

July 4, 2003

## Summer of Turbulence for Airlines

By EDWARD WONG

**T**he airlines' crucial summer season has arrived, but the industry's vital signs remain feeble. Like a comatose patient, the travel business is still struggling to lift an eyelid, despite endless rounds of medication and prayers.

Several airlines in the United States are reporting this week that traffic in June was below last year's levels, despite the easing of fears over SARS and the end of heavy fighting in Iraq. Advance bookings have picked up from the spring but have not gained much momentum. Airlines are filling a larger percentage of their available seats because they have been parking planes, but it is tough to tell whether that will give them leverage to raise fares.

If anything, the biggest airlines have been forced to lower walk-up fares in many markets — the fares on which they traditionally depend for their profits — because of the reluctance of business travelers and the growing competition from low-cost airlines.

As for travelers, they are complaining about security inconveniences and poor service that they attribute to rampant cost-cutting at the airlines.

"As it relates to this summer, what I can tell you is yes, planes will be as full as ever, but there's little evidence to suggest that the overall demand for air travel is rising," said Jamie Baker, an analyst at **J. P. Morgan Chase**. "There is even less evidence to suggest that the business traveler is emerging from hibernation or beginning to stir."

Lending substance to that perception, Paul Zackin, a trade magazine publisher from Connecticut, said on Wednesday at San Francisco International Airport that "travel in the last two years has been a pretty big hassle and I try to avoid it whenever possible. The airlines have cut back, and flights are harder to schedule, and the lines are really long."

Airline executives acknowledge that travelers have failed to return in large numbers. Gary Kelly, chief financial officer of **Southwest Airlines**, the world's most profitable carrier, gave a lukewarm appraisal of summer bookings.

"We've got some heavy travel periods during the summer, which is what we expect," he said. "It shouldn't suggest to you that things have dramatically improved. They have not. But they have not gotten worse."

The Association of European Airlines, the continent's main trade group, reported that traffic for the week ending June 15 was 3.7 percent below the same period last year, with traffic to the Far East down a staggering 23.4 percent. **British Airways** said yesterday that its June traffic rose 5.8 percent. But it added that the growth would not translate into higher revenue, because traffic had been stimulated by sharp cuts in fares.

Perhaps most telling in this country are the June traffic numbers reported on Tuesday by American Airlines, the world's largest carrier. Domestic revenue passenger miles, a standard industry measure, were down 4.1 percent from June 2002, which was itself a relatively bad month. American's international revenue passenger miles were down 1 percent.

The decline in traffic was not as steep as in April and May, when many people avoided flying because of the war in Iraq and the onset of SARS. Still, the only region in which American had a year-over-year improvement in June traffic was Latin America, with a 4.3 percent increase.

But like many airlines, American was able to fill a larger percentage of its seats because it cut capacity by 7.7 percent systemwide. It reported 4.4 percentage point growth year-over-year in the proportion of filled seats on domestic flights and a 1.7 point increase on international flights. The airline said in a recent filing with the Securities and Exchange Commission that it had positive cash flow from operations in May.

"Our bookings appear strong for the summer," said Tim Wagner, a company spokesman, though he declined to give specific numbers. "Since the end of the war in Iraq, we have seen what we would call pent-up demand from people who want to travel and now feel more comfortable traveling."

Mr. Baker, though, said his conversations with airline executives about advance bookings did not indicate that the travel slump was about to lift anytime soon. He wrote in a recent note to investors that "at least one carrier reports week-to-week domestic booking build as having ground to a halt."

The Dow Jones Airlines Index closed at \$125.46 a share yesterday, near its 52-week high of \$127.92 and considerably above the low of \$71.74. Analysts are forecasting an aggregated second-quarter loss of \$4.65 a share for the index, wider than the \$3.30 a share loss in the same period last year, according to Thomson First Call.

The higher percentage of filled seats these days does not necessarily mean the airlines will be able to make more money in the future. In theory, the lower the seat supply, the more the airlines can charge. But it is unclear right now whether travelers are willing to pay higher fares, especially since they have gotten used to declining prices: the average domestic fare paid has dropped almost every month since March 2001.

Continental Airlines reported on Tuesday that its revenue per available seat mile, a measure of unit revenue, remained flat in June versus the same month last year. That was despite the fact that Continental said it filled 81 percent of its available seats that month, a record high that was a 2.3 percentage point increase above June 2002 and a 0.6 point increase above July 2000, when air travel was booming.

Mr. Baker said he had expected Continental's unit revenue to improve over June 2002 by 1 percent to 3 percent.

Though the growth never materialized, that might not have been for lack of trying. On some routes, airlines are trying to raise prices to improve their bottom lines.

Terry Tripler, an airfare expert at cheapseats.com, said that as of a week ago, leisure round-trip fares he surveyed in 17 markets — 12 of them with hub airports — were \$10 to \$20 higher than the same time last year. Partly that is because the federal government gave the airlines an opening by temporarily suspending the \$2.50-a-leg security tax it added to tickets after the attacks of Sept. 11, 2001; as a result, many carriers raised domestic fares by \$5 each way in mid-May.

Walk-up fares, though, are running 10 percent to 50 percent lower on many routes than they were a year ago, Mr. Tripler said. "I have not found a business fare higher than a year ago," he said, adding that he had surveyed about two dozen markets traditionally popular with business travelers.

Those lower fares indicate slack demand for high-priced tickets, as well as increasing competition from low-cost airlines. When such airlines enter a market, big network carriers are usually forced to cut their fares. For example, American is charging no more than \$299 one-way between Kennedy International Airport in New York and three cities in California, because it is competing against JetBlue Airways and Frontier Airlines on those routes.

Low-cost airlines have also taken big hits during the continuing slump, but there are signs they will recover more

quickly. For one thing, several of them have remained profitable. And on Wednesday, Southwest reported somewhat upbeat June traffic numbers. Its traffic increased by 5.2 percent over the same month last year. Its load factor inched up one percentage point, even as the airline, flying against the crowd, increased capacity by 3.7 percent.

Since Southwest and other low-cost airlines tend not to fly outside the United States, they have been shielded from the regions with the worst downturns. In June, American's trans-Atlantic traffic fell 0.9 percent from a year earlier; trans-Pacific traffic dropped 22.5 percent. Continental's trans-Atlantic traffic was down 5.9 percent; its trans-Pacific routes plummeted by 30.1 percent.

Neither of those airlines, though, run many trans-Pacific flights; United Airlines, operating in bankruptcy protection, and Northwest Airlines rely on flights to Asia for a much larger proportion of their revenue. Northwest reported yesterday that its trans-Pacific traffic in June was down 21.2 percent year-over-year, and its systemwide traffic was down 10.2 percent.

Mr. Trippler said overseas fares were a "real, real wild card" right now. Trans-Atlantic fares have generally gone up with the arrival of summer and the end of heavy fighting in Iraq, he said, but there are still deals to be found. Fares across the Pacific remain relatively low.

United, the world's second-largest airline, said this week that it was restoring some trans-Pacific flights it had cut as a result of the SARS-related travel drop-off, though it also is looking at where it can cut capacity as part of its restructuring. Jeff Green, a United spokesman, said the company would finish negotiations over aircraft leases by September and file its reorganization plan with the bankruptcy court before the end of October.

On Tuesday, American, which is struggling to avoid a trip to bankruptcy court, said in a written statement that it was "nearing decisions" on overhauling its network and operations. The airline said it would cut another 57 planes from its fleet by next summer; that will leave it with about the same number of planes as in March 2000, before American bought Trans World Airlines.

American said it was scrutinizing its hub operations in Chicago, Dallas-Fort Worth and St. Louis, as well as eight reservations offices and three maintenance bases. It laid off 3,100 flight attendants on Tuesday, more than 1,700 of them from T.W.A. Industry experts said American could shut down its hub in St. Louis, which it acquired with T.W.A.

To raise \$254.9 million in operating cash, American is selling notes backed by seven planes that it counts among its last unfettered aircraft assets, according to a filing the company made on Wednesday with the S.E.C.

Jim Corridore, an analyst at Standard & Poor's, said that both American and United "still have an incredibly long way to go" before they become healthy companies — a goal, he said, that requires them to sharply cut capacity and increase efficiency. That could also mean having to give up market share.

"Their road to profitability would be easier," Mr. Corridore said, "if they said they did not have to stay No. 1 or 2 in the industry."