creates fast and uncontrollable customer feedback, and is seen to be increasingly influencing buying behaviour. Also as global recession eases European airspace is also likely to be increasingly constrained by minimal new airport expansion and a delayed Single Sky air traffic management system while at the same time pan-European train operations are likely to become faster and more reliable.

So unremarkable service may have to get a whole lot better if it is to stay unremarkable and the talent management required to sustain competent multi-skilled operational managers may also need to be reviewed.

Unremarkable service requires the combination of many elements: serviceable aircraft, fueled, cleaned, loaded and catered; briefed crew with logged flight plans; an available airport gate, ground transport, appropriate terminal facilities; processed joining and transit passengers, all ready within slot departure time and not just once but repeated many times during a day. This demands a careful allocation of resources between competing demands, involves dealing with variations and the unexpected, but it rarely involves facing totally new or previously unknown situations. So the managerial task may be stressful, with peaks and troughs, but for people who have worked in airlines it does not require remarkable skills, but competence and judgement.

Judgement within boundaries

Another complication faced by managers is that many ground operations functions are now outsourced. In larger airports the airline manager may well have to trade upon maintaining a good relationship so that additional staff or equipment is provided without recourse to the small print of a contract and also manage the internal hierarchy so that action to enable service recovery is not then criticised for coming in over budget or not following the rules. Ryanair has simplified this, no customers receive any extra service and if they do everyone gets the same. For other airlines distinctions between fare types, complicated by loyalty schemes, do not always lead to easy conversations at the customer service desk if one person is told they may receive more than another within earshot.

Does judgement matter or should the
rule book not always be the arbiter? Many airport staff will remark that when dealing with passengers who are disabled, bereaved, frequent flyers, or who may have expectations generated by partner airlines, travel agents or corporate accounts, the rule book does not always fit, especially if the espoused mission and values are about treating customers with respect and selling the next ticket.

Setting targets within the integrated world of operations is fraught with danger as meeting one may well disadvantage the system. A major airline had to shampoo its carpets most weeks because purchasing had saved money by buying thinner waste bags which frequently split. Cabin crew constantly struggle to reseat families on boarding when the terminal staff have assured the passengers this can be done – thus meeting check-in targets and dumping the problem on someone else. So an operations manager has to know the details of the work required, ensure compliance, especially of safety even if punctuality is threatened, and then have the energy to fight for resources, especially those that are required on occasion rather than all the time.

Is operations management important?

Is the management of airline operations of great significance in an economic climate where the financial survival of many airlines, issues of fleet selection, leasing, fuel cost, market access, yield management, product differentiation and the creation of viable alliances currently occupy most executive attention?

The answer is probably ‘yes’. It is not more important but to many airlines it is as important. Although the issues of managing a regular, reliable and punctual performance have not changed much since the advent of the big jets some fifty years ago and indeed have to an extent become much simpler because of automated and integrated systems, four largely external factors now have a growing significance.

These four factors are: the impact of a sustained period of cost-cutting, the growth of ancillary revenues, the importance of global networks, and the socially networked markets in which airlines compete for customers. The first may ease as with economic recovery but it may leave a longer term legacy that constrains the ability of airlines to remount more ambitious schedules. The latter two may well become very significant in increasingly competitive markets. Whatever the interaction, all four factors are combining to render today’s airlines more vulnerable to perceived poor operational performance than before (in turn impacting marketing propositions and the bottom line).

Relentless cost-cutting One result of the seemingly endless cost cutting of the last three years has been a reduction in operational management and staff. As a result, in a crisis there is no additional available resource to commit – this has been ruthlessly pruned. There are fewer people and often distorted age and length of service demographics. If training has also been reduced then the front-line competence may be thin, and with no reserves in terms of bodies or skill. At the same time a loss of collective experience as job levels are removed and experienced – and more costly staff outplaced - may result in a greater dependence upon the operating manual when the exercise of judgement and empathy with passengers may be more important.

Increase in ancillary revenues The pursuit of ancillary revenues is also starting to impact upon airline passengers and their perception of what is good operational performance. The days of acceptance of long delays at airports when an ‘all-inclusive’ price for a holiday had been paid, or when a company was funding business travel are fast disappearing. If passengers pay more for the carriage of their bag it had better arrive and quickly; if they pay more for a pre-ordered meal or on-board snack it had better be available and edible; if they pay more for preferential boarding and seat allocation it had better take place and produce a preferred seat etc.

The customer at the check-in desk or kiosk is very aware of how much they have
paid for a service. Unbundling provides revenue streams but also exposes front-line staff to transactional expectations that were previously opaque. Corporate travellers also have a heightened awareness of the components that make up the value of the service they expect and may have to justify to their own bosses.

The importance of global networks
One attraction of offering global networks is the connections they offer through single or multiple hubs, with seamless service and compatible products. These expectations at airport level provide multiple challenges: from privileged lounge access, baggage allowances, carry-on baggage size, upgrading policies through to language skills and an ability to meet growing requests to respect diversity. As the sophistication of the alliance marketing increases so will the complexity of delivering the promise in physically congested and time-constrained facilities.

It is also likely that operations control of networks will be influenced by the yield profiles on loads on inbound aircraft with a consequent pressure to hold some departing connections – yet maintain operational integrity across the terminal.

This is not new. Major European airlines have protected certain high profile commercial connections for years. What is new is the multiplicity of partners and increasing knowledge of corporate customers. The scale and the visibility of the demands are likely to increase and quite often junior staff are on the front-line.

Significance of social networking
The chaotic world of social networking continues to develop in unexpected ways. Think of the numbers that football stars, film stars and other celebrities have “following” them virtually and then think of them starting to twitter while delayed at airports; at airports waiting for their bags and hoping they will come and after flights describing their experience. Possibly, they will also soon be twittering on flights. If Stephen Fry can twitter in a slow lift, or a trade union official during negotiations then airline passengers, especially if agitated, will certainly find the time. The only slightly slower world (before the advent of the iPad and iPhone) of PC-based chat rooms and blogs has long been a source of informed feedback on flights. A troll through recent comments on the larger European LCC sites is very informative as to what matters to some paying customers. More interestingly, what matters seems to align with the comments made by other customers on blogs about the major network airlines, i.e. arriving on time with one’s baggage and not being ‘ripped off’ on price – whether as booked, or through ancillary revenues - matters.

Recent research shows that in this networked world it is another online person who is believed rather than an airline or an official statement. Social networks are probably not a passing phase and the views expressed on Facebook about current airline operations do not always make for pleasant reading.

Demanding leadership
Historically, operational management has not been held in the highest esteem in airlines. Elements of it being regarded as a bit technical, and sometimes physically dirty still remain. A key determinant of reliable, regular and punctual services is the management of the operation. But operational management, if one discounts pilot management, has rarely been prized either in terms of relative salary or as a route to the executive suite. In today’s environment the professional skills of piloting, engineering, finance or the law, or wider commercial experience and skills in marketing or IT tend to be favoured more.

Operational managers tend to love their work, however, and their career choice. Most quote the satisfaction that comes from delivering a high quality product and on occasion rescuing the operation from the problems that extreme weather, technical, infrastructure failure and major geopolitical issues are always liable to cause. They also tend to enjoy leading people, as individuals and as organised in unions. These problems go with the territory and it is often what distinguishes the
managers as people who regularly reflect on previous experience and adapt accordingly.

A role, not a profession

Crucially, operational managers need to be generalists. As Professor Richard Barker of Cambridge University’s Judge Business School argues in a recent *Harvard Business Review* article, management is not a profession pursued like accountancy, the law or medicine, piloting or engineering in the airline world. His argument is that much of our business education no longer equips managers for critical roles. An MBA is a useful qualification but it does not necessarily equip managers for a world in which peer relationships, team working, thoughtfulness, and flexible and adaptive attributes are more important than technical knowledge. This list of competence is from research compiled as to what organisations prize, not what business schools think they should deliver.

Back in the world of airline operations one characteristic of a manager stands out. The manager is responsible for bringing together many inputs and exercising judgement to affect the outcomes. At an operational level the manager, for some brief moments, is responsible for the combined value generated by all the inputs to the company. On her watch the value generated by marketing initiatives and brands are combined with the technical expertise from engineers, pilots, operations control, ground handling, passenger services, catering come together - or not. On her watch the value generated by the inputs from the company are enabled by the value of the inputs from alliance partner airlines, code-sharing partners, service partners, hotels, and transport services come together – or not. On her watch the value generated by the inputs from parallel agencies responsible for airport infrastructure, terminal facilities, security, immigration, and air traffic control are enabled – or not.

The very definition of an operational manager is that she works across functions, influencing and adapting the outputs and approaches of numerous silos to a common purpose: delivering to each and every passenger an operation that is timely, reliable, and to the expected standard. From these trade-offs and recognition of the best course to steer through conflicting demands comes added value on the day, and longer term added value - if the learning from the inevitable problems is translated back into future decisions.

Learning, not blaming

At most airlines the blame allocation meetings about why a flight departure was late are a thing of the past. Trying to pin the blame on whether the aircraft was late out of the hangar, denied a gate when required, or was awaiting crew or cargo, which in turn impacted on whether cleaning, loading and dispatch could take place in time is probably one of the most fruitless pastimes invented by airline managers. Add to this local context concerning access to de-icing when required, stand allocation, security procedures, concourse congestion, or waiting on valuable transfer passengers and the complexities of the blame game are clear.

As Gordon Bethune mused when turning around Continental Airlines; “There are a lot of parallels between what we’re doing and an expensive watch. It’s very complex, has a lot of parts and it only has value when it’s predictable and reliable.” A watchmaker exercises judgment to make the entire system balanced and reliable, and is not just assembler of parts.

So in today’s environment, discussions on patterns and wave theories tend to yield more value than looking at targets and blame. Only recently has analysis of traffic congestion, especially on major motorways identified the phenomena of waves of build up and congestion. There comes a point at which the system becomes overloaded and resolution comes from de-stressing the system by enhancing small additional capabilities throughout the system, rather than at the point of impact. In airline operations the same skill is deployed in a myriad of tasks throughout a shift to de-stress the
system. In the control centre through making minimal changes and accepting an occasional bad delay rather than ending up with too many crew and aircraft in the wrong places, and through careful stewardship of reserves of people and capacity rather than reacting in the moment.

Despite its name and 24 hour role this is not a theatre for histrionics. Both in the control centre and at airports many issues are resolved by listening to the staff at the sharp end and thinking system rather than activity. At airport level there are countless options to stop a wobbling system before it falls over: opening an extra check-in desk, deploying a dispatcher early, sending a loading team to a remote gate in advance of final allocation, requesting additional catering on standby, deploying additional hi-loaders, alerting immigration and security to potential additional peak throughput etc.

The key to good management in both arenas is that the important decisions are taken in advance and in the light of emerging and ambiguous patterns – hence experience and accessing the experience of specialist colleagues is important. This is second nature to the operational manager, it is what makes the job worthwhile, provided they understand the bigger system.

It is possible, however, that one product of the constant cost cutting of the last three years is now impacting upon the capability of airlines to manage the disparate function known as ‘operations’. There are fewer managers, and fewer staff, and amongst these there may be a reduced collective experience of how to avoid disruption, anticipate passenger reactions, and recover airline operations with a minimum of fuss, all in the quickest possible time.

Outside world judges

Brand values are built on emotion and as more people speak of their disappointment instantly and uncontrollably through social networks then the level of emotional reaction intensifies. But the challenge is not unique to LCCs. Maintaining premium pricing demands maintaining premium service, including punctuality.

Recently the bar has been raised on airline punctuality and reliability. Some people, especially travel agents looking after corporate accounts, do look at the government published punctuality reports. Ever since Bob Crandall effectively declared war on Frank Lorenzo’s Continental Airlines by lobbying the US Department of Transport to publish data, punctuality has been a market force.

Ryanair has consistently surprised other European airlines by beating them on regularity, reliability and punctuality and customers are aware of this. There may be other reasons why Ryanair is not an automatic first choice for many customers but punctuality is not usually one of them.

Underneath the hype that surrounds the Continental Airlines turnaround of the 1990s (which was not “new” - it built upon experiences from British Airways in the 1980s, Lufthansa in the early 1990s, and Southwest Airlines amongst others) three messages from that turnaround team to their managerial colleagues stand out.

First, what most people expect from an airline is getting them where they want to go, on time, safely and with their baggage. Second, the only way to deliver such a service is by ensuring all the staff want to provide it. Third, delivering good operations demands recognition of it as an interactive system, not a sum of the parts: exporting the problem down the line to someone else is not acceptable.

The role of the operations manager is to maintain these perspectives and to work continuously on both the inside world of the airline that delivers the outputs required and the outside world of passengers and customers. As UK high street banks have started to put executives back into branches to experience the whole system at point of impact; as supermarkets and retailers insist that executives manage outlets as a necessary experience; perhaps some airlines might benefit in a return to the wisdom of a few years back and ensure that some in the executive suite and those on the way there know what the term ‘operations’ actually entails.

By Roger Niven rogerniven@aol.com
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<td>Note: Annual figures may not add up to sum of interim results due to adjustments and consolidations.</td>
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## Aviation Strategy

### Databases

<table>
<thead>
<tr>
<th>Group</th>
<th>Revenue US$m</th>
<th>Costs US$m</th>
<th>Profit US$m</th>
<th>Net profit US$m</th>
<th>Operating margin</th>
<th>Net margin</th>
<th>Total ASK m</th>
<th>Total RPK m</th>
<th>Load factor</th>
<th>Total Pax 000s</th>
<th>Group emp.</th>
</tr>
</thead>
</table>

### US Airways Group
- **Year 2008**
  - Jan-Mar 09: 3,663
  - Apr-Jun 09: 4,839
  - Jul-Sep 09: 6,707
  - Oct-Dec 09: 7,416
  - Year 2009: 14,773
  - Jan-Mar 10: 976
  - Apr-Jun 10: 5,747

### American Year 2008
- **2008**
  - Jan-Mar 09: 23,766
  - Apr-Jun 09: 4,889
  - Jul-Sep 09: 5,126
  - Oct-Dec 09: 5,063
  - Year 2009: 19,917
  - Jan-Mar 10: 5,068
  - Apr-Jun 10: 5,674

### Continental Year 2008
- **2008**
  - Jan-Mar 09: 15,241
  - Apr-Jun 09: 2,962
  - Jul-Sep 09: 3,317
  - Oct-Dec 09: 3,382
  - Year 2009: 12,586
  - Jan-Mar 10: 3,169
  - Apr-Jun 10: 3,708

### Delta Year 2008
- **2008**
  - Jan-Mar 09: 22,697
  - Apr-Jun 09: 7,000
  - Jul-Sep 09: 7,574
  - Oct-Dec 09: 6,805
  - Year 2009: 28,063
  - Jan-Mar 10: 6,848
  - Apr-Jun 10: 8,168

### Southwest Year 2008
- **2008**
  - Jan-Mar 09: 11,023
  - Apr-Jun 09: 2,357
  - Jul-Sep 09: 7,574
  - Oct-Dec 09: 6,805
  - Year 2009: 10,350
  - Jan-Mar 10: 2,630
  - Apr-Jun 10: 3,168

### United Year 2008
- **2008**
  - Jan-Mar 09: 20,194
  - Apr-Jun 09: 7,000
  - Jul-Sep 09: 4,933
  - Oct-Dec 09: 4,193
  - Year 2009: 16,335
  - Jan-Mar 10: 4,241
  - Apr-Jun 10: 5,161

### US Airways Group
- **Year 2009**
  - Jan-Mar 09: 3,388
  - Apr-Jun 09: 793
  - Jul-Sep 09: 807
  - Oct-Dec 09: 832
  - Year 2009: 3,286
  - Jan-Mar 10: 870
  - Apr-Jun 10: 939

### JetBlue
- **Year 2008**
  - Jan-Mar 09: 3,388
  - Apr-Jun 09: 793
  - Jul-Sep 09: 807
  - Oct-Dec 09: 832
  - Year 2009: 3,286
  - Jan-Mar 10: 870
  - Apr-Jun 10: 939

### Note:
Annual figures may not add up to sum of interim results due to adjustments and consolidations. 1 ASM = 1,000 ASH. All US airline financial year ends are December 31st.
<table>
<thead>
<tr>
<th>Group</th>
<th>Year 1/12</th>
<th>Year 2/12</th>
<th>Year 3/12</th>
<th>Year 4/12</th>
<th>Year 5/12</th>
<th>Year 6/12</th>
<th>Year 7/12</th>
<th>Year 8/12</th>
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<td>Operating</td>
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<tr>
<td>Net profit</td>
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<td>1,400</td>
<td>1,500</td>
<td>1,600</td>
<td>1,700</td>
<td>1,800</td>
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<td>Total ASK</td>
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<td>115,000</td>
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<td>135,000</td>
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<tr>
<td>Total pax.</td>
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<td>16,000</td>
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<td>21,000</td>
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<tr>
<td>Total RPK</td>
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<tr>
<td>Group emp.</td>
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Note: Annual figures may not add up to sum of interim results due to adjustments and consolidation.
JET ORDERS

Boeing

<table>
<thead>
<tr>
<th>Date</th>
<th>Buyer</th>
<th>Order</th>
<th>Delivery/other information</th>
</tr>
</thead>
<tbody>
<tr>
<td>01 Oct</td>
<td>Luxair</td>
<td>1 x 737-800</td>
<td>exercised purchase rights</td>
</tr>
<tr>
<td>22 Sep</td>
<td>Cathay Pacific</td>
<td>6 x 777-300ER</td>
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</tr>
</tbody>
</table>

Airbus

<table>
<thead>
<tr>
<th>Date</th>
<th>Buyer</th>
<th>Order</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>20 Sep</td>
<td>Malaysia Airlines</td>
<td>2 x A330-200F</td>
<td>PW4000</td>
</tr>
<tr>
<td>16 Sep</td>
<td>Cathay Pacific</td>
<td>30 x A350 XWB</td>
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</tr>
</tbody>
</table>

Note: Only firm orders from identifiable airlines/lessors are included. Source: Manufacturers.
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Aviation Economics
James House, 1st Floor, 22/ 24 Corsham Street, London N1 6DR
Tel: + 44 (0)20 7490 5215 Fax: +44 (0)20 7490 5218. e-mail: kgm@aviationeconomics.com

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